ARE CO-OP SALES WORTH IT?

THEY CAN BE A SILENT PROFIT LEAK, BUT THERE ARE ALSO GOOD REASONS TO MAKE CO-OP SALES WORK

By Bob Schultz, Contributing Editor

In pursuing increased sales revenue while reducing unnecessary costs, excessive co-op sales have been a stumbling block for builders of all sizes. Many builders aren't aware of the profit leak that co-op sales can cause because outreach to real estate agents has become a common marketing and sales strategy. It's tempting to see only the sales that a co-op arrangement produces, without considering the inherent costs.

Co-op sales occur when brokers and real estate agents are invited to sell a builder's homes—in addition to the sales that are directly accomplished by a builder's internal sales team or the sales that have been outsourced to a brokerage company. The costs of commissions are paid in addition to the compensation that the builder is paying in-house or outsourced salespeople.

Ideally, you'd like to accomplish the optimum number of sales, at the quality your customers have come to expect, with the land you have available, while producing good margins and fulfilling your financial forecasts, without any co-op sales. But for many, this is a tall order.

PROS AND CONS

A plus of co-op sales is that they don't demand cash flow. At the same time, they can help increase market share and additional incremental sales. Unlike traditional marketing expenditures, which contribute to overhead and may or may not produce a buyer, a co-op sale becomes an incurred cost that's deferred and paid out of closing proceeds.

A downside to co-op sales is that although they're tempting to builders that are less than confident about their marketing and sales strategies, they're one of the most expensive sales you can make.

KNOWING THE NUMBERS

There's a joke that says the lottery is a tax on people who aren't very good at statistics. I suggest that too many co-op sales are a tax on builders that aren't very good at business math. The cost of a co-op sale is incurred only when the sale is final. Typically, most if not all of the proceeds come from closing. So it's important to understand the cost of a co-op sale.

- Sales price = $300,000
- 3% co-op commission = $9,000
- Builder's 10% net margin goal = $30,000
- $9,000 = 30% profit loss. For builders working on a 5% to 6% net margin, that diminution in profit can be as high as 50%

Again, it's tempting to ignore the math: The cost of a co-op sale is incurred only when the sale is final, and typically, most if not all proceeds come from closing. Builders generally need some percentage of outside real estate agent sales to supplement what they won't get on their own. The percentage varies depending on market conditions.

Immediate occupancy. Markets heavy with job-transfer relocation buyers, such as Atlanta, or military, like Colorado Springs, Colo., draw buyers who need to move and close quickly. Because of this, real estate agents are in demand. Here, your percentage of co-op sales could be 60 to 80 percent.

First-time buyers. In markets where there are more first-time buyers, these buyers typically don't use a real estate agent. In this case, the range could be closer to 30 to 40 percent.

STARTING SLOWLY

You'll need to monitor the number and percentage of co-op sales by salesperson and by community. With this, and a full understanding of market conditions, you'll be able to set a target range that doesn't exceed a forecasted number—otherwise things will quickly run amok. If in doubt, start out limiting sales to 30 percent co-op. You can always change, but only when circumstances prove that a higher percentage of co-op sales is warranted.

A builder recently told me that he was doing 80 percent co-op sales. "Why so high?" I asked. "Realtors like us," he replied. I suggested first that he set a goal. His 80 percent equaled about 160 sales. Enjoy those 160 sales, but be sure they make up no more than 50 percent of the total. Second, I asked him to observe his salespeople in action. A subsequent mystery video shop revealed that many of the salespeople lacked a process. They showed little focus and no follow-through on potential buyers who weren't with or sent by a real estate agent. The sales folks in question were courting agents and then counting on those sales for their commissions, which was sufficient for them but not profit-effective for the builder.

OUTLINING SPECIFICS

Even with the percentage target under control, so-called parachute or back-door sales can cost you if there's no clear working co-op policy. What if a real estate agent shows up after a builder's salesperson has been directly working with a buyer without the agent, and the agent claims he or she was working with that buyer and insists on being paid the commission? The builder's salesperson may be reluctant to deny that agent commission for fear of being blackballed and losing future sales. A situation like that can cost 30 percent or more in profit.

Real estate agent co-op sales aren't usually measured by the builder, and commission dollars are paid out of closing proceeds, so the cost doesn't show up as it would if a check were being written at the time of the sale. Follow these safeguards:

- Set a policy that at least clearly defines procuring cause—the dealings between a real estate professional and a buyer. The policy should require notification by email or web registration of a potential buyer being sent by the agent. State exactly what those parameters would be.
- Make the real estate agent community aware of your co-op policy.
- Many builder guest registration forms include the question, "Are you working with an agent?" with a blank to fill in. (For a buyer, this begs the question, "No—should I be?") Instead ask, "Accompanied by a registered Realtor/Broker?" with a Yes or No checkbox. Often a broker is brought into the sale when he or she wasn't the first contact because of this inadvertent warning given to buyers upon their first encounter with the builder.

By having a target of co-op sales that fits your revenue and profit margin objectives, by knowing that your salespeople consistently demonstrate superior skills and can sell to prospects who are not brought in or properly sent by a real estate agent, and by creating a policy that clarifies how you compensate co-op sales, you will be on your way to increasing sales revenue and eliminating unnecessary profit-draining costs. **PB**

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