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SIOR Firm Operations Survey:

Rising Costs Cut into Margins

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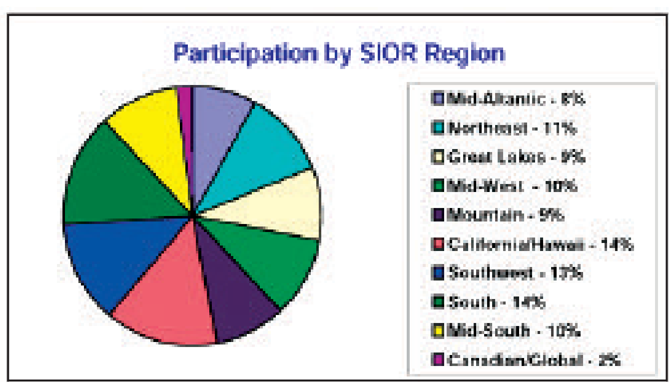
By Steve Lewis

Note: This article is based on interviews with SIOR members and an online survey of members across the United States and Canada taken in July. Although 147 members participated in the online survey and answered questions represented by percentages, no more than 50 members answered questions regarding average dollar value for the various costs of doing business. All expense averages were derived from these respondents minus outliers to produce the averages shown.

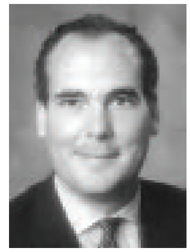
In SIOR's July survey more than 50 percent of participating members were from markets exceeding one million inhabitants; 76 percent listed themselves as independent contractors with their firm; 39 percent indicated that their firm employed a sales manager; and 60 percent of firms compensated their full-or part-time sales manager with a combination of either salary, commission, bonuses, or all three.




Dunn


Leffler


Osborn II


Tindle


Zacher

Keeping Up with Costs

Respondents agree that one of the greatest challenges they currently face is keeping up with rising costs. While the "easy" answer would be to boost revenues, a tough competitive market prevents that. Instead, managers take greater care where and when they spend money, coming up with creative solutions to increase operating efficiency.

"I'd say that operating costs across the board keep going up and you can't necessarily pass those costs on or translate them into higher revenue; there's sort of a disconnect between costs and revenue," asserts **Steven K. Zacher, SIOR,** The Zacher Company, Ft. Wayne, Indiana. "There are more and more companies to compete against, so it's harder to simply increase revenues to offset costs."

"Controlling variable costs is surely a challenge," adds **J. Claude Tindle, CRE, SIOR,** industrial specialist with Longleaf Realty Partners in Birmingham, Alabama. "If you look at marketing, soft costs, copiers, and printing, you can spend as much—or as little—as you want to, but if you are not careful they can really eat into your gross margins."

"You just have to close more deals and save on other things; be careful how you spend," says **David R. Dunn, CCIM, SIOR,** of Dunn Commercial in Arlington, Texas.

"In our case, rents are going up—mostly because we are in brand new space," says **Duke Leffler, CCIM, SIOR,** of PMZ Commercial in Modesto, California. "Our biggest costs are technology, rent, employment, and signage," says **Lester E. Osborn II, CCIM, SIOR,** of Piedmont Properties of the Carolinas in Charlotte, North Carolina.

Survey responses clearly illustrate why operating expenses present such a challenge. The average of all responses provided (disregarding outliers) for the most common operating expenses (annually) are:

Insurance:	$16,777
Telephone/Internet:	$13,319
Supplies/Equipment:	$12,096
Auto:	$11,545
Computers:	$10,674
Dues/Licenses/MLS:	$ 6,962
Postage:	$ 5,700
Legal/Accounting:	$ 4,342

Mix in additional occupancy expenses such as rent ($72,056) and utilities ($7,112); and the ongoing challenge of running a commercial real estate office becomes crystal clear.

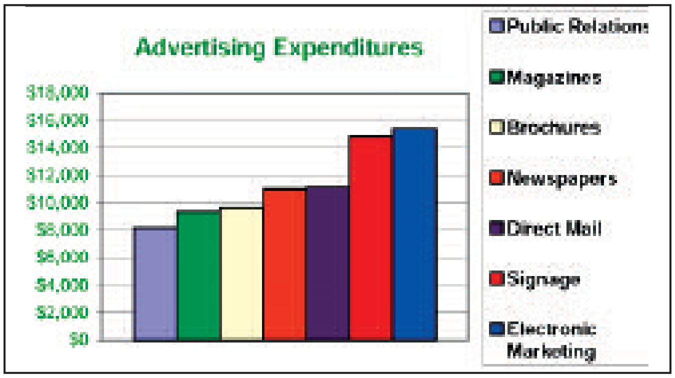
A review of expenses by region shows some surprises. While the Northeast Region was usually at the top of the list, second place often fell to the Mountain Region or the Mid-South, who reported average costs above those in California. Part of that is attributable to the fact that a higher percentage of the respondents in the Mid-South and Mountain Regions lived in cities with a population of one million or more than respondents from California, many of whom lived in smaller markets. Regional preferences also played a role; for example, California respondents spent relatively little on newspaper advertising because, as one respondent noted, they "don't believe" in advertising commercial real estate in the newspaper.

Advertising Expenditures

According to the survey, firms continued to spend significant dollars in this area; in fact, the average firm allocates about $80,000 a year for its advertising activities. The graph on page 16 charts the average expense of various advertising venues.

Survey respondents indicated that real estate companies, not clients, bear the vast majority of these costs. "Here in Charlotte, the company still pays," says Osborn.

There's a good reason, he notes, why signage is the second largest cost under the advertising



umbrella. "It's probably the best form of advertising there is," he asserts. In order to rein in costs, he adds, "We try to be aware of what we are doing, and re-use signs." A number of firms, he says, pass the cost of signage back to the client. "We've not done any of that—but we're thinking about it," he shares.

In this hi-tech age, the decidedly low-tech signage approach remains popular with a number of firms. "We have our own signage division," says Leffler, "But the cost to make and install a sign—typically painted, with vinyl lettering and three or four colors, on two posts—is more than $300, and that's a big number."

Since signage is used as a marketing tool, he explains, "If the property does not sell, that money comes right out of the bottom line."

Nevertheless, he continues, it remains a favored form of marketing. "We are not big on newspaper advertising in California," he says. "Here, brokers do not spend a dime in the newspaper for commercial real estate advertising."

"We are not a big proponent of advertising," says Tindle. "We have paid for it, but usually I prefer institutional advertising rather than marketing a specific property."

Support Personnel

Costs are on the rise for support personnel necessary to run an efficient commercial real estate office. The average compensation from all SIOR Regions for various non-broker/salesperson brokerage firm employees was reported as indicated below:

Managers	$102,650
IT Personnel	$58,272
Accounting	$48,400
Public Relations Personnel	$44,000
Researchers	$39,150
Administrative Assistants	$37,113
Clerical	$33,447
Receptionist	$29,362

Technology Costs Rising

SIORs noted that technology and related personnel costs continue to rise. "To be competitive you have to provide more resources to brokers—especially in the area of technology," says Osborn. "We went to a system with a mainframe that we can access with our laptops."

He says that this move was a "rather large one, and [we only do this] once every three or four years." He adds that computer technical support is one of his biggest challenges.

Technology "probably is driving more costs," adds Dunn. "You need more and more of it to keep up to date; people want a fresh, new look all the time. It's like wanting a new car."

Those costs can have an upside, notes Leffler. Because he considers his company to be very tech savvy, "We do not have many operating challenges. Everyone in the office has a computer, and company-wide we have four tech support experts doing nothing but supporting our agents. One person mans the phones and manages the files."

But Tindle says he really hasn't felt the pinch. "You can spend as much or as little as you want on computers, software, and copiers," he says. "We only add new systems as our volume goes up."

Controlling Costs

Survey respondents shared a number of approaches they take to keep costs in line.

"We have to be leaner in general across the board, so maybe it means a single broker assistant will take care of more brokers," says Zacher. "We try to have less support staff, more efficient and productive support staff, plus more productive processes—eliminating duplication. We have to look carefully at all activities, whether it is creating brochures, placing properties on the Internet, advertising, or sending out letters, in addition to how we handle the generation of documents, contracts, and so on."

Zacher stresses the importance of eliminating duplication. "Take data entry," he offers. "When we get a listing, we put it in the company database, from where it then goes to multiple places—on spec sheets, in brochures, etc. We're trying to find ways to enter it one time and feed it to multiple places—although we're not quite there yet.”

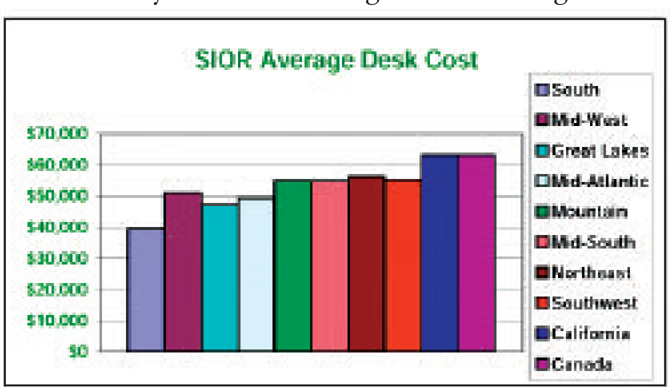
Dunn agrees. “You have to operate more efficiently,” he says. “If your rent is a big number, you can move to lower-cost office space—which I'm working on doing—and be really careful about overtime.” Another strategy is to bring college interns into the office to help. “They get credit for the work, and they get paid, too,” he says.

“I try to do take a ‘pay as you go’ approach,” says Tindle. “We are a small shop, so we try to look at the cost of leasing versus buying—or fixed costs versus variable costs. In my old firm everything was worn out by the time we finished the lease for computers, etc. My experience is that the cost factor makes buying much cheaper.”

His company owns a couple of buildings and occupies space in one of them, which creates an interesting conundrum. “As a landlord we want to do the best job we can, but we don't have control over electrical, water, and so on,” he notes. “From a tenant perspective, we are concerned about the fact that those operating costs have gone up pretty rapidly over the past 12-18 months.”

Creative Compensation Structures

When it comes to compensation, there are numbers . . . and then, there are numbers. While the survey results clearly delineate average costs and regional



Costs are on the rise for support personnel necessary to run an efficient commercial real estate office.

differences, when respondents get into the details about commission splits and employee incentives, an even more complete picture emerges.

The average desk cost per broker/salesperson was $52,005 with California and Canada neck and neck with averages of $63,232 and $63,236 respectively, and the South coming in at the lowest average—$39,500.

The survey respondents employ a variety of methods when it comes to compensation and how the company and its associates split revenues. “I've made the two top producers stockholders, and the two who are not stockholders are on a commission scale so things are in their favor; what they make goes to desk costs,” says Osborn. “This grew out of my desire to share the burden of running the company.”

Any common office item is considered a desk cost, he continues. “Brokers are on a sliding scale to where I figure they need to make $150,000 a year minimum in gross revenue to cover their desk costs. After that, the commission is skewed pretty much in their favor—90/10 or 80/20.” The three owners leave enough in to cover expenses, he adds. “If common expenses are $45,000 a person, and I spend only $10,000, I write a bonus check beyond that.”

Dunn says currently his brokers need to bring in $120,000 a year to cover desk costs.

“We don't charge a desk fee,” says Leffler. “We pay out commission-wise as high as 85 percent, where in some of the larger international organizations 60/40 is the best you can do.”

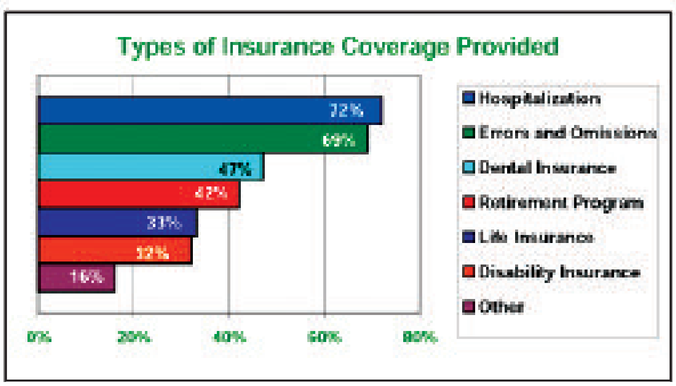
These splits, he concedes, “Have created the most pressure on revenues. If costs go up, we keep everyone out hustling and get the volume up, and we've been successful at doing that.”

SIORs are making adjustments in support staff compensation as well. “It's definitely gone up,” says Dunn. “We used to be able to pay from $23,000 to $27,000; now it's a minimum of $35,000-$40,000. And if you want someone more high powered you need to pay $50,000, $60,000, or $70,000.” Such a “high-powered” individual, he notes, “Answers phones, keeps all the Web sites up to date, puts proposals and leases together, runs the office, buys supplies, and keeps up with the office equipment.

Zacher agrees with Dunn that talent is expensive. “It costs more to get a better person,” he says. “But for us it’s important to have support staff that can be very flexible and adaptable to a lot of different functions. They can’t just be a really good word processor; they have to do desktop publishing, brochures, and be a customer service type person who can field calls and handle client issues.”

“In our market [Modesto, California] we are pretty fortunate when it comes to salaries for our support staff, because there is an abundant work force—we can find good people for reasonable wages,” says Leffler.

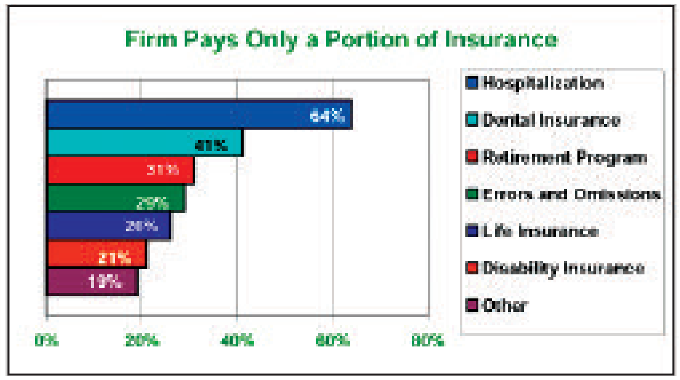
Tindle, who runs what he calls “a small shop,” has one support staff person. “My philosophy is that they need to have incentives just like brokers do,” he says. While he has not yet put a formal policy in place, “My idea is that we establish a baseline where sales need to be and anything over that I give support staff a point, or maybe we’ll base it on the number of deals per month and pay $50 or $100 a month for an amount over and above what was expected.”



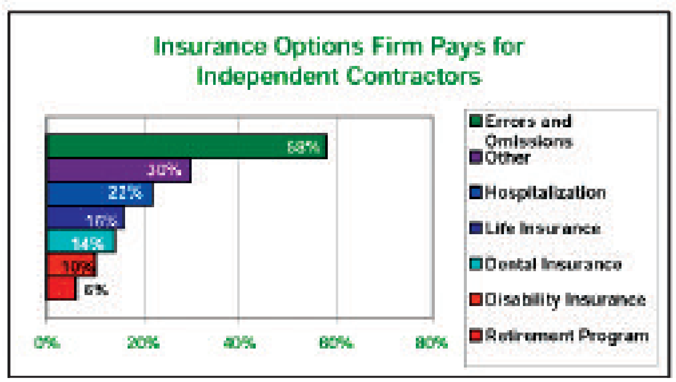
Sharing the Insurance Burden

Real estate companies provide various types of insurance coverage for their employed salespersons, non-sale employees, and key management personnel. The chart above indicates the percentage of companies that pay for the various insurance types according to survey respondents. Included in the “Other” option was vision and general health insurance.

Following up the question on what types of insurance coverage the firms provided, was a question on how many firms pay only a portion of insurance programs with the following results.



When it comes to brokers/salespersons who are independent contractors (who made up 76 percent of respondents) coverage paid by the firm decreases sharply. Those respondents who were independent contractors said their firms paid for the following insurance (rather than treating it as a draw):



“Health care is a case of pay me now or pay me later,” says Osborn. “It’s part of the cost of doing business and it affects us all. Brokers are independent contractors, so they are responsible for their own healthcare.”

Group policies for small companies like his make no sense, he continues. “There is a need for a broker organization such as NAR to come up with an insurance program that really works,” he says.

Zacher says health insurance for support staff is among the most pressing challenges he faces in firm operations. Commenting on Errors & Omissions insurance, Leffler says, “For each transaction, four percent goes into the E & O account.”

Travel and Organization Dues

In terms of dues and travel for brokers, company practices vary considerably.

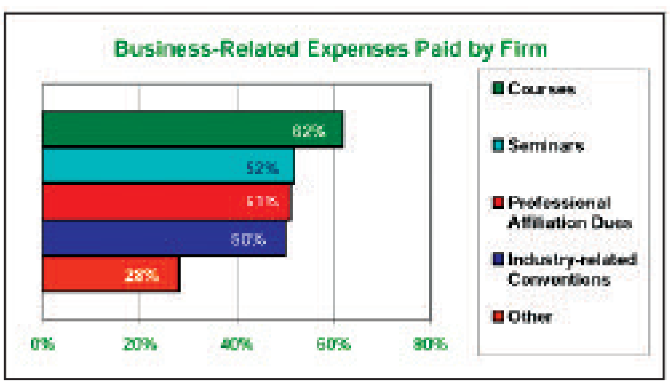
"We are members of CORFAC," says Osborn. "We try to get one of the principals to go [to meetings] first; if not, we open it up to someone else and we pay for them." His company always pays half the cost of education, like pursuing industry designations, which is encouraged, he says.

"In our case we've been pretty consistent," says Zacher. "We have an education and conference allowance that is pretty standard, and the brokers can use it as they see fit."

"Our company typically pays for everything other than MLS dues (PMZ has a large residential division), which commercial guys are required to pay, too," says Leffler. "Agents pay for NAR dues."

Those costs are definitely going up, he continues. "There are a lot of products out there, for example, a commercial MLS," he notes. "If the agents want to use it, they pay for it. But with something like CoStar Group properties—which provides international photos of properties and costs $2,700 a month—our office picks up the expense."

Survey respondents indicated that only 39 percent of firms pay for out-of-town travel for their salespersons and independent contractors. However, firms are much more accommodating when it comes to covering expenses geared to increasing professional knowledge and abilities.



While brokers typically pay their own travel and entertainment expenses, "If someone came to me and said they had a Home Depot account and needed to travel around the country, we'd consider [paying for] it," says Leffler. In many cases, he says, the firm will absorb half the tuition for certain industry education programs.

"Basically brokers pay for all their own travel unless it is pre-approved by the firm," says Dunn. He does add a creative twist, however. "If a broker has to go Los Angeles because he's working on a transaction, he fronts the money, but if it closes I'll split the costs off the top."

"We don't have any hard and fast rules," says Tindle. "For me as a principal, the company pays my [national] dues and I cover the conventions and local dues." While the company will pay for industry association dues, there is a catch; the brokers have got to attend those meetings. "We paid $700 in dues for a guy and he missed a couple of meetings," Tindle recalls. "We met with him said we would not pay his dues if he did not participate."

Not Everything Has a Price Tag

In addition to paying close attention to bottom-line issues, survey respondents say that individuals managing real estate firms must also be sure they have the "right stuff" to handle not only a complex and challenging business but a team of talented and ambitious individuals. Several of them candidly pointed out that success as a broker does not automatically mean success as a manager.

"Going from being a broker to being a manager is a big challenge," says Osborn.

"Lots of people who are good brokers are not good managers—and you have to be able to go back and forth between the two," asserts Zacher. "When you are the manager you have to be a motivator, be fair, and be empathetic—and, you have to watch the expenses. When you're a broker, you just have to think about closing a deal."

The most important skills needed to manage a real estate operation today are, "patience, tenacity, perseverance, and being a good leader as well as a producing leader," says Dunn.

Another key challenge for companies is finding and keeping quality personnel. "Our biggest challenge is hiring brokers and training and keeping them with the company," says Dunn. "We've joined Sperry Van Ness, which hopefully will help with retention of brokers and associates."

"Getting good talent, and getting good support staff is a big challenge," adds Tindle.

Finally, says Osborn, "You not only have to find good people, but you have to create the right mix—the right chemistry."