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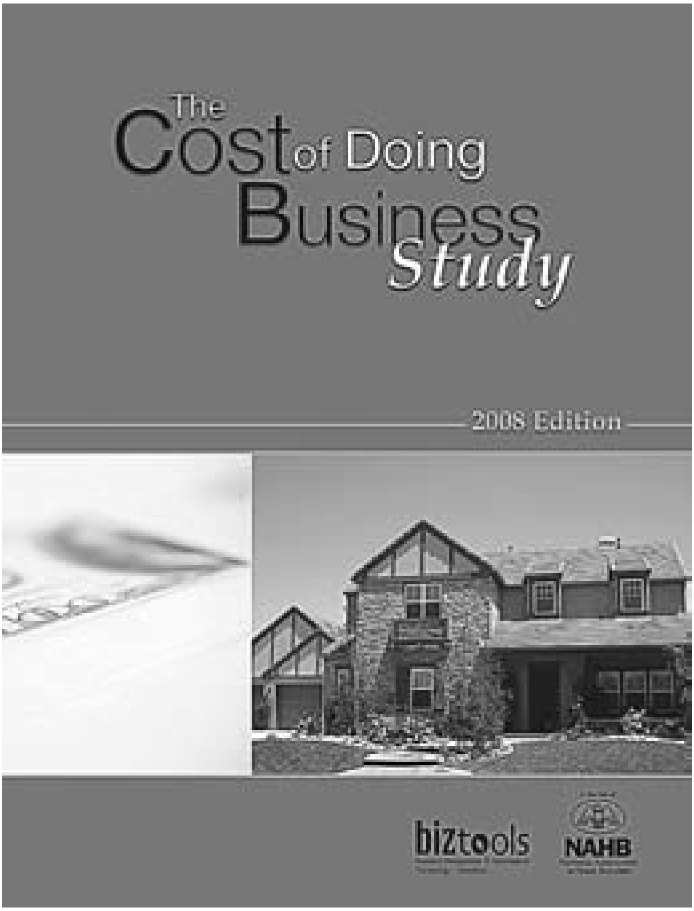

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Business Management for Home Builders
Succession Planning to Map Your Future
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Business Management for Home Builders
Succession Planning to Map Your Future

Designed by Joshua Nester

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Planning For Succession with a Homebuilding Company

By Steven W. Hays, Sr., CPA and Felicia M. Malter, CPA

Succession planning focuses on an ownership interest in a family business, which is a unique form of wealth. Family business owners and their advisors must blend “soft” issues as well as tax, legal and other technical issues in formulating a plan that effectively preserves family wealth from one generation to the next.

Issues on the soft side of the ledger include:

- Assessing the current stage of ownership of the business. For example, is the founder or other family member running the business young or on the verge of retirement? Are the heirs currently mature and experienced enough to take over the business?

- Identifying among potential family members those who are the most capable of and the most willing to work for and lead the company. It is often a mistake to assume that all family members are alike in this regard.

- Determining whether family members, who do not work for the business ("non-working family members"), should hold ownership interests. When non-working family members maintain an ownership interest, they may encounter liquidity problems. Unlike their siblings who work for the business, they do not draw a salary and must rely on dividends to obtain cash from their valuable but non-marketable investment. However, taking cash from the family business to pay dividends may limit the growth of the business. Hence, competing needs often arise among family members. This problem tends to get worse as the family members age and have increased needs for cash, and as the relationship among family members grows more remote (e.g., cousins versus siblings). Ironically, the more successful the family business is, the more these tensions seem to be heightened, because there is more at stake.

- Devising plans to provide cash to the non-working family members. Alternatives include cashing members out via redemptions or cross purchases, or more limited measures, such as arranging for properties used in the business, such as an office building, to be rented from the non-working family members.

These "soft" issues can involve sensitivities that may be difficult to resolve among family members due to underlying emotions that are likely to be agitated. To help the family deal with these and other strategic issues, an advisory board should be formed with one or two outside board members considered to be highly qualified individuals with proven track records in corporate or family management.

The technical issues associated with succession planning involve various techniques for selling the family business or transferring ownership of the business within the family. Tax issues play a significant role in such planning.

If the current owner determines that the business should be sold to outside parties rather than passed to heirs, the goal will be to maximize after-tax sale proceeds. If the business has been organized as a "pass-through" entity, (i.e., a partnership, limited liability company or an S corporation), assets could be sold, rather than stock, which could give the buyer the opportunity to write off all or a significant part of the purchase price over a period of three to 15 years. Because the tax subsidy provided to the buyer from the write off of the asset purchase price, the buyer may be willing to pay more for the business than if stock is purchased. Further, legal and other non-tax issues play a role in the decision.

If the family business owner decides to pass ownership to heirs, several planning possibilities come into play. These include:

- Organizing the business as a family limited partnership or limited liability corporation to avoid the potential for business earnings to be double taxed, and to facilitate transfers of ownership in the form of limited partnership interests valued at a discount.

- Organizing the family business as an S corporation to avoid double taxation of business earnings in the same manner as a partnership structure.

As can be seen, succession planning for closely-held businesses involved numerous considerations: some technical and some non-technical. The home building business provides particular challenges due to the cyclical and seasonal nature of the business. Moreover, the planning process is not a one-time effort. As factors change, so must the plan. The key is at all times to have a plan in place reflecting the most current information about the family business and the goals of the family business owners.

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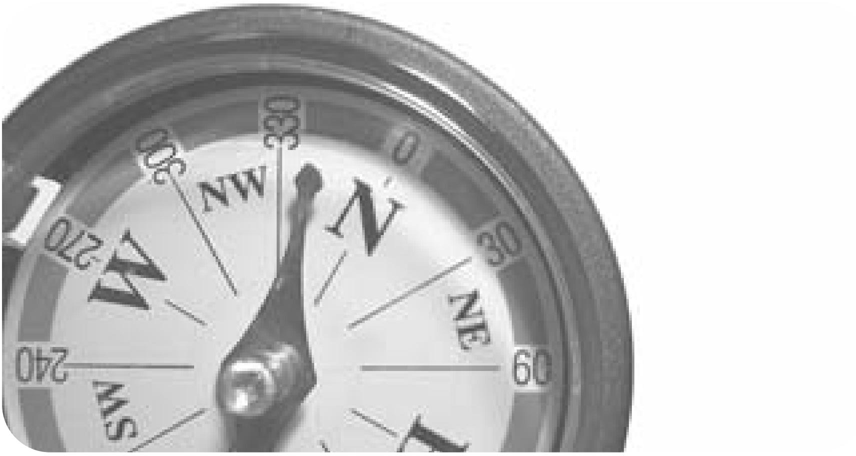

Succession Planning for Your Business

By Bondi & Co., LLP

Have you dreamed about winning the lottery? Of course you have. Like any hard working American, you would probably retire early and spend the rest of your days on the Greek Isles.

Let's face it. Your chances of winning the lottery are slim. Yet you probably spend more time dreaming how you'd spend lottery winnings than you do planning for the future of your business.

Don't gamble with it! Succession planning is a necessary step in assuring the survival of your business. Even if you plan on selling the business, to get top dollar, the business must be in healthy condition.

Most business owners start the succession planning process just before retirement. This may be too little, too late. A family-owned business stands only about a 35 percent chance of survival after it is passed on.

One of the primary steps in succession planning is to determine what you want to happen to your business when you retire, die or become disabled. Do you want to keep it in the family or sell it to an outside party, including employees?

Keeping the Business in the Family

The succession planning process is much like writing a book of rules on how family members should enter into the business. Since they have different management styles, philosophies and work ethics, the family's long-term plan and vision for the company must be defined. Are they committed to keeping the business in the family? Do they eventually want to sell the business?

Only when you understand your family members' intentions should you determine how to transfer ownership. The form of the transfer could have both income and estate tax effects. A written strategic plan could address the company's strengths, weaknesses, opportunities and threats. The plan should state in detail each person's function, compensation, and how a position will be earned. (This will help avoid family arguments in the future).

Transferring Ownership to Employees

You have a number of ownership management options for your company when you retire, other than keeping the business in the family. Many times business owners don't have the option of transferring their business to immediate family members or relatives. When this situation occurs, an owner is usually faced with selling the business to strangers. This could be a hard decision if your retirement income relies on the continuing operations of the company. You may want to consider transferring ownership to employees who have worked faithfully for you over the years.

Establishing an Employee Stock Ownership Plan (ESOP) allows you to transfer ownership to one or more of your employees over time. Each shareholder receives dividends produced by the stock as long as he or she remains employed by the company. As employees leave or retire, they receive the stock or its equivalent in cash.

Congress has passed laws that encourage the use of ESOPs. The laws truly attempt to create a retirement program that benefits everyone involved. Some of the changes are:

- The seller may defer the gain on the sale of stock to the plan if certain requirements are met.

- The employer can deduct contributions to the ESOP to buy the stock, and receive favorable tax treatment when borrowing money for stock purchases.

As with any business decision, carefully analyze your options and keep in mind your family's long-term business plans. Changes in tax laws, personal issues and business conditions may alter your succession game plan; thus, review it annually with your CPA or business advisor. Your success in business came from taking risks and betting on yourself. Don't gamble with your retirement by putting off succession planning.

Bondi & Co., LLP, Englewood, CO, specializes in accounting services, management consulting, and financial software. For more information, call 800-250-9083 or 303-799-6826.

Planning for All Levels of the Company

By Felicia Harris

Succession planning is one of the most important steps to ensure the future success of a company. While many business leaders focus on replacing their executive positions, succession planning runs far deeper than just the CEO of the company. All employees must be replaced at one point or another, and planning for this inevitable cycle is critical. Therefore, all positions, including the head of the company, should be incorporated into a succession plan.

"All too often, succession planning is considered only for the president or CEO, but front-line and functional managers also need to dedicate time and energy to developing their people," says Ted Bellamy of the Daniels Group, a Denver-based search firm

Many businesses currently cope with replacing staff within their homebuilding businesses at a fast rate due to the conditions of the housing market. If possible, businesses should quickly replace employees, or reorganize vacant positions to fill the hole in order to ease understaffing. However, this does not ensure your staff will be competent. Businesses should start thinking about succession planning from the beginning.

A key component of hiring staff to make the employee transition smooth is to have a list of important qualities needed for an individual to excel. In addition, it is also significant to pay attention to the employees already at the company. Take notice of employee performance. When it's not up to par, or exceptional, you develop a rubric to measure against for the next hire. With the hiring costs associated with training and educating new hires, it's important the fit is as seamless as possible.

Being aware of why employees leave is another component to hiring the next member of staff. If an employee leaves dissatisfied with the work, position or coworkers, it may be time to reevaluate these areas. By doing so, you may be able to create a better working environment. Don't be afraid to critically evaluate how positions are organized and responsibilities are allocated. You may avoid having a future employee leave for the same reasons.

Many company owners who plan to retire often hand over their business to other family members, especially their children. In this instance, succession planning should begin many years prior to retirement. This entails introducing the family member into the business for an extended period of time before the succession begins. The future company owner should know the details of the company and have previous experience working there. Consequently, the business will continue its operations at a similar rate prior to the new owner.

Succession planning should be one of the main objectives of a business. It is a process that should have significance and adds value to any company. Replacing staff effectively shouldn't be a hardship. By planning effectively long enough in advance, employee transitions will be more a benefit rather than a burden to a homebuilding business and stir success.

Felicia Harris served as the NAHB Business Management Department's intern for the summer of 2008. She is a current student at University of Maryland studying business.

Passing the Torch: Choosing the next leader

By Mary Alice Hewitt

Keeping a business in the family is no easy task. Approximately 67 percent of all family businesses in the U.S. fail between the first and second generations and the failure rate jumps to an astounding 83 percent when families attempt to pass a business on to the third generation. To improve the likelihood of success, CEOs must consider estate planning, financial planning and succession planning.

Estate planning is concerned with moving assets from one generation to the next and who owns the company.

Financial planning considers who will be paid to run the company and tax obligations, including whether a company could handle the financial obligations of a gradual transition, where a CEO emeritus, along with a new CEO, would continue to be paid.

Succession planning is where the choice of a new organizational leader of a company is made.

While all three types of planning are essential for the successful transfer of a company, the focus of this article is on the third type of planning.

Four Phases of Succession Planning

Many business owners, caught up in day-to-day operations, put off succession planning. It requires decisions about issues that may seem a long way off: precisely when to leave the business, what to do after that, and who will take over and lead the company. However, a plan is imperative even if an owner's retirement is not imminent. Proactive succession planning allows for smooth transition of leadership in both emergency and non-emergency situations. Having a plan makes it clear to everyone what will happen to the company when the leader steps down due to retirement, death, divorce, or other unforeseen events.

A succession plan takes different forms, according to where a parti cular business is in its lifecycle. In other words, succession planning is a dynamic process, so your company's plan should change over time:

Phase 1: At this early point, a business owner is fairly young and the next generation that could eventually take over is likely to be far too young for the responsibility. For this reason, think about whether the business would be run by a spouse; conferred on a non-family employee, who would take over until the children are old enough to handle the business; or sold.

Phase 2: The owner is traditionally middle-aged, and the children may be in school or postsecondary education. During this phase, children may work in the business during summer vacations. Not only does this help you assess their skills and readiness to assume responsibility for the family business, it allows you and them to gauge their interest in carrying it on. Of course, you need to share with them the possibility that they will be asked to carry on the business, while keeping in place the plan developed in Phase 1.

Phase 3: Now your children are working, but they should be working somewhere outside of the family business. Working elsewhere first allows your children to gain the necessary skills and build their confidence for when they eventually take their place in the family business. It allows them to enter your company with credibility. Without this external experience, longtime non-family employees may resent a child being "handed the job on a silver platter." Truly, leadership should

Choose a Successor Who Will Keep Your Company Growing

- Be as objective as possible in the decision process.
- Look to and consider the future of your company when choosing a new leader.
- Make sure that the selected individual has the respect of the other employees, industry suppliers, and customers.
- Once chosen, ensure that the new leader receives proper training and development.

be apparent in a child, so they have more than just family ties bringing them into their position. Thus, assess each child's talents and potential capability for being a future leader.

Phase 4: This late in the game, you need more than an emergency plan. A formal succession plan should take place in this fourth and final phase. This plan for who will take over leadership is typically developed four to eight years before a CEO's retirement. Choosing who the successor officially will be is usually a year-long process, and the remaining preparatory time should be spent developing the individual for the job.

What to Include in the Formal Plan

Once you have established the formal succession plan in Phase 4, you should:

Hold family systems meetings to keep family members organized and focused. Meetings should be held on a regular basis and have planned agendas set ahead of time. These gatherings are a crucial way of informing family members on how succession planning will work and also help to prevent misunderstandings and possible resentments. Furthermore, you should let your children know what the company is really all about during these meetings – the good, the bad and the ugly.

Compose a communication plan so not only your family, but also employees and suppliers, know what is going on. You should not keep your plan in your head. What if something happened to you today that kept you from running your business? Your plan would be lost forever and your family would have to scramble to decide what to do with the company. Additionally, when communicating your plan, family members are not the only ones that should be "in the know." You also must clarify your plan with employees who are outside of the family. Once your formal plan is stabilized, you should also communicate it with your customers and suppliers. When people know what to expect, they have peace of mind and can better deal with change when it comes.

Establish a board of advisers to assess your children objectively as candidates for the leadership position. You have preconceived notions of your children based on their childhood years that you may not be able to transcend in order to decide who should take over for you. A child you would have ruled out may actually make a good leader. A board of outside advisers can offer objective, unbiased feedback on who to hire as your successor and be a shield for you, the parent, in choosing a successor from among your children.

Don't lose the "business" of your family business, or allow family to "get in the way" of your succession planning. A family business is not an entitlement.

Moving away from your own business is never an easy thing to do. However, you can make the experience more bearable by knowing that you are leaving the company in good hands. By carrying out a proper succession planning process, you can be sure that you chose the right man or woman for the job. Your family business can be passed successfully from one generation to the next, and that success starts with choosing the proper successor.

Mary Alice Hewitt is a graduate of Franklin & Marshall College in Lancaster, PA with a bachelor of arts in business administration. She worked with NAHB's Business Management Department as an intern in the summer of 2006.

Laura Michaud, also contributed to this article, is a third-generation family business owner for almost 20 years, was a contributor to this piece. A nationally recognized speaker, author and family business coach. She shares her expert advice on family businesses through her work with The Michaud Group. For more information on her company and work, contact 630-835-0333 or visit www.lauramichaud.com.

Succession Planning: Can Your Business Survive Its Owner?

By Lucy T. Katz, CAPS

Death is something no one can avoid, yet planning for it is rarely on a business owner's list of priorities. Most owners start thinking about succession plans when they consider retiring or leaving the business. But what would happen if you died tomorrow? Who would run your company and see to it that your business continues to produce top-quality homes, satisfy its customers and turn a profit?

Because nothing in life is ever certain, it's wise to put strategies and procedures in place now for how your business would proceed if you die or become incapacitated. This will help your business survive even if you don't, and will help protect your assets and your employees.

It Could Happen to You

Several years ago, a dear member of our builders' association was being treated for cancer. He seemed to be responding to his treatments, but then developed difficulty in breathing. Assuming the cancer had returned, his physicians admitted him to the hospital and placed him on a ventilator. Within a few days he died of a heart attack – not from cancer.

Neither the member nor his wife had made provisions to protect the building process in case the member died. They were building a very large and expensive home knowing that he had a very serious case of cancer. Recovery, of course, was always a possibility, but they were in denial. Neither one wanted to address the fact that the member might not be around to finish the project. And, unfortunately, most of the information about the house was in his head and wasn't documented.

The grieving wife tried to finish the home with the help of several builders. She quickly realized that this was more than she was capable of. The home was sold at a bargain price and was finished by the buyer.

As I watched the chain of events unfold, I realized that this could be me. Experiencing our friend's death and the aftermath created an opportunity for us to develop systems and procedures to protect Katz Builders, our family-owned business, and the individuals who helped us build it.

The "All in the Family" Problem

According to Michael E. Gerber, author of The E-Myth Revisited and The E-Myth Contractor, small businesses often are owned and managed by entrepreneurs whose employees are family members. These employees frequently are drawn into the business because they have skills that are desperately needed, but for which no realistic salary has been budgeted.

We expect and trust our family member employees to do a great job. They have a vested interest in the company's success, but they may not be the most qualified individuals for the positions they hold. This keeps the business from really growing and becoming all that it has the potential to become. Family members accumulate experience handling a particular portion of the business, but as the business grows, so does the potential of them achieving their level of incompetence (a concept outlined in The Peter Principal by Laurence J. Peter).

Peter Drucker, a distinguished business scholar, set forth four rules for family businesses to follow if they wish to prosper:

- Family members must work as hard as non-family members.

- Family businesses need to add non-family managers.

- A non-family manager should fill at least one top job in each family business.

- Before the situation becomes acute, the issue of succession should be addressed and entrusted to an expert who is neither part of the family nor part of the business.

Developing a Succession Plan

As I did my research and audited our business, I realized that many of Katz Builders' systems and procedures were documented and current. However, there was still much work to be done to update and streamline procedures and to address issues that we had never documented or even thought about.

David Rodriguez is an attorney at the law firm of Bell, Turney, Coogan & Richards, LLP, in Austin, Texas, who specializes in business planning. He suggests that business owners "make a list of the things that keep them up at night and let the professionals they trust help them put a solution into place."

Below are some items and issues for business owners to consider when developing a succession plan. These components will help facilitate the safe, effective succession of a family-owned business.

Business plan. This document gives everyone a road map of where the company is going and how they are going to get there. Having one in place assures your employees that the company can continue on its course. (Read "Reap the Benefits of Business Planning" following this article)

A will. This document dictates how the assets of a family-owned business will be distributed and provides instructions for the succession of one business owner to the other.

Statuary durable power of attorney. This document provides for a temporary power of attorney that allows the business to continue without much interruption when the principal or owner is unable to perform important tasks.

Stock restriction agreement. What would happen to the business if your business partner files for bankruptcy protection? How would you like to be in a partnership with her bank or lien holder? What would happen to the ownership of the business if a shareholder divorces, dies or resigns from your company? In case of a shareholder's death, do you want her husband or children as your business partner(s)? A stock restriction agreement can limit these possibilities.

In addition:

- Consider forming a Family Limited Partnership, a Limited Liability Company or a Sub-Chapter S Corporation instead of keeping the business in a sole proprietorship structure. (Type "Legal Structure Basics" in the search field on www.nahb.org/biztools.)

- Consider using life insurance to create an irrevocable life insurance trust or to fund a buy-sell agreement.

- Consider the use of a split-dollar life insurance policy.

- If the business is a corporation, consider providing an employee stock option plan that creates an incentive for employees to keep the company going.

Operational issues. Create a centralized operational binder or a password-protected section of your computer system that contains at least the following information:

- Documentation of codes and passwords for computers, gates, safes, safety deposit boxes, payroll data and all bank accounts

- Extra keys for access to critical areas

- Lists of vendors, suppliers and trade contractors your company does business with

- Critical information and documents related to current jobs (such as project scopes and specs, estimates, budgets, etc.)

- Lists of existing contracts and the location of hard copies
- Lists of in-process proposals and bids
- Information about current and past clients
- List of prospective customers

Cross training. One person shouldn't do everything. Cross train employees in your organization to do multiple tasks. If someone is out of the office, the work keeps getting done and the business doesn't stop. One person shouldn't open the mail as well as deposit and write checks.

In addition:

- There should be a back-up person on every project, whether the project is in the bid stage or is in progress. This individual should be a secondary contact for clients, suppliers and trades, and should know what is going on at all times. The back-up person often is the company owner's or most senior person's "right hand."
- Give at least two other trusted persons (employees or people outside your company) the authority to sign financial documents and take care of banking issues.
- Train at least one other person on internal controls and where to get necessary information quickly. That information could be kept in a notebook or in the password-protected section of your computer system.
- Train at least one other key person as a contact person for bids, and involve that person in the biding process as well as with jobs in progress.

Start Now

Developing a succession plan requires time to really think things through. Remember, you needn't go it alone when putting your plan together. It's a good idea to find skilled experts who can customize succession plans, organizational systems and procedures specifically for your company's needs. Start with your lawyer, who probably can recommend additional consultants if you need them.

Overall, your family members and managers need a shared picture of your business operations, products, and goals, and a plan that will protect your team's hopes and dreams for the future. There is much work to be done, and no time like the present to start.

Lucy T. Katz, CAPS, is vice president of customer service and client development for Katz Builders, Inc., which won a Custom Home Magazine Pace Setter Award for customer service. Lucy also is a consultant who works with home builders to develop and improve their organizational systems and procedures. Contact Lucy at lucykatz@katzbuilders.com or 512-301-6000.

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Reap the Benefits of Business Planning

A business plan is an operating tool that helps you manage your company more effectively. It eliminates the uneasiness and uncertainty associated with flying by the seat of your pants. Functioning as a road map, the business plan outlines where you want your company to go, how you intend to get it there and what it will look like when it arrives.

Business planning forces you to evaluate your business as it relates to the competitive environment, to develop strategies to overcome possible pitfalls, to set priorities based on long- and short-range goals, and to create action plans. In addition, it offers the following advantages:

- Minimizes the potential for surprises and crises and prepares you to handle problems more effectively if they arise.
- Helps you identify your resources and determine staffing requirements.
- Encourages employees to work together, under the same directive, toward a common goal.
- Establishes the foundation for better time management. Setting priorities enables you to use your human and material resources

most efficiently. The way you manage your resources can significantly impact your company's success.

- Indicates to outside lenders, investors and customers that you know what you are doing and have a plan to make a profit.

- Saves you money and time by focusing your thinking, and helps you establish a realistic business strategy by giving you more control over your finances, marketing and daily operations.

- Creates an opportunity for you to build your business on paper before putting your ideas to work in the field. Planning allows you to consider several different scenarios for future action and to examine how each scenario might affect your operation. Identifying potential challenges may help you to deal with them more effectively or possibly eliminate them completely.

Managing a business without a good financial and business planning system is like playing the game without keeping score. You never know if you are winning, losing, making progress, making an adequate profit, or simply marking time. Maximizing your profits requires a well prepared, well executed financial and business strategy. Planning is the key.

Documenting the following items ensures that your plan is functional and that you can evaluate your progress at each step in the planning process:

- Identify the results you want and expect. Write them down. If you can't state your objectives clearly, you may not truly know what you want to accomplish.

- Set priorities. Don't try to accomplish everything at once. Look at all of your tasks and determine which ones must be completed most urgently. Concentrate on these items first. Identify items that must be addressed in the near future and those that can wait until a later date. Attempting to complete all tasks simultaneously is nearly impossible and may prevent you from reaching any of your goals.

• Set goals for priority items. Goals must be realistic, measurable, specific, accomplishable within a time frame, and worthwhile. In addition, they must identify who, where, what, when, why and how.

• Develop a plan of action. Without a written plan of action, goals are little more than wishes. Understand how each goal affects the others. Identify obstacles and find ways to avoid them. Be prepared. Recognize potential problems and consider alternate solutions so that you can take immediate action should those problems arise.

This material is excerpted from the PRO Builder Business Plan Guide*, which features step-by-step exercises that walk you through the process of developing your own business plan. It offers a specialized tool not found anywhere else — an electronic spreadsheet for developing the financial section of your plan.*

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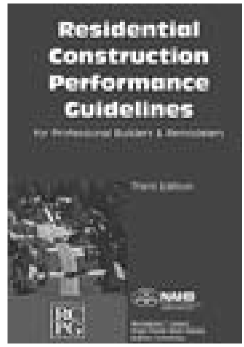

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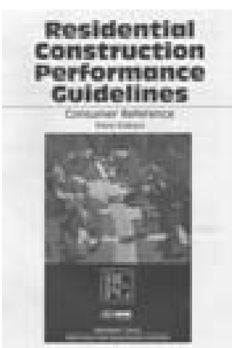

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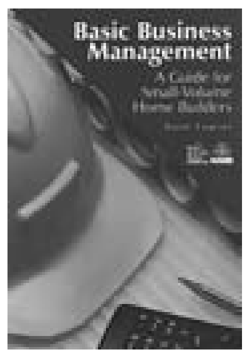

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This guide will take you through the steps, and give you direction, in planning the next stages of your business. From the experiences of seasoned NAHB members, we offer you *Business Management for Home Builders: Succession Planning to Map Your Future*.

This booklet is one piece of a broader effort NAHB-wide to help the builder navigate through this market. The Business Management Department offers an array of materials on its BizTools site at www.nahb.org/biztools. There you'll find more articles like the ones contained in this booklet.

To help builders get back to basics, members can also access NAHB's newly reorganized toolkit at www.nahb.org/toolkit. This resource is also a collection of informative and timely articles for builders, by builders.

This booklet is part of a series produced by NAHB's:

- Business Management & Information Technology Committee
- Custom Home Builders Committee
- Single Family Production Builders Committee
- Single Family Small Volume Builders Committee

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