Broker Management - Analyzing the Financial Aspects

4 Correspondence Continuing Education Hours

Broker Management- Analyzing the Financial Aspects

Orientation

Course Objectives

Welcome to the PDH Academy course Broker Management: Analyzing the Financial Aspects. This course is designed to help licensees plan for the financial success of their brokerages and employees. Our learning objectives for the entire course include:

1. Identify startup costs of a new brokerage
2. List expenses for a typical year
3. Predict annual income for the first year
4. Explain the concept of company dollar
5. Plan a commission schedule based on desk cost and income
6. Use income and expense information to create a profitable brokerage

Important Information

To enhance comprehension, review questions will be asked throughout the course.

A final exam will be administered after the course is completed to check for mastery of the material.

If you do not pass the final exam, you can review the course material and retake the exam at no additional cost.

If assistance is needed with this course you can contact PDH Academy at 888-564-9098 or at pdhacademy@gmail.com.

After completing the course and final exam, we ask that you take our course survey to help us continue to provide high-quality continuing education.

Course Introduction:

This course is designed to be an introduction to the topics outlined below. It is a survey course, in that the time frame for this course does not allow in-depth exploration of these topics. Students who take this course and open their own offices will undoubtedly seek additional learning and seminars in the day to day operation of a real estate brokerage.

Finances and Business Planning

Most people who become owners of real estate brokerages come from the industry as salespeople. The skill set needed to list and sell real estate is very different from the skill set needed to run an office, and manage other people. Many agents segue into management, or owning their own company, because they are bored with selling and are looking for another challenge. Some are seeking to make more money, although many agents find out the hard way that their income can be negatively impacted, for a variety of reasons we will discuss in this module.

Let's start with the basic understanding that one of the top reasons small businesses fail is a lack of capital, and a lack of financial planning. Anyone starting a small business should anticipate 1) not taking any money out of the business for at least the first year, and 2) having adequate capital to add money into the business. Of course, you will need to make certain you have enough to provide for your personal needs during that year. You may very well end up being able to take money out of the business; but if you can't, you will be prepared. On top of that, you will have startup costs before you even open your doors. In the next module, we will figure out our budget for the first yea. If you need to borrow money, and most small businesses do, your lender will want to see both a business plan and a budget. The business plan will include the startup costs, so let's begin there.

<u>Physical location:</u> Whether you own a building that would be suitable for your office, or need to rent space, you will have the cost of space. You will want to select an office location based on a number of factors, which include:

- Convenience to your clients and customers
- Proximity to your target market
- Visibility and ease of access
- Cost and length of lease

Even if your long term plan is a large company, it is generally unwise to buy or rent more space than you need. As you add agents, they should produce more income, making it possible for you to expand. You can either plan to expand in your existing location, if that is a possibility, by opening a branch office, if that makes sense, or by moving altogether. If you are contemplating buying a building, a good move is to purchase one which has additional, rentable space. That way, you can bring in some income, and if you need to expand later, you can wait until your tenant's lease expires, and start using that space. In some small towns, you may find buildings which are mixed use, both residential and commercial. In those cases, you can continue to rent out the residential space. By being in the real estate business, you are perfectly positioned for seeing new listings as they come on the market. If you are going to rent space, you have to decide on the term. The pros of a short term lease are if the business does not work out, you are not stuck with several years' worth of rental payments; the cons of a short term lease are that you could lose your lease. Because you are in the business, think about negotiating a mid to long term lease with the right to assign the lease to another entity. This way, if that location does not work out, or the business does not work out, you can re-lease the space. Most real estate offices will contain:

- Public space, such as a waiting room, with an area for a receptionist
- A conference room to meet with clients and have closings, which the public will also see
- A private broker's office, which the broker will use to meet with agents, staff, clients and customers
- One or more office areas for agents, some of which may be "bullpen" type, or shared; these areas are usually non-public; agents meet with clients in the conference room
- Rest rooms; for both staff, agents, and public
- Kitchenette/break room; private for staff and agents
- Storage for office supplies, signs, etc., private area for staff and agents

Things to consider for the building and the space, understanding that the space may be a suite in an office building:

- How does the space measure up to ADA requirements? Can your handicapped clients access it?
- Is there parking available? Is the parking area well lit?
- Can you place signage on the building so your clients and customers can find it?
- Is the building well secured, or able to be well secured?
- Is the building well maintained? Who does the maintenance? If you are renting an entire small office building, will you be responsible for exterior maintenance (lawn, snow removal, etc)?
- If maintenance is included, is it for common areas only (parking lot, stairways, sidewalks), or will the service clean your offices as well?
- If maintenance is not included, you will have to determine a monthly cost for subcontracting it out (or you might do it yourself!)
- Is the interior space configured in such a way that you can easily use it, or can it be easily reconfigured?

Once you have identified your space, you will know what your monthly cost will be for the space. This is either the rent, or a mortgage payment. If you are paying a triple-net lease, you will be responsible for taxes, insurance, and maintenance. Whether you own, or rent, you will typically have utility costs. Although you might find a building where heat and air conditioning are furnished, you will usually be responsible for electricity, Internet, phone, and possibly garbage removal. Obviously, in a triple-net lease or ownership situation, you will be responsible for all utilities, including any deposits that the utility requires if you are a new customer. Your startup costs are whatever you need to pay for the space at the beginning, which could be first and last months' rent, as well a security deposit; it could involve a down payment on a building you are going to purchase, and then the monthly mortgage payment. Also include in your budget, if needed, fresh paint, new floor coverings, new blinds, etc.

Tip: If you personally, or with a spouse, business partner, or other person own the building, you will probably want to pay rent from the company to the owners of the building. The reason for this is that rent payments are completely deductible for a business, and this is a way to pass income to you as the owner.

Furnishings: Once you have the space, you will need furnishings. They do not have to be new, or top of the line, but they should be in good repair, functional, and attractive. Furnishings would typically include:

- Desks
- Chairs
- Pads for under wheeled chairs, to protect floor covering (if needed)
- Filing cabinets
- Waiting area chairs
- Small table(s) in waiting area
- Lamps
- Conference table & chairs
- Shelving and/or bookcases
- Kitchenette/break room table & chairs

Equipment: This will include high tech and lower tech equipment. Minimally, you will need:

- Computer(s): In addition to a computer reserved for the brokers and certain internal functions, such as bookkeeping, you will need at least one computer that can be used by the agents, or even the public
- Television set(s) if desired
- Phone system, probably with multiple lines
- Docking stations for laptops, where agents can plug in
- Wireless Internet
- Printer/Fax/Scanner (you can get these separately, or as an all-in-one)

- Refrigerator for the kitchenette (dorm size may be fine)
- Silverware, mugs, plates for kitchenette
- Microwave
- Cleaning equipment (broom, mop, dustpan, snow shovel, vacuum cleaner) Note that even if you employ a cleaning service, or janitorial service is provided, you will need to clean up messes and spills
- Cameras

<u>Office Supplies:</u> In this list, we'll include tangible and intangible things you need to run a real estate office.

- MLS membership, which will be Internet based. Many associations of REALTORS® require an initiation fee, and most charge per agent per month for use and access to the MLS
- REALTOR® Association and MLS dues, as well as dues in any other professional organization, such as the Chamber of Commerce
- Form software: this is often provided by the MLS, or by the Association of REALTORS®. In fall, 2015, the National Association of REALTORS® announced that they were furnishing access to ZipForms© to all members, at no additional cost
- Insurance: this includes liability insurance, which you need whether you rent or own; contents insurance, if you are renting, Errors and Omissions Insurance, building insurance if you own the building, vehicle insurance if the company owns or leases the vehicles, workmen's compensation insurance for your *employees* (agents are independent contractors, so they are not covered) and any personal needs insurance for the owners, including, but not limited to: health insurance, dental insurance, disability insurance, life insurance. Of this list, the personal needs insurance are the only ones which are optional
- Paper: this list includes copy paper, brochure paper, letterhead, envelopes, business cards, note pads, legal pads, down to paper towels and toilet paper
- Pens, pencils, markers, paper clips, large envelopes
- Signs, which will usually include arrow directional signs, as well as "tent" Open House signs
- Signage for the building
- Key box, which should be a box you can lock to store keys in
- Lock boxes (which may be part of your membership in your local association or MLS; there may also be times when you choose to use a combination lock box)
- Minimal cleaning supplies, even if you employ a cleaning service

- Licensing fees: in most states, there is a fee to license a real estate company; some states require an inspection from the state real estate commission or board
- Software: this can include anything and everything from CRM software (contact management) to financial software needed to generate payroll checks, 1099s and W-2s at the end of the year, etc.

How do you determine what these costs will be? Well, depending upon how far in advance you plan to start your business, you can begin to accumulate some of what you need in advance, particularly if you have storage space. Let's start with **furniture** for the office: you can look up costs at office supply stores, check and see if there is an outlet for used business furniture in your area, and develop a budget for these items. When it comes to **equipment**, you may have some of this already, especially if you are an active agent and you either have a home office, or you have furnished your own equipment in the office where you are now working. If you need these items, the office supply place will give you an idea of costs. You can pick up kitchen equipment at a chain store, or even a used furniture store, and most of us have enough extra mugs, plates, forks and spoons to furnish an office. The large chain store will also be where you can shop for cleaning equipment and supplies. **Licensing and membership fees** can be easily obtained from the state (for your license) and from the local association of REALTORS® (for initiation fees, and ongoing dues and MLS fees). **Internet, TV cable and phone** are often bundled by providers, so you can shop competitively and find out both the installation cost as well as the first year's fee. You will also shop competitively for **telephone systems**, and add into your budget for additional wiring or boxes which might be needed for a phone system. When it comes to **utilities**, you can find out from the building owner what utilities have cost previous tenants; you can also check with the utility company to get an estimate. *In all your estimates, err on the high side! If you estimate costs higher than they actually are, you are in good shape; if you underestimate costs, it will be very difficult for you to open up and run your business.* You should be able to obtain costs for **software** online, or in an office supply store; **sign quotes** can be obtained from a supplier. **Signage** for the building will require an estimate from a sign painter. Most of these costs can be obtained easily via Internet shopping or asking for bids.

<u>Marketing:</u> Marketing encompasses everything from signage on your building to business cards, but in the case of a startup, there are also fees you will incur at the beginning that you may not incur again. Some of these include:

- Setting up a company website, Facebook page, Instagram Account, Twitter Account, LinkedIn account. Some of these you may already have; you may have the capability of doing these things yourself. One of the important steps will be registering a domain name. If the name of your company, for example, ABC Realty, is a domain name already owned by someone else, you will have to extend it in some way until you find a domain name not in use.

For example, ABCCityRealty.com might not be in use. GoDaddy is the place where most people find and register domain names. If you find a domain name that works, and is not in use, you will probably want to acquire, at a minimum, both the .com and the .biz names.

- Having a "Grand Opening". You want to do something to attract past clients and customers to your business, and here's where you can spend some money. A "Grand Opening" will generally include refreshments, balloons, possibly a ribbon cutting with a local dignitary, and (hopefully) some free press coverage. To get the word out, you can utilize social media, but you will want to send printed invitations to some past clients and customers, and to affiliated business people, such as lenders, inspectors, appraisers, title companies, attorneys, etc. You can simply use the MLS Intranet to invite competing agencies and agents. A good time of day to schedule this is at the end of the day, when people are heading home and will stop in to view the office and say hello. Giveaway items are a good thing to have on hand for this event; these are usually small, useful items with the company name, phone number, and website on them. You can go with the ubiquitous pen, or possibly invest more money and give away flash drives.
- Billboard, radio, TV, newspaper advertising: some brokers use these on a regular basis; some do not. However, if you are the new company in town, an advertising blitz can help draw attention to your new business. You might consider a postcard blitz to go along with this, in neighborhoods that are part of your target market. That will involve printed postcards, and postage. Many companies will target a zip code, part of a zip code, or even segmented demographic sections of a market for you, and send direct mailers out, for a reasonable fee. And, for all of this, you might hire a marketing or advertising company to come up with a campaign. If you are opening a franchise company, they will have advertising you can use; if you are starting up your own brand, you need a logo; you need fonts; you need sign colors, and you need all of this to be consistent across the board. If you think of the major franchises, for example, the "black and gold" company does not mix up their advertising by using red, white and blue.

Once you have assembled all of these costs, if you are a conservative person financially, you might want to add 5 to 10% to them, just to be certain you will have enough money. Most of this money you will need in a short time frame; the several weeks before and after you open the office. If you are planning on opening your own company, and you have time, begin putting money aside as soon as possible. If you have storage space, begin to acquire items you will need. If you do not yet have a location, begin looking for one. Become informed (if you are not already) about commercial rents in your area. Also, again consider an existing business where the owner is ready to retire. The advantage of an existing business is that even if you change the name of the business, many things in place would not have to be changed. However, make certain that the existing business enjoys a good reputation in the industry. If the broker is well respected and well known, see if he or she will stay on for a period of time to introduce you to the firm's existing clients. Most new business owners borrow money to begin with; having a detailed list of startup costs is one piece that the lender will be looking for. The next piece is the preliminary first year's budget, which is in the next module. For now, take the following quiz.

The following 15 questions will be a review of the content from this section.

These questions will **NOT** be graded.

These questions are provided to help gain insight in the course material.

Review Questions

1. Startup costs include which of the following?

    a. signage for the building

    b. signs for the listings

    c. Letterhead, business cards, and other stationery

    d. all of the above

2. Which of the following is **not** a consideration in selecting a location for a real estate office?

    a. cost

    b. visibility

    c. ADA compliance

    d. Proximity to a donut shop

3. Which of these is most likely a private part of the office, meaning that you would not typically take clients or customers there?

    a. the reception area

    b. the conference room

    c. the broker's office

    d. the break room or kitchenette

4. For which of these items might you hire a marketing firm?

    a. To design your office

    b. To orchestrate a “Grand Opening”, complete with advertising, giveaways, new logo, etc.

    c. To help you find an office

    d. To design your business cards

5. In which of the following situations would you, as the owner of the company, be responsible for all utilities, taxes, maintenance and insurance?

    a. If you own the building where you are putting your office

    b. If you have a triple net lease

    c. Both a and b

    d. Neither a nor b

6. A good source of cost estimates for office equipment would be:

    a. Craigslist

    b. An auction house

    c. An office supply store

    d. Any retailer

7. A person who is conservative financially would:

    a. Never open a real estate brokerage

    b. Deduct 5% from the total costs for overages

    c. Add in 5% to 10% for unforeseen extra costs

    d. Just plunge in and worry about the costs later

8. A good source of estimated costs for utilities would be:

    a. The building owner

    b. A former tenant of the same space

    c. The utility companies

    d. All of the above

9. Which of the following types of insurance would be considered optional?

   a. Dental insurance for the owners

   b. Errors and Omissions Insurance

   c. Liability insurance

   d. Contents insurance

10. Which of the following items are often bundled, and worth shopping around for?

   a. Dorm size refrigerators, microwaves, and kitchen equipment

   b. Internet, phone service and TV cable

   c. MLS and REALTOR® fees

   d. Copier and fax machines

11. Which of the following individuals should probably receive a written invitation to your Grand Opening?

   a. The agents who have committed to coming on board with your new office

   b. Other brokers in the MLS

   c. Affiliated businesses, such as title companies, attorneys, lenders

   d. All the agents in the MLS

12. Which of the following media would be used to announce a Grand Opening?

   a. Social media sites, such as Facebook and Instagram

   b. Billboards

   c. Print advertising

   d. all of the above

13. An alternative to consider, other than opening a new office is:

   a. staying put until you have accumulated enough cash to have no debt going into your new business

   b. Acquiring an existing brokerage, where the broker is ready to move or retire

   c. Demanding that your existing broker sell you the business

   d. Do nothing; something will come up

14. The pros of a building with additional rental space include:

a. Income from that space, to defray your costs

b. Space for potential expansion

c. Both a and b

d. A only

15. If, in order to get the location you want, you have to sign a long-term lease, a clause you want in the lease is:

a. The right to sublet your space to another qualified tenant

b. An acceleration clause, raising the rent every year

c. A non-renewable clause at the end of the term

d. All of the above

The First Year's Budget, or "Show Me the Money!"

As we said in the previous chapter, you need a solid financial plan to start your own brokerage. This includes both startup costs as well as a budget for the first year. Most people who start a brokerage will borrow money. This is often set up as a line of credit. If you and your business partner(s) own real estate with equity in it, many times a lender will secure this loan with a mortgage against the real estate. The advantages to a line of credit are that you can draw on it as you need it; pay against the balance as you are able; and often you are able to have an arrangement where for a specified period of time you pay interest only on the loan. In the last module, we calculated startup costs. If you are borrowing money, any initial loan fees will be calculated with startup costs, but the ongoing payments of interest, and possibly interest and principal, are in your budget.

The advantage you have is that you have probably been in the real estate business long enough that you are used to the peaks and valleys of income. Among other things, you understand the variability of commission income, as well as the need to keep the pipeline full. You also have a proven track record as an agent, which will be part of the package you present to a lender. All of this works to your advantage.

The disadvantages you have are that some of the things that *have* to be done, someone else has been doing. If you have been a top agent, but not a manager, someone else has been dealing with the details of running the office. The exception to this would be if you have been paid to manage a real estate office, in which case you have been juggling sales skills and management skills already. We talked in the first chapter about business partnerships, and if you are going into business with another person consider these things:

- Someone whose skill set is opposite of yours, and therefore compliments you. In other words, you are the "people person" and your partner is the "paper person"
- How you will allocate tasks within the office—who will train the agents, for example? Who will do the bookkeeping (if you do not use another company to do that)? Will one person devote more time to listing, and another one to sales? Do you each bring a niche into your business?
- How will you have checks and balances in the business? No matter how much you trust a business partner, it is never good business practice to have one person handling the finances without the other person knowing what is going on, and reviewing it

How much money can you reasonably expect to make in your first year? Once again, this is a question answered by history. You and any partner(s) will want to look at the last few years of production. What was the gross dollar volume you each sold? What was the amount of commission income generated? How many sides to transactions did you have? Then, being prudent, estimate that you will *not* generate the same amount of business your first year, because some of your time will be devoted to starting the business, recruiting and training new agents, marketing the business, etc. How much should you discount it? How nervous are you about money? A very conservative person might discount it by half; a more confident person by only 10%. If you have agents lined up who plan to come with you, look at their income, and again, take a discount. The new agents will have to spend time letting their client base know they have moved to a new office, and will be marketing the new company to that base.

The money you plan to earn will come from whatever market share you and your company can get. Although you have established clients and customers, realistically, not everyone will follow you to your new company. On the other hand, there are people who may not have wanted to do business with your old company, for whatever reason, and are interested in doing business with you. Your goal about market share should be realistic. People in the real estate industry not only keep score, but with MLS systems, it is very easy to pinpoint your competitors' market share. On the one hand, you cannot realistically expect to grab a large market share your first year (like 30%), but on the other hand, do not underestimate what you can do by making it very low (like 2%). For your lender, you will want to back your figures up with figures from your MLS. For example, you might say: "Overall, in Happy Valley MLS, last year, $100 million worth of residential real estate was sold. Of that, my partners, the two agents we have recruited, and myself sold 10%, or $10 million. From that, we generated $270,000 in commission income. We are estimating for our first year that we will sell $8 million, and generate $220,000 in commission income." If you are bringing seasoned agents on board, have their sales records available for your lender to review.

We are discussing a one year plan here, but it is to your advantage to develop a 1, 5, and 10 year plan for your business. This sounds like a lot of work, and it is. But, proper planning will help ensure that you reach your goals. Your lender will also be impressed if you have taken the time to map out at least the next five years. The goal will be to grow the business each year, in terms of income, if not in terms of both income and adding agents. If you achieve your goals, and begin to take market share, and your company is well run and a good place to work, you will have agents coming to you. An example of a five year plan might be:

<u>Year 1:</u>

We estimate we can sell $8 million, and generate $220,000 in commission income.

<u>Year 2:</u>

We estimate we can push our market share to 12%, and that the market in Happy Valley by then will be $110 million, so our share will be $13,200,000. We plan to have more listings in year two, which allows us greater control over the commission rates, so we estimate year 2 revenue at $396,000.

Year 3:

We plan to recruit agents during year 2, and by year 3, we should be up to 10 agents. We estimate the Happy Valley market will be growing steadily, and will be around $113 million that year. We aim for a 20% market share in year 3, or $22.6 million. This boosts our revenue to $678,000. Note that in our financial plan, we have budgeted to add a manager and two administrative assistants in the period from year 2 to year 3.

Year 4:

We realize that as we are picking up market share, our competitors are taking notice. We plan to be friendly competitors, so we can sell some of our competitors on the concept of "If you can't beat 'em, join 'em!" Part of the plan for year 4 is to acquire at least one small brokerage where the owner is ready to retire. We estimate that this can add market share of another 5%; we also estimate that by then the overall market will be about $115 million. That puts our share at $28,750,000, with estimated revenue of $862,500. The expenses will increase; if we succeed in acquiring a brokerage on the other side of town, we will continue to operate that as a branch office.

Year 5:

In year 5, we plan to push to get our market share up to 40%, which is a 15% increase over last year. We will acquire any offices which are attractive, and continue to recruit agents. Assuming a slight increase in the overall market to $116 million, we will have $46.4 million, with revenue of almost $1.4 million. We will add additional support staff as needed.

This plan shows one side of the equation, which is the income side. We need to estimate the expense side as well. As Micawber, a character in Charles Dicken's book, David Copperfield said: "'My other piece of advice, Copperfield,' said Mr. Micawber, 'you know. Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds nought and six, result misery." Simply put: it doesn't matter how high the income is; if you are spending more than the income, you are in misery.

Let's look at costs.

Fixed Costs:

Fixed costs are those items you will have regardless of whether or not you sell a single house. Fixed costs are the backbone of your budget, and once certain decisions have been made, you are tied to these costs, whether you like it or not. Examples of fixed costs include:

- Rent or mortgage payment
- Utilities, including Internet and phone*
- Insurances
- MLS fees
- Dues
- Office supplies
- Salaries and wages
- Payroll taxes
- Other taxes
- Maintenance, and this includes equipment maintenance*
- Draws to broker/owner(s)
- Charitable donations**

*both utilities and maintenance can vary, depending upon weather conditions, and other things beyond your control, but do not vary based upon sales. **You may consider this variable; you may not consider it all, but see the discussion at the end of the next paragraph.

<u>Paying Yourselves (Draws and Commissions):</u> It is very rare to not have to take money out of the business for your personal expenses, even when you are not yet making any money. This decision will be very personal, and will be based, in part, on your personal financial situation, and other sources of income you may have in your household, such as another person's income, rental income, etc. Many broker/owners pay themselves the same commission they would have earned as an agent, with the portion the company would have kept remaining in the new company. Other broker(s) or owner(s) will set a certain amount as a draw every month, and put it into the budget. If you do this, some of the time you will be paying yourself with borrowed money, which you will pay interest on, and have to pay back. The optimum situation is when the prospective owner has saved a considerable amount of money, but this is often just not possible for new brokers. Finally, many new broker/owners defer providing benefits to themselves initially, in order to save money. Once the business is established, you can add health, dental and eye insurance; 401Ks; life and disability insurance, etc., as you wish.

<u>Variable Costs:</u>

Variable costs are ones which can and do change. Some of them you can control, by choosing not to spend the money (print advertising is an example). Some of them you cannot control, such as the cost of snow removal in a horrible winter. Some of the variable costs will be tied to production and the number of agents. The more agents you have, and the more productive they are, the more commission income you are paying out. You may increase commission splits at some level, to keep high producing agents. We'll discuss commission schedules in an upcoming chapter. Variable costs include:

- Commissions paid out
- Advertising
- Franchise fees (if you are in a franchise, as these fees are a percentage of commission revenue generated)
- Marketing, including brochures, more signs, billboards, etc.
- Postage and printing
- Sales supplies
- Benefits for broker/owner(s)
- Draws/salaries for broker/owner(s)
- Charitable donations

<u>Charitable donations:</u> We included this, because in our experience of running a brokerage for many decades, as soon as you are in business, people begin knocking at your door looking for money. This can be the request to sponsor a youth sports team, and get your name on the T-shirts; take out an ad in a program; sponsor a hole in the golf tournament, or sponsor someone who is doing a walk or run for charity. You can build good will by sponsoring events, etc., but like everything else, it has to be budgeted for. You may also wish to decide annually which charities you are sponsoring that year. This gives you a reason when you are approached by someone else; you can say: "We decided at the beginning of the year that our charitable donations this year would go to Habitat for Humanity and the SPCA." Some brokerages choose several charities, in the community, and then donate a set amount per side after each transaction, with the gift being in "honor of" the client, and by allowing the client to choose. Donating your time is something else to consider. It is never bad PR to be seen volunteering at the Food Bank, or the Habitat for Humanity Build. Many brokers, including me, have the philosophy, that if I'm going to take money out of the community in terms of fees, I will return a lot of it by shopping locally, and donating to local charities.

<u>Reserves for Replacements:</u> The term reserves for replacements is an appraisal term, and is used by appraisers when appraising a commercial or income producing property to recognize that money needs to be set aside for eventual replacement of component parts of a building, such as heating system, roof, windows, etc. If you own your building, you should have a reserve schedule, and it is often included with the appraisal. For your business, even if you do not own the building, there are big ticket items you will replace over time. Furniture and equipment are the expensive things; and in today's world, where technology moves quickly, and equipment and technology become obsolete quickly, you should be setting reserves for replacement of equipment. Some expensive equipment, such as high speed copiers, can be leased; this relieves you of the need to come up with several thousand dollars all at once, but it creates a monthly obligation for the lease payment.

Creating a budget:

For example purposes, we are going to create a budget to go with our projected income outlined above. Note that we included payment to the owners both as fixed and variable. In the last module, we urged you, if possible, to consider not taking money out of the business during the first year. This will only be an option for those of you with savings, or other household income. There are some options for paying the owner(s). The first is to pay yourself and any partners commission income, just as if you were still an agent, but retain the company portion to run the company. If you intend to start out and run the company as a "100% commission" company from day one, you will have to calculate **desk cost**, which we will explain later.

Sample Budget: As you recall, we estimated annual gross income the first year to be $220,000 in commission income. Here are our estimates for our fixed expenses. In this scenario, we are assuming there are two partners, and two agents. For some expenses, such as MLS fees and dues, the agents pay their own fee, so the amount shown is for the two partners. The agents also contribute their share to E & O; the amount shown is the brokerage share. As recommended previously, when in doubt, round *up*, not down, so if you are off, you are ahead, not behind!

Rent:	$1200/month	$14,400/year
Utilities, including Internet and phone:	$300/month	$3600/year
Insurance		
E & O:		$3600/year
Tenant, contents & liability:		$600/year
MLS Fees:	2 @ $125/month	$3000/year
Dues:	2 @ $500/year	$1000/year
Office supplies:	$100/month est	$1200/year
Salaries and wages*:	2 @ $500 month	$12,000
	Temp @ $1000 month	$12,000

For the first year, you have budgeted for a temp, to be used part time. The temp agency takes care of payroll taxes, workmen's compensation, etc. Each partner is taking a $500 draw, plus regular commissions.

Maintenance:	$50/month	$600 year
Our fixed costs are estimated at:		$52,000.00 year

Now let's look at variable costs:

Commissions paid out:	$132,000

In this scenario, we are assuming that we're paying out 60% of the gross commissions received, including commission to the partners for their personal production.

Advertising:	$1000/month	$12,000
Franchise fees:	0	0

In this example, the company is not a franchise, and there are no fees.

Marketing:	$1300/month	$15,600

We are going to be aggressive with marketing, and invest in "Just Listed/Just Sold" postcards; high quality brochures, company giveaways, billboards, and even events.

Postage and printing:	$450/month	$5400
Sales supplies:	$50/month	$600
Charity:	$200/month	$2400
Total income:		$220,000
Total expenses:		$220,000

In our example, we have broken even. There are no benefits paid on behalf of the owners; but we end the year without being in the red. Of course, in a course example we can make everything come out even; in real life, the numbers will be odd, and there will be years when either income does not hit projections, or expenses are greater than expected. We also did not factor in debt cost. You will need to adjust your figures to reflect debt cost. Let's do a quick example. Assume we have a line of credit of $100,000 @6% interest, and we access $50,000 of it the day we open our company; our lender will allow us to pay interest only for the first 24 months. If we get through the year with only borrowing $50,000, we have $3000 in debt service, which works out to $250 a month. In the budget above, we could probably easily trim sales supplies and charitable donations to cover that. So, when you do your budget, include all your costs, including debt service, if you have it. However, now we can talk about desk cost.

<u>Desk Cost:</u> The expenses for the company are $220,000 a year. Assuming all four people in the company are selling (including the partners), the desk cost per agent is $30,000. What does this mean? It means that unless and until an agent generates $30,000 in revenue for the company, the company is losing money on that person. The desk cost is simply the total operational costs divided by the number of producing agents. Put another way: if you were using a 100% commission model, the $30,000 per agent per year would be divided by 4, and each person would pay $2500 a month to the company for desk cost. Once you and your agents have generated enough income to cover expenses, you begin to make money. We will discuss various compensation plans in an upcoming module.

But, you can see that if when you analyze desk cost, you have agents who are not earning desk cost, or anything near it, they need to either step up production, or you need to help them leave your company; they are dead wood.

Budgeting: A budget is no good if prepared and left in a drawer. You need to revisit your budget *monthly*, checking income and expenses to see where you are. If you have a good month, and income exceeds expenses, put some of that money aside for a lean month. As someone in the real estate business already, you know that until the closing occurs and you pick up the commission check, anything can happen. We have a budget for the first year, but previously in this module we outlined our goals for income and how the company would grow in the first five years. As the company grows, expenses will also grow. One of the things that will help you recruit and keep producing agents is support staff, which can be administrative assistants, personal assistants, closing coordinators, and the like. The goal of support staff is to do things that need to be done, but when the agent does them, it is keeping the agent from being in front of buyers and sellers. Agents make money when they are listing and selling. They don't make money sitting in the office sending out postcards, although this marketing is vital to keep clients coming to them. They don't make money sitting in the office waiting for the title company to call with final costs, but this is vital to a smooth, professional closing. And, for retaining agents, having an assistant that you pay for will be very attractive.

Wrap-Up: You should have a blueprint for developing your own estimated income and expenses. Our costs are given *for example purposes only;* you will have to research costs for your market. Now, take the quiz.

The following 15 questions will be a review of the content from this section.

These questions will **NOT** be graded.

These questions are provided to help gain insight into the course material.

Review Questions

1. When we present our business plan for the first year's income to our lender, what are the sources we use to estimate income?
    a. Past performance of the principals as a percentage of the total market
    b. An educated guess
    c. At least 2 times the production the prospective business owners had last year as agents at other companies
    d. The annual sales in our MLS, divided by whatever market share we think we can capture

2. In our five year plan for income, we estimated our income in year two would increase based upon which of the following?

a. an increase in our percentage of market share

b. an increase in our listings, which allows us to control commission rates more

c. A only

d. a and b

3. One of the methods suggested in our five year plan for growth includes:

a. Changing our commission rate to a very low one, in order to drive out competitors

b. Offering a 100% split without a desk cost fee to the top agents

c. Acquiring brokerages where the broker is ready to retire, or just sell and stay on

d. Recruiting agents at Open Houses

4. Which of the following is a variable cost?

a. rent or mortgage

b. utilities

c. MLS fees

d. Benefits for the owners

5. As a broker/owner you can pay yourself by:

    a. Taking commissions from your own sales

    b. Setting up a monthly salary or draw

    c. Both of the above

    d. Neither of the above

6. Reserves for replacement refer to:

    a. Setting aside money to replace big ticket items, such as expensive copiers

    b. Setting aside money to pay to recruit replacement agents

    c. Reserve money for normal business expenses of things which must be replaced, such as paper, pens, etc.

    d. None of the above

7. Which of the following is the formula for determining desk cost?

    a. Determine Net Operating Income (NOI) and divide by the number of desks in the office

    b. Determine gross expenses, and divide by the number of agents in the office

    c. Determine gross income, and divide by the number of agents in the office

    d. Take one and one half times the annual expenses, and divide by the number of active agents

8. One of the reasons a broker determines desk cost is:

    a. To decide if the agents who are working are producing enough income to pull their own weight

    b. To determine what the broker's profit should be

    c. To determine which costs should be cut

    d. To analyze net operating income

9. When planning your income for your first year in business, you would generally take your normal commission income and:

a. Add 10% because you will give yourself a better split

b. Deduct a percentage, based on how conservative you are financially, to reflect that you will be spending more time building the business and managing it

c. Add 10%, because you know all the agents you hire will outperform their previous sales records, and you will make a pile of money

d. Assume your production will remain unchanged in your new role.

10. You should review your budget, including income and expenses:

a. weekly

b. quarterly

c. monthly

d. annually

11. As you add agents and generate more sales, which of the following costs will probably increase in a direct proportion?

a. cleaning fees

b. Internet and utilities

c. marketing

d. Rent

12. As the company grows, adding more agents, which of the following expenses would you expect to increase?

a. payroll for additional administrative assistants*

b. Franchise fees on commissions, if you are in a franchise

c. commissions paid out

d. All of the above

13. Leasing high cost equipment, such as high speed copiers does which of the following?

a. creates a monthly obligation in the form of a lease payment

b. reduces the amount of reserves for replacements needed

c. a only

d. a and b

14. One of the ways broker/owners often cut costs in their first year is to:

a. Go without Errors and Omissions insurance

b. Go without liability insurance

c. Go without providing benefits to the owners, such as a 401K

d. Go without eating

15. A local youth sports team approaches you to sponsor their team. You will get the company name on the back of the T-shirts the kids will wear while playing the sport. This is:

a. charity

b. marketing

c. Both a and b

d. Advertising

Commissions

In this chapter, we will discuss commission rates, commission schedules, and how to use commission schedules and other things to motivate agents to produce, and to encourage top producing agents to remain with the company and continue to produce. Our learning objectives include:

- Defining a commission schedule
- Understanding how commission rates and splits should be set
- Understanding Sherman Anti-Trust Laws as they apply to real estate
- Developing a plan to set a commission schedule
- Determining profitability

"Show Me the Money" is a phrase which has a lot of meaning in the real estate business. With some exceptions, virtually all real estate agents are commission based salespeople. They work exclusively on commission, meaning that they can have a great month or an awful month. Commission rates are very important to agents, and are often the reason an agent will cite when they leave one company for another. Obviously, if you have a top-producing agent, as the broker, you want to encourage that person to stay with the company and produce. As we said in the last chapter, if you don't make a profit, you won't be in business long. Real estate is too stressful and complex to qualify as a "hobby business" where the owner only wants to break even, and not make any money. So, in this chapter we will explore setting commission rates and commission schedules to accomplish two goals: profitability for the company and an acceptable commission schedule for the agents.

<u>Desk Cost:</u> In the last chapter, we discussed desk cost. On a simple level, it is simply the amount of money which has to be generated by any and all active agents (including broker/owners, if they are still selling) to cover the expenses of the company. One of the things we did not factor in was your time as a broker/manager. In the early days of most brokerages, the broker continues to list and sell. For many small brokerages, the broker *always* continues to list and sell. However, some of you will have a plan where at some point, all of your time will be devoted to management, and you will *not* be personally listing and selling property. The larger the company the more likely it is that there may be several licensed people who no longer list and sell. These can include the owner, the sales manager, the trainer, branch managers, etc. Although these individuals are not listing and selling, they are providing value to the company with what they do. However, the income to the company must be able to cover their salaries, benefits, etc. You may be a long way from considering an operation large enough to have layers of management, and paid trainers. But, you must consider that all of the time you are now spending as a broker, solving problems, managing the company, staffing the company, etc., is taking time away from your personal listing and selling. You have to receive compensation for this, or you will end up working harder and earning less, which was probably not your plan. One of the ways you will get compensation

is from the commission splits, assuming that after the bills are paid there is money left over. This is profit, and as the owner, you are entitled to profit—it's why people go into business. So, when you are adding up your costs, fixed and variable, to arrive at a desk cost, you need to minimally add in the value of your time, based on your estimate of how much time you are spending on managing the business, not listing and selling. An example might be, that if you have determined you are worth $100 an hour, and you are spending 20 hours a week managing the office, then the office should generate $2000 a week income for you (above and beyond the bills).

Commissions—Big Picture

By big picture, we mean gross commissions, or what the company charges clients. Because many sales are co-brokered, this will also include the compensation offered to your company by other cooperating companies. Before we get into this, let's review the Sherman Anti-Trust Law.

Sherman Anti-Trust

These laws govern   competing businesses and business practices. It is violation of anti-trust law for real estate agents or companies to:

- Set fees or commissions
- Allocate customers or markets
- Engage in group boycotts

Sadly, all of these things happen more frequently than they should in real estate. One of the first training sessions you should have with your agents is training in how to answer the question: "Don't all you real estate companies charge the same fees?" Many brokers still compare notes, and surveys reveal that industry wide, most brokers *do* charge the same fee.
http://www.mortgagecalculator.biz/c/commissions.php

The fact that many brokerages charge around the same commission rate can also be interpreted as the result of many brokerages trying different fees, and concluding that a fee in the range of 5% to 7% ensures profitability.

Because of this, some of the things you should do include:

- ✓ Educating the agents that you as the broker set commissions, and how to respond to customers who say "You all charge the same", which is to direct the consumer to you, the broker
- ✓ Consider having a different set of commission rates, for different services, different types of property, and possibly for property which will be more difficult to market
- ✓ Explain that your fees have been set based on *your* analysis of the market, expenses, and profitability

Allocation of customers and markets can be a "gentleman's agreement", as in "Our Company will stay out of the south side of town if you guys stay out of the north side of town." In this case, brokers are agreeing between them to divide a market. This is **not** the same as a business decision such as "We don't do commercial real estate" or "Our niche is the condo market, that's pretty much all we do." In those cases, the broker has independently decided what type of business they want to pursue, but they haven't "given up" a segment in return for another broker "giving up" a segment.

Group boycotts can include a group of real estate brokers all deciding to not advertise in a particular publication, or, as is more common, brokers either boycotting a particular company or agreeing to pay a very low split to that company. This is most likely to happen when a broker comes into a local market with a business model that is either a flat fee brokerage, or a reduced fee brokerage. Often, this company joins the local REALTOR® board and MLS. They will advertise their rates, often with statements like "Why pay 6% or more, when ABC Realty will sell your house for just 2% (or a flat fee of $1500)" [Note that **this is purely an example, and not based on any specific company**]. Brokers who run traditional companies feel threatened by this and decide to not cooperate with this company, and encourage the other brokers to do the same. This is a violation of anti-trust, and a bad idea. So, knowing all of these are taboo, let's get back to the big picture of commissions.

<u>Commissions Are Set by You</u>

Commissions are a broker's decision. They have to be high enough to sustain the company, keep the agents, and make a profit, and low enough to be competitive. Certain brokerage business models approach commissions in specific ways. Let's discuss two of them:

<u>Discount Brokerages:</u> As cited above, these are companies whose business model is to charge a lower than market commission, or a flat fee for services. The model is based on reduced services on the brokerages' part. In some instances, the brokerage enters the listing into the MLS, places a sign on the property, but all advertising, showings, and negotiations are handled by the owner. Many discount brokerages have levels of service which correspond to a fee for that service. Be certain, before adopting this business model, that your state laws allow you to limit certain services. In many states, for example, brokers are obligated to present offers.

<u>100% Commission Offices:</u> These companies, of which the RE-MAX franchise is the most well-known, pay 100% of the gross commission to the agent. But, agents pay all their own expenses, plus a monthly "desk cost" fee to the brokerage. The desk cost fee reflects the cost of running the company, and will often include a prorated share of a management fee, to have access to a broker for questions and problems. State licensing boards require that one licensee be designated as the "managing broker", "broker in charge", or "broker of record". Because this

individual has specific duties under state law to manage and supervise agents, most of those individuals want some kind of compensation for this.

Sides of Commissions: Each transaction has two sides; the listing side and the selling side. When both sides are handled in the same company, it is referred to as an "in-house" transaction. When one company has the listing, and another company has the buyer, it is referred to as either a "co-brokered transaction" or a "cooperative transaction". When you have an in-house transaction, you as the broker completely control the amount of the fee. Typically, the seller is charged a fee, which is the gross fee the seller pays to have the house sold. At the time of the listing, the broker (or agent) will explain that the gross commission will be split with the selling brokerage, if it is another office. The REALTOR® Code of Ethics requires that listing brokers advise sellers of their policies regarding sharing this compensation (Standard of Practice 1-12). Most state laws also require disclosure and consent of this. If it is an in-house transaction, the entire fee stays with the company, and the broker divides it between the listing agent and the selling agent, according to her commission schedule. In co-operative or co-brokered transactions, what you receive as the brokerage handling the buyer side depends upon the compensation offered to you by the listing office. Most of this cooperation comes from membership in a Multiple Listing Service (MLS), where the members agree to share data on their listings and allow agents from other companies to show and sell their listings. The fee the listing agent is willing to pay the buyer agent must appear in the MLS, and the REALTOR® Code of Ethics requires that any change to this cooperative compensation must be "communicated to the other REALTOR® prior to the time that REALTOR® submits an offer" (Standard of Practice 3-2). Brokers may change the cooperative compensation by mutual consent (Standard of Practice 3-3) and if there is a **variable** commission rate, this must be disclosed to the cooperating brokers (Standard of Practice 3-4). What is a variable commission rate? Suppose a seller has a house worth $1,000,000, and desires to list it. When he asks the agent what the commission rate is, the agent says X%. The seller says: Gee, that is high, can you do better?" and the agent says, "Well, I can offer you a variable rate commission, which means that if we sell your property in-house, we will charge you X-1%, but if we sell it through a cooperating broker, we will charge you X%, because we have found we must typically offer half of X% to cooperating brokers so that they will sell our listings." The seller elects the variable commission rate. If the agents are REALTORS®, the Code of Ethics requires that this be disclosed in the MLS (Standard of Practice 3-4). This SOP (Standard of Practice) also requires the listing broker, if asked to disclose the differential in the commission to brokers seeking cooperation. The listing broker must then disclose the differential to their buyer client, per SOP 3-4. This ties in with SOP (Standard of Practice 1-15), which says: "REALTORS®, in response to inquiries from buyers or cooperating brokers, shall, with the sellers' approval, disclose the existence of offers on the property. Where disclosure is authorized, REALTORS® shall also disclose, if asked, whether offers were obtained by the listing licensee, another licensee in the listing firm, or by a cooperating broker."

How does this play out? Assume you are the cooperating broker for the listing where the listing broker is charging the seller X-1% for an in-house sale, but X% for a co-brokered sale. If the seller receives two offers which are basically identical in terms of price, terms, and conditions, the seller is $10,000 ahead by taking the in-house offer. The cooperating broker can find out the differential, and per SOP 3-3, agree with the listing broker to accept a lower commission, which in this case would be half of X-1%. Even MLS services which are not owned by REALTOR® Associations follow these general rules. This explanation is necessary to get us to the point that if you allow your buyer side compensation to be determined by what the listing office is offering, it may be less than you want your fees to be. Let's look at an example. **All numbers used in the following example, and the rest of the examples in this course, quizzes and tests, are for example purposes only; not based on particular business practices, and not a suggested guideline for setting commission rates.**

Example:

Broker Bill charges his sellers a 6% commission. In the MLS, he offers 2.5% as compensation to the selling broker. Broker Beth charges her sellers a 6% commission, but offers 3% as compensation to the selling broker. Both Bill and Beth have listings which sell for $300,000. Broker Bill earns a gross commission of 6%, or $18,000 on his sale. He pays 2.5%, or $7500 to the cooperating broker. This leaves Bill with $10,500. Beth also earns $18,000, but she pays out $9000, so she has $9000 left. Bill has just under 17% more income remaining with his company. Obviously, Bill has made more money. Now, look at this from the viewpoint of an agent with another company, who has buyers who want to look at both listings. If the agent sells Beth's listing, she makes $1500 more than if she sells Bill's listing. As a broker, you do not want the fee to interfere with your agents making sure the buyers buy the best house for them, so you want to establish an office policy regarding buyer side fees.

Buyer Side Fees: Many agents, even today, work without written buyer representation agreements. This is dangerous, because without a written contract with the consumer, in many states, you are not entitled to a fee. REALTORS® can invoke arbitration with the local association to recover a fee, providing that they can prove they are the procuring cause of the sale, but it is much more professional to establish fees on the buyer side. There are many nuances to agency law and agreements across the 50 states, but agents in all states are able to establish a written agreement with a buyer, and get paid for their services. One thing to consider is that if both buyer and seller are going to pay the agent a fee, there should be disclosure and informed consent, per the REALTOR® Code of Ethics (Article 7) and by most state laws. Does having a written fee agreement with the buyer mean that the buyer will always have to pay the company directly? No, it doesn't—let's talk about the methods of achieving compensation.

Using the example above of Bill and Beth, we have another broker, Betty, who has established a policy in her company that the buyer agent fee must be equal to or greater than 3%. This is in Betty's buyer agency agreements, which also allow for her company to receive more than 3%, if it is offered. Betty has a buyer interested in Bill's listing. How can Betty sell this listing and still receive compensation?

- She can, *prior* to showing the property, call Bill and ask to renegotiate the commission to her company to 3%. By the way, Bill should not refuse this request *without* asking his principal, the seller
- She can write a sales agreement which calls for the sellers to pay .5% of buyer's closing costs, which in this case is the .5% differential in the fee. The seller pays that to the buyer, who pays it to Betty. The Code of Ethics (Article 7) says disclosure to all parties and informed consent of the REALTOR®'s client is required.
- The buyer can write Betty's company a check for .5% at closing for her fee; again Article 7 applies

Note that for properties being sold with VA financing, the selling broker is limited to accepting the fee offered by the listing agent.

<u>Commission Schedule:</u> Just as you set the fees for your company, you set the commission schedule for what will be paid to agents. This is known as a commission split, and it can be uniform for all your agents or different based upon production. Here's what you need to consider:

- What you will pay of commissions you receive from co-brokered sales
- What you will pay of commissions you receive from in-house sales
- What you will pay of referral fees

At one time in the real estate industry, many brokers worked on a 50/50 split, which meant:

- 50% of what came into the office on a co-brokered sale was paid to the agent; 50% retained by the broker
- 50% of each side of an in-house transaction was paid to the respective agents, with the broker keeping 50% of each side
- 50% of referral fees

Over time, commission splits became more generous as top producing agents went to companies which either offered a 100% commission plan, or more generous compensation. Changing commission splits will have several effects on agent behavior. For example, if you want more listings, increase the percentage paid on listings. This will get more traction than designated parking spots, smiley face notes, and any other motivational methods you try. If you want more sales, increase the split paid on the buyer side. If your goal is to have more in-house sales, modify that split.

Basics of Commission Splits:

For any commission policy to work, it has to be clear to the agents, and fundamentally fair. The same rules should apply across the board to all agents, and it needs to be clear-cut with no "grey areas". It needs to be associated with profitability for the company. Because you do not want to be accused of violating Anti-Trust laws, you set a schedule of commission splits based on desk cost and profitability. You **do not** set commission splits by conferring with other brokers, or even by asking agents what they think they should be, or what they think they are at other companies.

Sliding Commission Scales

Many brokers have found a sliding commission scale is a good solution for an office with a variety of agents and production levels. For example, consider this sample company:

The company, Small Town Realty, consists of 5 agents, and the broker, who still lists and sells. The five agents are:

- ✓ Saul, a brand new agent, eager to learn, but requiring lots of training and assistance. Saul has had one closing to date, earning $6500.
- ✓ Tim, an agent with two years' experience who is just hitting his stride. Last year, Tim sold over $3.5 million dollars' worth of real estate. He earned $94,500.
- ✓ Carol, a very experienced agent with over 15 years' experience. Carol sold $5 million last year, and earned $145,000.
- ✓ Eloise, who has three years' experience, but is still struggling, with gross sales of $1 million and earnings of $27,500 last year
- ✓ Hubert, a steady producer who is easing into retirement. Last year he sold $2.5 million and earned $75,000.

It is the end of the year, and you want to devise a commission schedule that rewards the top producers and encourages the lower producing agents to aspire to produce more income. You have determined that your desk cost per agent (including an allowance for your time and effort, as the broker/owner) is $35,000 a year. If you do the math, you will note that when you divide the commissions received by the gross sales volume, using more than 2 decimal places, that Tim has earned, on average, 2.7% in commissions; Carol has earned 2.9%; Eloise has earned 2.75%, and Hubert has earned 3%. You know this is because both Carol and Hubert are more confident with buyer agency agreements, and negotiating greater splits with cooperating brokers who do not offer 3%, which is what your company wants the buyer fee to be (although the agents are free to take what is offered on a co-brokered sale). As you immediately see, Carol, Hubert and Tim have all covered desk cost, and are making the company money. Eloise and Saul are not. Here's one example of a graduated commission schedule you could put into place.

Revenue generated for company	Percentage paid on listing side	Percentage paid on sales side	Percentage paid on both sides (in house)
0 to $35,000	50%	50%	50%
$35,000 to $55,000	60%	60%	65%
$55,000 to $75,000	75%	75%	75%
$75,000 to $95,000	80%	80%	80%
$95,000 to $115,000	85%	85%	85%
$115,000 to $135,000	90%	90%	90%
$135,000 and above	95%	95%	95%

Implementing this *will* affect the company bottom line, so before you do it, make certain you will still cover all the bills and be profitable. Many brokers reset sliding commission scales at the beginning of every year, meaning everyone is back at the lowest level. The schedule above, if implemented that way, would put every agent back to the lowest split at the beginning of the year.

Some brokers, however, will use the previous quarter's earnings to set the commission schedule for the next quarter. To do this, you have to break down productivity into quarters. Here's an example. Desk cost is $8750 per quarter, so:

Revenue generated for company, quarterly, before splits	Percentage paid on listing side	Percentage paid on selling side	Percentage paid on Both sides (in house)
0--$8750	50%	50%	50%
$8751-$13,750	60%	60%	60%
$13,751-$18,750	70%	70%	70%
$18,751-$23,750	80%	80%	80%
$23,751-$28,750	85%	85%	85%
$28,751-$33,750	90%	90%	90%
$33,751 and above	95%	95%	95%

Let's look at Carol, as an example.

Carol sold $5 million of real estate, but it wasn't evenly divided into $1.25 million per quarter. Last year, she sold $1 million the first quarter; $1.5 million the second quarter; $1 million the third quarter, and $1.5 million the last quarter. Desk cost is $8750 per quarter.   Carol starts the year, with the new program, at a 50/50 split. She generates $58,000 (gross) the first quarter (remember, she is, on average, generating 2.9% in commissions, mostly because of splits she is accepting from cooperative brokers. You will extrapolate from that an average gross commission of 5.8%, which is two times 2.9%)

For the second quarter, Carol would jump to the 90% category. The gross income generated is $87,000 (5.8% of $1.5 million), of which Carol gets $78,300. The third quarter, she generates $1 million in sales. She's now at the 95% category, because she generated a lot of income in the second quarter. The gross income she generates is $58,000, of which she gets 95%, or $55,100. She stays at this split for the last quarter, generating $87,000 in commission income for the company, of which she keeps $82,650. The difference between a regular split and this split is shown below:

Revenue/Regular Split	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year End
Gross Sales Dollars	$1 million	$1.5 million	$1 million	$1.5 million	$5 million
Gross Revenue	$58,000	$87,000	$58,000	$87,000	$290,000
Carol's Share	$29,000	$43,500	$29,000	$43,500	$145,000
Company Share	$29,000	$43,500	$29,000	$43,500	$145,000
Revenue/Sliding Split	$1 million	$1.5 million	$1 million	$1.5 million	$5 million
Gross Revenue	$58,000	$87,000	$58,000	$87,000	$290,000
Carol's share	$29,000	$78,300	$55,100	$82,650	$245,050
Company Share	$29,000	$8700	$2900	$4350	$44,950

Note that this plan does not give 100% to the agent at any level. The small percentage left over will always be needed, either to cover shortfalls from other agents, or to contribute to a rainy day fund. Brokers, having been real estate agents, understand that ups and downs of income in real estate, and wise brokers set aside funds when times are flush to carry them through slower times.

<u>Offering Perks Instead of Dollars:</u>

Encouraging agents to stay can also be accomplished by paying for something of value to the, such as the use of a personal assistant. So, another approach could be to offer a certain amount of hours of a paid administrative assistant, at a certain level of production. In our office above, the broker could hire an administrative assistant to be shared by the three top producing agents. But, to keep things fair, he would want to allocate the time according to their production. Collectively, these agents generated gross commissions of $629,000 to the company. Carol generated 46% of that; Tim, 30%, and Hubert, 24%. You could split the administrative assistant's time this way, but it would probably be easier to have half her time go to Carol, and half to Tim and Hubert. Adding an administrative assistant will affect desk cost. Assume that the cost of the assistant's salary and benefits is $45,000 a year. You will divide this by 6 and get $7500, so desk cost would to $42,500. This is one of the many reasons you need to review your compensation plan annually. You will look at it during the year, but adjusting it more than once a year may cause confusion to the agents, and some will feel that they are being manipulated.

<u>Profit Sharing:</u>

Another approach you can take is to offer profit sharing at the end of the year. This will take into account the performance of everyone in the company, but only those who helped make a profit will share in it, and the share should be proportional to their production. The office produced $14 million in sales overall, including the personal production of the broker. The gross revenue was $805,000. The desk cost is $210,000 (6 people, including the broker). Four people contributed to the profitability; the broker, Carol, Tim and Hubert. Saul and Eloise are being carried by the broker's production. This leaves a profit of $595,000. From here, as the broker, you can determine what percentage of the profit you will share. Because you are taking all of the risks, and have all the responsibility, let's say you decide that 50% of the profits will be shared. That's $297,500. The 50% you kept for the company is your share; the balance of $297,500 will be shared among the three producers. By the way, for the industry, this example is extremely generous; a more normal split would be 90% of the profits to the broker and 10% to the agents. The model of 50/50 might be more appropriate if all of those participating are owners of the company. If the company is set up as a LLC, these four could all be owners. LLC's also allow shares to be sold, creating more owners, or allows an owner to sell out. But, let's look at our very generous example.   Carol would get $136,850 (46% of the profit); Tim would get $89,250; and Hubert would get $71,400. Note that under this profit sharing plan, Carol makes more money than she would on a sliding commission scale; she would earn $145,000 on the 50/50 split, plus $136,850, giving her $281,850.00. On the sliding scale commission, the company revenue from Carol would be reduced to $100,050 for the year, which is about 16% of the gross revenue she brought into the company. If we assume that we put all three top producers on a sliding scale, and each one earns enough that the company's percentage of their gross commissions is 20% overall, then the company income is $125,800 ($290,000 + $189,000 + $150,000 = $629,000 x 20% = $125,800. The company's gross revenue was $805,000; and on a 50/50 split, the company would have kept $402,500 of that. But, by paying sliding scale commissions, here's what would happen:

- ✓ Gross sales are $14 million

- ✓ $11 million of this comes from our three profitable agents (we are not counting the broker in this calculation)
- ✓ We are assuming an average 5.75% commission rate, given the vagaries of co-brokered sales
- ✓ Carol, Tim and Hubert produced $632,500 in gross commission dollars
- ✓ Because the company put them on a sliding scale, the company retained 20% of this, or $126,500.
- ✓ The balance of the revenue is $230,000 ($4 million x 5.75%)
- ✓ This makes the total company dollar $356,500
- ✓ Desk cost total, including the broker, is $210,000
- ✓ This leaves a profit of $146,500
- ✓ If the broker keeps 50% of the profits, then $73,250 is used for profit sharing
    - Carol gets 46%, or $33,695
    - Tim gets 30%, or $21,975
    - Hubert gets 24%, or $17,580

This plan also assumes the three top producers, on average, kept 80% of the gross commissions they generated for the company. Using both a sliding scale commission schedule **and** profit sharing, here's what it looks like:

	Carol	Tim	Hubert
Gross commissions generated	$287,500	$201,250	$143,750
80% paid on sliding scale	$230,000	$161,000	$115,000
Profit sharing	$33,695	$21,975	$17,580
Total	$263,695	$182,975	$132,580
Commissions paid on 50/50 split model with no profit sharing	$145,000	$94,500	$75,000
Additional income under this plan	$118,695	$88,475	$57,580

One of the things you have to realize about both sliding scale commissions and profit sharing is that there is no room in this business model for non-producing agents. Non-producing agents are carried by those who do produce, and if it goes on too long, those who produce will become resentful of the "dead wood". Consider, if in the example above, the broker was not selling. We allocated $2 million of production to the broker. Instead of $14 million, we would have $12 million. The three top producers are bringing in almost all of that income.

Labeling Profit-Sharing

We have used profit sharing because the concept is easy to understand, but here is a caveat: formal profit sharing plans can be qualified or non-qualified. If they are qualified, they are subject to many Federal regulations. Also, most profit sharing plans are set up as retirement plans for employees. A good way to handle this is to not call it profit sharing, and not pay it at the end of the year. Instead, when the books are settled as of December 31, if you are on a calendar year basis, wait and pay a "bonus commission" to the top producers in January, with the advice that they consider putting some or all of it into their retirement plan. Many retirement plans can be funded up to April 15 for the tax year. Most retirement plans allow contributions to be made tax-free; the exception is the Roth IRA. Speaking of taxes, not only can the agent avoid taxes by putting the money into retirement. The other consideration for self-employed people is that a large extra payment in December can have serious tax consequences for self-employed people. Self-employed people are required to estimate their annual federal taxes, and make quarterly payments for them. Receiving a large payment at the end of December, when the agent hasn't put enough into the quarterly payments, could result in a large tax bill, and possibly interest and penalties.

The reasons for adjusting commission splits should be based on sound financial data, and should never jeopardize the firm's solvency or profitability. Remember you can use commission splits to encourage more listings, more sales, more in-house sales, or whatever you are seeking. You can even set commission splits to encourage agents to be more active in a market you are trying to establish a foothold in.

The following 15 questions will be a review of the content from this section.

These questions will **NOT** be graded.

These questions are provided to help gain insight into the course material.

Review Questions

1. As a broker, if you wanted to encourage your agents to list more properties, one of the things you could do would be:
    a. Increase the overall commission split
    b. Pay more in house commission on the listing side
    c. Deduct a percentage off the commission for sales side transactions
    d. All of the above
2. As a broker, if you wanted to encourage your agents to sell company listings, one of the things you could do would be:
    a. Increase the in-house split for selling company listings
    b. Pay more in-house commission on the listing side
    c. Reduce the amount of commission formerly paid on the sale side of co-brokered sales
    d. All of the above
3. A good way to explain the company's commission policy is to:
    a. Compare it to other companies' schedules
    b. To simply announce it, and say it is not open for discussion
    c. To explain company dollar, and lay out the expenses that must be covered by commissions to keep the company running
    d. To tell the agents you have always done it this way
4. A company's commission schedule should be *primarily* based on:
    a. What the competition is charging
    b. What the agents want
    c. What it takes to be profitable
    d. What it takes to break even
5. Sherman Anti-Trust Laws cover which of the following?
    a. Price fixing
    b. Allocation of customers and markets
    c. Group boycotts
    d. All of the above
6. As a brokerage becomes profitable, sound financial planning suggests that:
    a. You open more branch offices
    b. You hire more staff
    c. You increase the commission split, to share the wealth
    d. You put aside some of the money in a "rainy day" fund

7. To retain high producing agents, without raising commission splits, you can:
    a. Advertise for more agents like them
    b. Start a profit sharing plan for them
    c. Get an "Agent of the Month" parking sign and let the top agent have the spot
    d. Write them notes with smiley faces on them whenever they have a closing
8. An effective profit sharing plan would:
    a. Include all the agents, take the profits at the end of the year, and divide them equally among all the agents and the broker(s)
    b. Include all the agents, take the profits at the end of the year, take 25% off for the broker, and divide the balance equally among the agents
    c. Include only agents who have sold over $20 million of real estate, and the profits, after your share of 50%, would be divided equally among them
    d. Include only agents who have achieved enough income to cover their desk cost; set a percentage of the profits that will be shared, and share it proportionally based on each agent's production
9. An advantage of a sliding commission scale where the current quarter's splits are based on the last quarter's production is:
    a. That agents always drop back down to the basic split
    b. That agents never drop back down to the basic split
    c. That agents are motivated to keep producing, even in "slow" quarters
    d. That the agent will always know two quarters in advance what their split will be
10. An alternative to increasing a commission split is to, at a certain production level:
    a. Pay for an administrative assistant for the agent
    b. Tell the agent to hire, at her expense, an administrative assistant, as it will make her more productive
    c. Give the agent a $25 gas card every week
    d. Allow the agent to have more floor time
11. A sliding commission rate scale should be:
    a. Based on dollar volume of sales only
    b. Based on company dollar only
    c. Based on both company dollar and dollar volume
    d. None of the above

12. One of the ways agents can ensure that they earn the buyer's agent fee they want is to:
    a. Only show listings where the co-op split suits them
    b. When writing the sales agreement, put in a clause requiring the seller to pay more commission to them
    c. Only show company listings
    d. Always have a written buyer agency agreement, which outlines the fee that will be paid, either by the buyer alone, the seller alone, both buyer and seller, or by a seller concession to the buyer
13. A sliding commission rate program should be:
    a. Included in the Policy and Procedure Manual, so that all agents understand it
    b. A separate, secret document, so you can adjust the sliding commission scale based on the person's gender, and how much money their spouse makes
    c. Not subject to revision annually, or at any time
    d. A top secret document; agents must sign that they will not disclose to anyone what their scale is
14. Your commission rate schedule and your Policy and Procedures Manual are:
    a. To be shown to the agents upon hiring, but not to be given to them
    b. Proprietary company documents, which the agent must agree to not take with them if they leave the company, or share with anyone outside the company
    c. Generic, and will be provided by the local REALTOR® Association
    d. The property of the agents who receive them
15. The base split in the company for commissions is what is offered to:
    a. New agents only
    b. All agents
    c. Agents who have not yet produced enough revenue to cover desk cost
    d. All of the above

Profitability

In this module, we are going to consider what we've covered before and discuss how you can make certain your brokerage is profitable. Profitability requires management of finances and agents. We will begin the chapter by talking about managing finances, and end the chapter by talking about managing the agents. Our goal is tie this together for you, so you leave the course with a solid plan for running your own brokerage in a profitable manner.

Financial reports: Whether you generate the financial reports yourself, or outsource this to an accounting firm, you need regular financial reports so you know how you are doing. There are many software packages available that will help you generate financial reports in-house, and many of them integrate with all of the other financial aspects of your company, from check writing to payroll taxes. Organization is a must! You cannot wait until the income tax return for the company is prepared to find out you are losing money. Let's talk about individual reports that should be generated for a real estate company.

Balance Sheets

Balance sheets are a quick picture of your assets and liabilities. If you use a financial software program such as Quickbooks©, it will generate balance sheets. You will have to set up your business in Quickbooks© (or a similar software package) and enter beginning data. This will include setting up categories of expenses, etc. You can compare accounting software programs here: http://accounting-software-review.toptenreviews.com/

One of the decisions that go into a balance sheet is whether or not the business is being run on a cash basis or an accrual basis. A detailed explanation is here: http://www.accountingcoach.com/blog/cash-basis-accrual-basis-of-accounting Most real estate brokerages use a cash basis. In this method, income is counted when received, not when earned. This makes sense in our business, where we do not receive our commissions until the property closes. An accrual basis would mean that you would "book" the commissions when the contracts were written, not when you get them. Everyone reading this chapter can recall a closing that did not occur on time, or never happened at all. And, if you are running your company on a calendar year basis, a closing postponed from December 30 to January 3 would cause a big headache in an accrual accounting system. Cash system also means that you enter the bills the day they are paid.

Here's a sample balance sheet (all numbers are rounded for example only, in actual accounting, the balances would be correct to the penny):

Reality Real Estate

Balance Sheet

As of December 31, 20XX

Assets		
Current assets		
Checking/savings:		
Escrow checking:	$26,500	
Operations checking:	$30,400.	
Money Market Fund:	$5,600	
Total checking/savings:		$89,000
Furniture & equipment:		$35,000
Less accrued depreciation:		$10,000
Depreciated value of furniture & equipment:		$25,000
Total assets:		$114,000
Liabilities and Equity		
Liabilities		
Current Liabilities		
Credit cards		
Staples:	$1000	
Visa:	$3500	
Total credit cards:		$4500
Other current liabilities:		
Earnest money:		$26,000*

*Note that this does not equal the amount in the earnest money, or escrow account. This is because the broker had to use his own money to open the account.

LOC	$16,500.	
Payroll expenses:	$9,900	
Total other current liabilities:		$56,900.00
Total liabilities:		$56,900.00
Total equity:		$57,100.00
Total Liabilities and Equity:		$114,000.00

How to Read a Balance sheet:

Reading this statement, you first see the balances in the accounts the broker has. The money market fund is a savings account for the company. This may be the broker's rainy day fund, or a fund to eventually purchase an office building. The escrow account specifically holds deposit money belonging to clients. It shows up again as a liability, because the broker owes this money to the clients. The amounts are not equal, because to open an escrow account, the broker has to come up with some money. The amount of money a broker can put in his own escrow account is governed by state law; note however that any bank charges must be paid for by the broker. The assets of the company are listed as furniture and equipment. The depreciation is based on the IRS allowance, which is over a 5 year period for most furniture and equipment. Moving on to liabilities, we have the escrow account, which we have discussed. The company uses two credit cards; both have balances on them, and these are liabilities. The line of credit is for the company, and we are showing the outstanding balance. Payroll liability is unpaid payroll expenses, which include both pay due to employees and payroll taxes.

Net worth is the difference between assets and liabilities. In this case, the net worth, also called equity is $57,100. This shows a healthy company; the broker is paying bills, making money, and saving for the future. Balance sheets should be prepared monthly.

Next, let's look at a sample Profit and Loss Statement. Again for convenience sake, all numbers were made round for this example.

Reality Real Estate

Profit & Loss

January through December 20XX

Ordinary Income/Expense		
Income		
Commission income:		$600,000
Total Income:		$600,000
Gross profit:		$600,000
Expense:		
Ads:	$6000	
Advertising & Promotion:	$700	
Bank Service charges:	$100	

Online subscriptions:	$200	
Insurance expense, business, contents,		
Liability:	$800.00	
E & O Insurance:	$3800.00	
Internet & land line phone:	$2800.00	
Office supplies:	$3000.00	
Maintenance agreements:	$500.00	
Maintenance of office:	$3600.00	
MLS fees:	$2200.00	
Legal and professional:	$2450.00	
Continuing education:	$500.00	
Payroll prep fees:	$1200.00	
Marketing & virtual assistants:	$10,000.	
Dues and subscriptions:	$2000.00	
Professional development:	$4200.00	
Rent:	$24,000.00	
Payroll expenses:	$25,000	
Utilities:		
Gas:	$800	
Electric:	$2400	
Office equipment:	$2400.00	
Licensing fees:	$325.00	
Commissions paid to agents:	$400,500	
Total expenses:		$499,475.
Net Ordinary Income:		$100,525.

Net profit and net operating income are the same thing. This is a positive number, so the company is operating in the black. A negative number would mean the company was operating at a loss. P & L statements are usually prepared annually.

Budget Tracking: We are not going to include a full sample here, but another report that you might want monthly, or possibly just quarterly, would be a budget tracking report. This report would show what you have budgeted for income and expenses, and basically shows how you are doing. For example, if you estimated income at $400,000 a year, you would want your first quarter budget report to show you made at least $100,000. It's also a way to see if you have cost overruns. For example, you budgeted $1200 for heat, but it's a nasty winter, and your heating bills are running $300 a month.

Wrap up:

In this course, we've discussed the financial ins and outs of running a brokerage. Like any business, the numbers don't tell the whole story. You can have a great agent who hits a rough spot in their personal life, and their production suffers. You can have a new agent who looks like he is going to set the world on fire, who later fizzles out. Your job as a broker is to provide a company where agents have the tools and opportunity to succeed. Your job is to train them, supervise them, and keep them focused on the real estate business. Your job is also to weed out, at least from your company, anyone who is dishonest, ethical, or just doesn't have the skill set necessary to succeed in this business. Returning to an earlier theme, this is why it is so important to have agents commit to written goals, to revisit those goals, and, if it becomes necessary, to help them exit the business—or at least your office. Your agents can understand the finances of your business, and they will totally "get" desk cost. Allowing unproductive agents to hang on lowers the standards for your company, and some agents will leave a company for that reason. The opposite is also true; if you have a heavy hitter agent who makes lots of sales, that person may actively resist other agents joining the company. In some circles, these agents are referred to as "800 pound gorillas", and many a broker has found that once the 800 pound gorilla leaves, production of other agents surges. Adding more agents does not decrease the slice of pie each one gets; it enlarges the pie for everyone. At this point, you are ready to take your final quiz, and then your final exam. We hope our two courses on Brokerage Management have helped you.

The following 10 questions will be a review of the content from this section.

These questions will **NOT** be graded.

These questions are provided to help gain insight into the course material.

Review Questions

1. The "bar is set" of minimal acceptable sales standards for your company and your other agents by:

   a. Desk cost
   b. The maximum amount of production done by any agent at the company
   c. Your personal production as a broker
   d. The minimum amount of production done by any agent at the company

2. The money left after all bills and expenses, including commissions, has been paid is known as:

   a. Net income
   b. Desk cost
   c. Gross revenue
   d. Depreciated value of assets

3. An accounting system which lists income when actually received, as opposed to when earned, is:

   a. A cash system
   b. An accrual system
   c. A credit system
   d. A debit system

4. A P & L statement showing a negative number for net income would indicate:

   a. Revenues exceeded expenses
   b. Some expenses were not paid
   c. Profitability
   d. The company is operating at a loss

5. Which of these accounts is both an asset and a liability?

   a. the general office checking account
   b. the money market fund for savings for the company
   c. the escrow account
   d. all of the above

6. Unpaid payroll taxes are:

a. an asset
b. a liability
c. a debit
d. a credit

7. Which of the following statements would you expect to prepare annually, as opposed to monthly?

a. A P & L statement
b. A Balance sheet
c. Budget report
d. Reconciliation of office checkbook

8. A broker has budgeted for an expected income of $500,000 for commission income and $30,000 a month for expenses. She is reviewing a budget report as of the end of the first quarter, which shows income in the first quarter of $65,000 and expenses of $135,000. Which of these statements is correct?

a. The estimated budget was correct for both expenses and income
b. The estimated budget was correct for expenses, but there is a serious problem with income
c. The estimated budget may still work out, she should not panic
d. Both estimates were off; the budget needs to be revisited immediately

9. Which of these statements is correct regarding balance sheets and P & L statements?

a. They must be prepared by a CPA
b. Anyone can prepare them
c. Many financial software programs will generate these reports
d. The broker's bank will prepare these

10. Assets minus liabilities equal:

a. Equity
b. Net operating income
c. Desk cost
d. Owner's draw

Correspondence Course Affidavit:

By signing your name below, you hereby attest to the following:

I understand that I must personally complete the entire course. My work in this course will be based solely on my own efforts, unassisted by any unauthorized individual or resource. I understand that receiving unauthorized assistance will invalidate my course credit.

____ ________________

(Signature) (Date)

____

(Printed Name)

Broker Management: Analyzing the Financial Aspects

Final Exam

1. Which of the following would probably require a specific price quote from a professional?
   a. signage for the building

   b. signs for the listings

   c. Letterhead, business cards, and other stationery

   d. all of the above

2. Of the following, which is probably the most important in selecting a location for a real estate office?

   a. cost

   b. visibility

   c. ADA compliance

   d. size

3. Which of these is most likely a public part of the office, meaning that you would expect clients and customers to be there?

   a. the reception area

   b. the agent “bullpen” area

   c. the storage areas

   d. the break room or kitchenette

4. For which of these items might you hire an interior design firm?

   a. To design your office

   b. To orchestrate a “Grand Opening”, complete with advertising, giveaways, new logo, etc.

   c. To help you find an office

   d. To design your business cards

5. If you own the building, you are responsible for which of the following?

   a. Taxes

   b. Insurance

   c. Maintenance

   d. All of the above

6. If you own the building, you might have the real estate company pay rent to you as an owner because:

   a. You can hide this income from the IRS

   b. Rent payments are 100% deductible to the business

   c. It’s complicated enough to confuse the IRS

   d. None of the above

7. Adding 5% to 10% to your estimate of startup costs is:

    a. What you do if you have no confidence in your own numbers

    b. What you do if you are prudent (conservative) about finances

    c. What you do to get to borrow more money

    d. This is never a good idea

8. A good source of estimated costs for insurance would be:

    a. The building owner

    b. A former tenant of the same space

    c. Other brokers in the area

    d. A competent insurance agent

9. Which of the following types of insurance would **not** be considered optional?

    a. Dental insurance for the owners

    b. Errors and Omissions Insurance

    c. Life insurance for the owners

    d. Disability insurance for the owners

10. Which of the following is generally **not** an ongoing expense?

    a. Yard signs

    b. Advertising

    c. Postage

    d. Signage for the building

11. Which of the following actions on your part would be beneficial to the agents, and encourage top producers to stay with you?

a. Raising the salary of the receptionist, so she's in a better mood

b. Hiring, at your expense, an administrative assistant

c. Providing benefits to the owners

d. Advertising the company generically

12. The way to determine if your agents are "pulling their weight" in terms of production is to:

a. Compare them to the top producing agents in the area, and see if their sales are equal or greater

b. Take your net operating income times a factor of 1.5, and then divide that by the number of agents you have

c. Estimate your annual desk cost, and see if each agent is producing, income, at least enough revenue to cover their desk cost

d. Notice which ones are good about making coffee and cleaning up the break room

13. One method of compensation to the broker/owners is:

a. Unemployment compensation

b. Commission income on their sales

c. A fee charged to every agent at every closing

d. Return on equity

14. Which of the following is a fixed cost?

a. commissions paid out

b. Advertising and marketing

c. Office supplies

d. Rent

15. Which of the following is a variable cost?

a. Rent

b. MLS Fees

c. Renter's contents and liability insurance

d. Charitable donations

16. Something to consider when budgeting for paying the broker/owner(s) a draw is:

a. If the money is borrowed, you have to pay back the amount borrowed, plus the interest

b. It should be more than you have previously made in the past, because you need a flashier lifestyle now

c. It should be no more than $500 a month

d. It should be no less than $2500 a month

17. One way to cut down on the expense of an accountant (to some extent) is to:

a. Have the receptionist do the books

b. Use temps, because the temp agency handles all the payroll expenses and reporting

c. Pay your administrative assistants cash under the table

d. Do it all yourself

18. When calculating budget figures, which of the following is recommended?

a. Take the costs and round *down* to the nearest $500 or $1000 dollars

b. Use the figures given in this course as a guideline

c. Take the costs and round *up* to the nearest $100 or $500 dollars

d. "Guesstimate" the costs

19. Our business plan to our lender should include which of the following?

a. start up costs

b. first year estimate of income and expenses

c. 5 year plan

d. all of the above

20. One way to involve clients in your charitable giving as a company is to:

a. Ask them at the closing table to donate to your favorite charity

b. Ask them to choose from one of the charities your company supports, and make a gift of a designated amount in their honor

c. Allow the clients to determine how much, and to which charity, you will donate

d. Put collection cans in the reception area of the office for your favorite charities

21. One way to increase production of agents on either side of a transaction (listing or selling) is to:

a. Raise the overall commission rate to clients

b. Adjust the in house split to agents for whichever side you wish to increase

c. Run a sales contest, with the prize being a $25 gas card

d. Reduce the office commission, so that more clients will use your company

22. Profitability is measured by:

a. Cash flow on a monthly basis

b. Excess cash left after all expenses have been paid, and desk cost has been covered

c. Whether or not there is money in the office checking account at the end of the year

d. By calculating net operating income

23. Which of the following is true about desk cost?

a. Ideally, every agent generates enough income to cover his or her desk cost

b. Desk cost is a broker’s expense, and some of the cost should be covered by the broker

c. Once each agent has covered his or her desk cost, the broker can stop selling

d. Desk cost is a monthly gauge of how productive the agents are

24. The basics of a commission compensation plan are:

a. It needs to be clear-cut to the agents

b. It needs to be fair

c. It needs to be associated with profitability for both the agents and the company

d. All of the above

25. The broker’s commission compensation plan for the company should typically be modified:

a. Monthly

b. Quarterly

c. Annually

d. On the anniversary of the agent’s start with the company

26. Broker "A" has a sliding commission schedule, where agents in the top tier receive 80% of the commissions they generate for the company. In Broker A's company, every agent's commission schedule resets on January 1st to the brokerage basic commission schedule, which is 60% of the commissions they generate for the company. Broker "B" also has a sliding commission schedule, and her agents also receive 80% of the commissions they generate for the company, if they are at the top tier. But, in Broker B's company, an agent's previous quarter's production is the basis for their commissions schedule in the current quarter. Agent Sally works for Broker A, and Agent Susie works for Broker B. Both agents have had a very productive 4th quarter, earning commissions that in both companies, qualify them for the top tier commission rate. Both Sally and Susie both have listings on homes which close Jan. 3 2XXX. Both companies charge a 6% gross commission. Both homes sell for $250,000. Which of the following is correct?

a. Sally earns $9000 in commission, and Susie earns $12,000

b. Both Sally and Susie earn $6000 in commission

c. Sally earns $4500 in commission, and Susie earns $6000

d. Both Sally and Susie earn $7500 in commission

27. Broker Juan based his desk cost calculations on expenses for the previous year, when setting this year's commission schedule. However, he finds his overall costs have increased 6.5%. His last year of expenses (before the increase) was $150,000. He bases his desk cost on 5 agents, including himself, because he is a selling broker. Which is correct?

a. His desk cost per desk is now $19,500

b. His desk cost per desk is now $32,000 (rounded)

c. His desk cost per desk is now $40,000

d. His desk cost per desk is now $26,600 (rounded)

28. When establishing a commission policy, the best way to research this is to:

a. Ask other brokers what they pay their agents

b. Ask the agents what they have heard other agents get paid

c. Calculate desk cost and set the commission schedule so desk cost is covered

d. Ask your CPA what he or she thinks

29. Broker C has a company where the agents can either be 100% commission agents, who pay a monthly fee, or a traditional company, where agents earn commissions based on a commission schedule. Which of the following is correct?

a. Desk cost calculations only include the traditional agents

b. Desk cost calculations only include the 100% commission agents

c. Desk cost calculations include both traditional and 100% commission agents

d. Because some of the agents are 100%, the concept of desk cost does not apply

30. Which of the following would most likely encourage high producing agents to remain with the company and keep producing?

a. A company golf club membership, paid for by the company

b. Profit sharing, based on each agent’s production

c. Designated parking spots for the “Agent of the Month”

d. The company providing a certain amount of paid financial consulting for the agent, at company expense

31. Which of the following is a report that you would typically want to prepare and review on a monthly basis?

a. Profit and Loss statement

b. Cash flow statement

c. Federal tax return

d. Balance sheet

32. Most real estate brokerages use:

a. A cash basis accounting system, where income is counted when receive

b. An accrual basis accounting system, where income is counted when received

c. A cash basis accounting system, where income is counted when earned

d. An accrual basis accounting system, where income is counted when earned

33. Which of the following is correct about accounting software packages?

a. They are available only to accounting firms, and you must have a degree in accounting to understand them

b. There are only a very few software packages available, and they are more expensive than hiring an accountant

c. There are a number of software packages available; most of them integrate with the day-to-day bookkeeping of a company

d. You would need several accounting software packages, one for the check book, one for the P & L statement, one for payroll, etc.

34. The difference on a balance sheet between assets and liabilities is also known as:

a. Cash flow

b. Net worth

c. Capitalized return

d. Owner’s equity

35. An escrow account is listed as a liability on the balance sheet because:

a. This is money the broker owes on the line of credit

b. This is money belonging to other individuals, who have put it down as deposits on properties

c. Because we have to balance the assets with the liabilities

d. Because this money really belongs to the state

36. A report that you might prepare and review quarterly, which would indicate income and expenses year to date, and compare them with what you had expected would be:

a. Profit and Loss statement

b. Balance Sheet

c. Cash Flow report

d. Budget report

37. Joe Broker runs a quarterly budget report on his brokerage and discovers the following: He had estimated annual income of $200,000; at the end of the first quarter, his income is $100,000. He had budgeted monthly expenses of $10,000; at the end of the first quarter, his year to date expenses are $25,000. Which is correct?

a. Joe is right on track for both income and expenses

b. Income is running 75% above projected income; expenses are 30% less than expected

c. Income is running 100% above projected income; expenses are even

d. Income is 50% ahead of projections, and expenses are approximately 83% of what was projected

38. The amount already borrowed on the broker's line of credit would be:

a. An asset on the balance sheet

b. A liability on the balance sheet

c. Unreported income on the balance sheet

d. A debt on the balance sheet

39. On the balance sheet, which is correct about the depreciation on the furniture and equipment?

a. It is deducted from the value of the furniture and equipment, and the depreciated value is added on the balance sheet

b. It is a liability, because it is associated with taxes

c. It is noted, but the number is not added or subtracted

d. Depreciation only shows up on the federal tax return

40. One of the benefits of paying a bonus commission to top producers in January or February of the year following the year where they earned the bonus is:

a. They can use that money to pay last year's bills

b. They can put some of that money into a retirement plan by April 15, and get a deduction from their taxes for contributing to a retirement plan

c. They won't be tempted to spend the money over the holidays

d. The money won't be taxed during that calendar year

Course Evaluation Form

Name:____

Course: ____ Completion Date:_________

On a Scale of 1 to 5 (1 being low and 5 being high) rate your instructor on the following:

Demonstrated knowledge of course content _______________

Encourage feedback and questions _______________

Responded to my questions quickly _______________

Instructor's support of student _______________

Instructor/student interaction _______________

On a Scale of 1 to 5 (1 being low and 5 being high) rate the content & materials on the following:

Orientation was thorough and clear _______________

Organization of content _______________

Course objectives were clearly stated _______________

Content was what I expected _______________

Value of resource materials _______________

On a Scale of 1 to 5 (1 being low and 5 being high) rate the delivery method on the following:

Satisfied with my learning experience _______________

Course provided interactivity with instructor _______________

Course provided interactivity with other students _______________

Program met my needs _______________

Degree of problems with self -paced instruction _______________

Please answer the following questions in your own words:

How was the orientation session accomplished?

Who answered your questions regarding course content?

Were they able to sufficiently help you? If not, explain.

What suggestions do you have to improve this program?