Summer 2012

Property Agent Matters

Opening the doors to future prosperity

Going for Gold

How to achieve a successful exit

As we move rapidly towards the Opening Ceremony of the Olympic Games, it seems like a good time to think about what all these athletes have been working and training so hard for. It is all about that gold medal and making sure all of the hard work has been worth it.

The same can be said for your business. You put in a lot of hours, deal with a lot of stress - why go through all of that? The majority of agents, I would suggest, will be looking to earn a good income and, hopefully, achieve a nice capital growth by the time they want to retire.

However, like any good athlete needs to train and plan their route to the Olympics years in advance, so any agent needs to plan well in advance to ensure they can get the most out of their business on an eventual exit.

Now, it may seem strange to think about exits when a lot of you are just interested in getting through this prolonged period of economic gloom but, in my view, it is never too early to think about exit, the timing of it and how you're going to achieve it, because things are rarely straightforward.

The main ways of achieving an exit are:

- A third party sale
- Management Buy Out
- Partial exit, for perhaps one of a number of shareholders
- Family arrangements and succession
- Closing down and winding up

Third party sale

Timing of any sale is, of course, key. So, if you can all get your crystal balls out, have a look at them, and find out when the property market is going to top out, the key time to exit is just before that point. The problem with waiting until it has topped out is that, at that stage, there is only one way for the market to go, and it's not a good way!!

When planning for a third party sale, it is important to identify potential acquirers. This could be a local competitor who wants to buy a larger market share, a medium chain who haven't established themselves in your area, but have offices nearby, or a large corporate that hasn't managed to force its way into your area yet.

If the list is small, your adviser will generally call them on a names basis to see if there is any interest. If the list is larger, you might want to split into an A list and a B list. The A list should be contacted by phone. The B list should be sent a "blind profile", which sets out basic information, without giving anything away.

If the third party is interested, you would get them to sign a confidentiality undertaking before then providing them with an Information Memorandum, which gives much more detailed information about your business, including financial information.

The main area of risk is that your intention to sell becomes publicly known. Confidentiality undertakings aim to limit that risk, but it is always a possibility. If staff find out, it could result in them leaving, then what happens if the sale doesn't go ahead?

Often an acquirer will ask for the last three years financial results so planning early is essential. There are various ways of making your accounts look as good as possible during this period.

If a third party agrees to purchase, you are into the details of the transaction and how it is structured. Often, there are tax planning opportunities here in respect of any excess cash and you should get good professional advice to ensure you pay as little tax as possible, utilising the 10% capital gains tax rate that may be available.

Management Buy Out

A Management Buy Out (MBO) relies on your business having the staff with the drive and determination to buy and run the business so, if this is a route you want to have open to you, it is important to take on or groom the right people.

One of the biggest problems with an MBO is the ability for the team to raise finance. As you know, the banks aren't exactly free and

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easy with their cash at the moment. If they can't raise the finance, the chances are you will have far more in the way of deferred consideration compared to a third party sale, so you will have to wait longer for your money.

To cover your risk on this side of things, you could retain a small shareholding or a special class of shares, which could provide you with some dividend income, or protect you from the MBO team ruining the business (so you can buy the shares back for nominal value). Alternatively you could have an anti embarrassment mechanism, to cover a situation where they sell to a third party for five times the price you sold to them.

With an MBO you also need to consider the effect of working with a management team at the same time as trying to sell your business to them. It can create frictions during the process and you need to consider the potential impact on your relationship with them if the sale does not go ahead.

Partial exit

If you operate as a limited company, have a number of shareholders and just one wants to exit, what can you do if you don't have someone coming through the ranks who can buy the shares? In that situation, you could consider a company purchase of own shares.

This does exactly what it says on the tin, the company buys back its shares from the exiting shareholder. The company, therefore, utilises its existing cash and reserves to facilitate the exit of one of the shareholders.

From a tax perspective, normally this would be treated as a dividend. However, providing certain qualifying criteria are met, this can be treated as a capital distribution and, if the shareholder qualifies for Entrepreneurs' Relief, taxed at 10%.

If the resources aren't available, there are alternative structures that could be considered, such as forming a new company to acquire the shares from the outgoing shareholder.

If you operate as a partnership, this represents more of a challenge, although not if you don't recognise the current value of goodwill on your balance sheet. It may be that the partnership agreement just allows you to extract your capital account. Banks may agree funding for an established business to enable that to happen, or alternatively you could consider incorporation as part of the exit strategy.

Family arrangement

It's nice to provide for your family and to think that all your hard work is going to give your children a great future. The only problem is, if you just pass on the business, you won't have any capital sum to retire with. You could consider selling to your children, but there's more chance of your children asking for money from you, rather than the other way around!

If you do decide to go down this route, you need to be sure that the next generation want to do it. Don't force them because you think it's the right thing for them. If they aren't interested, they will fail and all your hard work will have gone to waste.

When transferring down a generation, you can defer capital gains tax by making a holdover election and it's important to do that, otherwise you're left with a tax liability and no capital sum to pay it with!

Bearing in mind you will not have that capital sum, it is important to retain some shareholding or class of share to provide you with a pension in your retirement to keep you in the manner to which you have become accustomed.

Close down and wind up

Certainly the easiest way of exiting a business. Lock the doors, stop trading and take your money and run. Obviously, if you're a company, you will need to liquidate the company to distribute the cash, but that should be relatively inexpensive.

The problem here is that you have no capital sum in respect of the goodwill you have generated for your retirement, and it can be quite emotional to just close your business and not see it continue. Despite that, it is without doubt the simplest way of exiting, if not the most exciting.

Other issues

Other issues that you need to be aware of:

- Valuation - how your business is valued. For Estate Agents it is often on a multiple of earnings. The multiple applied will depend on a number of factors, but principally the state of the market and the number of acquirers around at the time. It should not be forgotten that adjustments will always be made to your results to arrive at a "future maintainable earnings figure" for acquirers, such as imputing a salary for a manager to replace you as owner. For Letting Agents, value tends to be linked to turnover but, again, will depend on market activity.
- Where there is investment property or you own the offices from which you trade, consideration needs to be given as to whether or not these are to be part of the sale. If not, you will need to plan as to how you are going to extract them from the business in a tax efficient manner.
- Legals - the appointment of a good solicitor in a sale situation is critical to ensure your commercial and legal position is secure. Make sure you use a specialist corporate team rather than a general practitioner. They may be a little more expensive, but could save you much more in the long run.

As you can see, there is a lot to think about and, before you get to the point of exit, a lot of work to do as well. Your exit plans should be constantly under review and move over time, depending on market conditions and how you are feeling from one year to the next. Whatever you do, don't leave it until the last minute because a failure to plan will cost you dear and you will definitely be missing out on that gold medal.

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