Real Estate Compensation

STEPHEN RUSHMORE

A UNIQUE EMPLOYEE COMPENSATION PLAN

Little has been written about compensation in consulting organizations. Such firms are often staffed with bright, independently thinking individuals who require high levels of monetary and nonmonetary rewards. This article describes the unusual compensation package utilized by Hospitality Valuation Services, Inc. in Mineola, New York. Its compensation plan was designed to motivate its employees and to give them maximum incentives for producing a high quality and quantity of product.

BACKGROUND AND STRUCTURE OF THE FIRM

The firm is a consulting organization that specializes in hotel-motel valuations, market studies, and counseling. It serves a broad client base of hotel companies, developers, lenders, and municipalities from its main office in Mineola, New York and a regional office in San Francisco. Although it provides a variety of hotel-related counseling services, the end product is typically a comprehensive, detailed written report that ranges in length from 100 to 200 pages and costs from $20,000 to $30,000. Each assignment is normally performed by an "associate" who devotes an average of three to four weeks per study.

Currently, the firm consists of eighteen associates, five editors, two production assistants, a secretary, and a college intern in its Mineola office. Because of the unique expertise required to render hotel-related counseling services, the associates are all hotel *school graduates. Ten of the eighteen associates* were recruited directly from college, and eight associates had varied backgrounds in the hotel industry. Three associates have master's degrees in hotel administration; fifteen have bachelor's degrees.

The five editors are responsible for proofreading and editing the reports that the associates print out on a network word processing system. The editors paginate the report, develop the necessary charts and tables, and conform the report to the firm's editorial style. Each report usually requires moderate to heavy editing that takes approximately one week of editorial time.

Although an associate has ultimate responsibility for the integrity of the final product, the editorial function assures readability, organization, and quality. Each editor, therefore, has a degree in English or a strong journalism background.

The two production assistants are responsible for assembling and binding the final reports, which are typed on word processors. They prepare the graphics (including maps, computerized graphs, and laminated photographs) and maintain the data files, office library, and supplies.

The secretary types all the correspondence, proposals, invoices, articles, and other nonreport documents.

OWNERSHIP STRUCTURE AND OBJECTIVES

Hospitality Valuation Services, Inc. (HVS), a New York corporation owned jointly by Judith and Stephen Rushmore, is a cash-basis taxpayer with a November 30 fiscal year. Over the past five years HVS has minimized its tax liability by distributing the majority of its profits in the form of salaries, profit-sharing contributions, and bonuses.

Several ownership objectives have been established for the future, which include continuing to provide clients with the highest quality hotel counseling services; expanding the product line (ser-

Guest columnist Stephen Rushmore is President of Hospitality Valuation Services, Inc., a Mineola, New York-based counseling organization, specializing in hotels, motels, and restaurants. This article is an edited version of one that appeared in the Fall/Winter 1985 issue of *Real Estate Issues*, a publication of the American Society of Real Estate Counselors.

Mr. Kovach's concluding article on compensation of property managers will appear in the next issue.

vices) into other hospitality-related areas (i.e., ownership, financing, management, development, and syndication); continuing expansion of the New York office and the establishment of additional regional offices in selected U.S. cities; increasing client base through the development of new products and continuing penetration into markets and services currently dominated by other consulting organizations; promoting the generic identity of HVS rather than the individual reputation of its founder; and minimizing employee turnover in order to prevent losses to competing consulting organizations.

Organizational and Employment Philosophies

The key component of any counseling organization is its professional staff. Since consultants are in the business of selling their experience and expertise, the quality of a counseling firm is directly related to the abilities of its employees. Thus, attracting, motivating, and holding strong professional associates are key objectives of a counseling organization.

Over the years, HVS has developed the following organizational and employment philosophies to sustain its staff:

☐ *Maintaining direct client contact.* From day one, a consultant should work directly with the client, attending all meetings and presentations, participating in the development of data and conclusions, and seeing assignments through to their finish. If a new consultant is assigned backroom responsibilities, grinding out portions of reports, he/she misses the experience gained from client interaction and never appreciates the full impact of the assignment.

☐ *Eliminating organizational chart stagnation.* A complicated organizational structure with an elaborate chain of associates, supervisors, managers, and partners is unnecessary, unproductive, and expensive. All starting associates should work under the close direction of an experienced associate and progress quickly to autonomous standing, which means that they are totally responsible for their assignments, subject only to upper-level review. Consultants need to feel they are working for the client rather than for a firm or a supervisor.

☐ *Establishing certainty about earning prospects.* New associates, regardless of background and experience, start with the same compensation—a mix of salary, percentage of gross billings, selling incentives, and profit sharing. They are informed about their maximum compensation level. The time it takes to go from the starting compensation to the maximum level is based solely on ability and effort.

☐ *Establishing incentives.* Everyone within a consulting organization should receive, as part or all of his/her compensation, a percentage of the professional fees that the firm collects. Associates, editors, and production personnel are motivated when their paychecks directly reflect the amount and quality of their individual output.

In addition to compensating pure output, the remuneration formula rewards continuing education and personal development. Supervision, time sheets, and time clocks can be eliminated when people are paid on the basis of product, effort, and expertise rather than on the basis of time.

☐ *Rewarding new business development.* All members of a consulting organization should participate actively in new business development. Even junior associates should be encouraged to seek out potential clients and market the firm's services. Involvement in professional and trade organizations, along with contributions to literature and educational activities, are excellent means of generating client exposure, firm recognition, and new business.

Just as associates should be compensated on the basis of their output, they should also receive direct benefits based on the new business they create and repeat business from satisfied clients. When everyone has a financial interest in new business development and repeat client incentive, the firm benefits from continuous growth.

☐ *Eliminating the yearly compensation review.* Compensation increases should be based on the individual's ability to perform assignments competently and independently and on his/her success in creating new business. Raises must come continuously as the associate moves toward these goals rather than at specific dates or points in time. The elimination of a managerial hierarchy allows the associate to progress to a level of autonomy and monetary compensation based solely on ability rather than time in grade or office policy and politics.

☐ *Encouraging pursuit of professional designation.* Many consultants leave the field with nothing to show for their investment of time but experience. By providing associates with the opportunity and incentive to secure a professional designation (CRE, MAI, SREA, CPA), a consulting firm offers its staff a tangible asset that has lifetime value.

☐ *Publishing to prosper.* A consultant is in the business of selling credibility. All the associates who participate in an assignment should personally sign the finished report. Encouraging associates to publish and lecture under their own names rather than to ghost write for the boss allows them to develop professional recognition and individual identity.

☐ *Providing flexibility and freedom.* A professional consultant should be treated as a professional. Hours, schedules, and vacations are up to the individual. As long as the flow of work is maintained, it makes little difference whether office hours commence at 9:00 A.M. or 3:30 P.M.

INCENTIVE COMPENSATION FOR PRODUCTIVITY

To implement the preceding organizational and employment philosophies, the following employment structure was developed for HVS.

Associate Compensation

All HVS associates receive a starting salary of $210 per week plus 5 percent of their gross billings. If the new associate remains at this level during the first year, he/she would earn approximately $20,000. As the associate gains skills and demonstrates an ability to work independently, the salary plus commission increases as follows:

Level	*Salary Per Week*	*Percentage of Gross Billings*
1	$210	5%
2	220	7
3	230	9
4	250	11
5	250	14
6	Draw	25
7	Draw	30
8	Draw	35
9	Draw	40

The firm reviews each associate's performance and most new associates progress to level 3 by the end of their first year.

When an associate reaches level 6, salary is replaced by a $20,000 per year draw against a straight commission of 25 percent of gross billings. Commissions rise through three subsequent levels to 40 percent.

Promotions through level 5 are based on general ability and effort. Promotion to levels 6–9 not only requires the associate to demonstrate greater ability and continued effort, but also the passage of specific MAI courses and requirements as well as the achievement of certain levels of new business development. Exhibit 1 outlines the additional requirements for advancement into levels 6–9.

EXHIBIT 1

SPECIFIC REQUIREMENTS FOR ADVANCEMENT INTO LEVELS 6–9

Level	*MAI Requirements*	*New Business Development Requirements*
6	Completion of courses 1A1, 1A2, 1BA, 1BB, 2-1, 2-2	None
7	Completion of all courses	10% selling for last 12 months equal to 10% of the average associate volume per person
8	Demonstrate appraisal accepted	10% selling for last 12 months equal to 25% of the average associate volume per person
9	MAI designation received	10% selling for last 12 months equal to 50% of the average associate volume per person

The primary purpose of the Exhibit 1 requirements is to spur associates to rapidly complete the course work and demonstration appraisal for the MAI designation.

The "10 percent selling" requirements for levels 6–8 can best be explained by example. To reach level 7 an associate must have created in the past twelve months new "10 percent business" equal to 10 percent of the average associate volume per person. For example, if the average associate within the firm works on $200,000 of assignments per year, then the new business requirement for level 7 would be $20,000 (for level 8, $50,000 and for level 9, $100,000).

Editors' and Assistants' Compensation

Initial editors' salaries are $210 per week plus 1.5 percent of their gross billings. During a twelve-month period, editors should work on approximately $600,000 worth of assignments. Thus, starting compensation, salary plus commission, is about $19,900. As their editing skills improve, their salary moves up to $300 per week and their commission increases to 3 percent (about $33,000 annually).

Production assistants receive a salary of $180 per week plus 0.5 percent of their total gross billings.

SELLING COMMISSIONS

In addition to advancement in rank (and thus in overall compensation) associates receive two types of selling commissions.

New Business With Existing Clients

Associates receive a 5 percent selling commission for any new business they create from a previous client. This type of commission is a client satisfaction incentive. Associates who perform superior work and maintain close client contact are rewarded when a satisfied client calls them with new business. Associates also receive a 5 percent selling commission for any new business referred to them by the firm. For example, each day one associate is designated the "associate of the day" (AOD). Any phone calls requesting information about the firm, its services, or general questions pertaining to hotel valuations and market studies are referred to the AOD. If one of these phone calls results in an assignment, the AOD is entitled to a 5 percent selling commission.

Associates earning a 5 percent selling commission have the option of either working on the assignment themselves or turning it over to another associate.

New Clients

A 10 percent selling commission is paid to associates who develop new clients for the firm. To receive a 10 percent commission, the associate must demonstrate that it was his/her individual and personal effort that brought the new client to HVS. Once an associate creates a 10 percent client, he/she is entitled to receive selling commissions from all future business generated by this client. If, however, another associate "sells" a future assignment to this client, the 10 percent associate will relinquish 5 percent of the commission to the selling associate. This procedure maintains the client satisfaction incentive while capping the firm's selling expense at 10 percent.

SUBCONTRACTING

The real incentive offered by HVS for new business development is subcontracting. When an associate sells a 10 percent assignment, he/she may either work on the assignment and receive the appropriate percentage of gross billing level or subcontract the work to another associate and earn the spread between the amount he/she would receive from the percentage of gross billing level and the actual cost to the firm to have the other associate work on the assignment. The economics of subcontracting can be illustrated by the following example.

Associate *A* sells a $20,000 appraisal to a new client he met while attending an appraisal course. Associate *A* is currently at level 7, making a draw against 30 percent of the gross billings. Since this client represents a 10 percent selling commission, Associate *A* decides to subcontract the assignment to Associate *B*, who is at level 2, earning $220 per week plus 7 percent of the gross billings. Associate *B* works on the assignment under the direction of Associate *A* and devotes a total of twenty days to the project. Associate *A* visits the subject property, assists in the analysis, meets with the client, and spends a total of four days on the assignment. Exhibit 2 sets forth the compensation of both Associates *A* and *B*.

EXHIBIT 2

ASSOCIATE A SUBCONTRACTS TO ASSOCIATE B

Associate *B*	
Commission ($20,000 × .07)	$1,400
Salary ($220 × 4)	880
Payroll Taxes and Benefits	279
Medical Insurance	75
Total Compensation	$2,634
Associate *A*	
Commission—Selling ($20,000 × .10)	$2,000
Commission—Work ($20,000 × .30)	6,000
Total	$8,000
Less: Associate *B* Compensation	2,634
Net to Associate *A*	$5,366

As shown in the exhibit, Associate *A*, by subcontracting, is able to spend only four days on this assignment and net $5,366, or $1,341 per day, as compared with doing the complete assignment over twenty days and earning the full $8,000 commission, or $400 per day.

An associate's ability to create and personally service any new business through the process of subcontracting is equivalent to owning his own business without the overhead of maintaining a staff. Subcontracting follows the same principle as leveraging real estate, and it creates a highly motivated entrepreneurial spirit within the organization.

PROFIT-SHARING PLAN

HVS has a profit-sharing and retirement plan for all full-time employees who meet the eligibility requirements. Under the current plan, the firm contributes a minimum of 10 percent and a maximum of 25 percent of each employee's total earnings. These tax-free contributions are managed by the plan administrator and compound tax-free until withdrawn upon retirement.

Under the current plan, an average associate can accumulate approximately $90,000 in the profit-sharing plan with five years of eligibility. To date, HVS always has contributed between 20 and 25 percent to the profit-sharing plan. Because of the tax-shelter benefits, a profit-sharing plan has significant value to high-income employees.

THE MAXIMUM COMMISSION LEVEL

The top commission level of 40 percent has been established because it represents the approximate level at which the firm breaks even on an assignment. The following table shows this calculation:

	Percentage of Total Fee
Maximum associate commission	40%
Selling commission	10
Editor commission	3
Editor salary	2
Total	55%
Profit sharing (25% × 55%)	13.75%
Payroll taxes (10% × 55%)	5.55
	74.30%

When the associate is at the 40 percent level, approximately 75 percent of the total fee is paid out to the associate and the editor in the form of salaries, commissions, profit sharing, and payroll taxes. The 25 percent remaining must cover the firm's overhead expenses, such as medical insurance, office supplies, computers and equipment, telephone, rent, etc.

This calculation demonstrates that assignments performed by 40 percent associates generate little or no profit for the firm. By paying these top associates literally all of the consulting fee available for professional salaries, HVS is attempting to eliminate any incentive for an associate to leave and set up a competing practice.

REGIONAL OFFICES

The ultimate goal of any consultant is to become a partner of the firm. In most organizations, a partnership interest consists of a small piece of a large pie (i.e., the firm's equity is split among many partners). But an ownership hierarchy would run counter to the HVS entrepreneurial goals of compensating associates for their direct and personal contributions rather than for ownership interests. Consequently, HVS provides its associates with an opportunity to obtain a large piece of a small pie in the form of a 50 percent ownership interest in a regional office.

Once an HVS associate receives the MAI designation, he/she is eligible to open a regional office. The ownership of the regional office is split 50/50 between the associate and Hospitality Valuation Services, Inc.-New York (HVS-NY). The associate contributes the sweat equity needed to start the office and develop new business. HVS-NY lends all opening and operating capital and directs business to the regional office. The commission structure is identical to that of HVS-NY (described previously) with the associate partner also receiving 50 percent of the bottom-line profit plus the residual ownership value created in the regional office. Since the personal and individual effort involved with generating revenue and controlling expenses will benefit a 50 percent partner in a small firm more than, say, a 5 percent partner in a large firm, this ownership structure increases the performance incentive.

New associates hired by a regional office have the same opportunity to progress to an ownership position. Upon obtaining their MAI designation, they can open a subregional office as a 50 percent partner with HVS-NY and the partner of the regional office, each of which has a 25 percent interest.

SOME DRAWBACKS

The HVS organizational structure functions reasonably well, but it does have some drawbacks and potential problems.

☐ Determining whether a client is a 5 percent or 10 percent client is sometimes difficult. Similarly, it is sometimes hard to establish which associate was actually responsible for bringing the new business to the firm.

☐ As associates become successful in creating new business, the firm must hire more new associates so that the selling associate can make a profit by subcontracting. This system rewards and perpetuates growth, which means the organization will not remain small.

☐ Since the firm essentially breaks even on 40 percent associates, there is more incentive to assign the firm-generated business to lower-level associates. High-level associates must, therefore, create a sufficient amount of 10 percent business to justify their level of compensation.

☐ The bookkeeping required to keep track of everyone's salary and commissions is horrendous.