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CORPORATE PERFORMANCE, SHAREHOLDER VALUE AFFECT REIT COMPENSATION PLANS

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Although compensation trends among REIT executives have fluctuated over the past few years, patterns are emerging around those trends that affect executive pay—patterns that look like they are here to stay. These were revealed in FTI Consulting's 2016 REIT Executive Compensation study; it focused on the pay practices at the nation's largest 125 REITs, with issues of executive pay, total shareholder value, and transparency regarding bonuses among the factors affecting the compensation. The results reveal some industry bellwethers to be mindful of as 2017 approaches.

1. Continued correlation of NEO pay increases to REIT returns.

As annual REIT returns go, so goes annual pay for named executive officers (NEOs). The average annual NEO pay had increased by eight percent since 2010, but only three percent in 2015 over the previous year. This corresponds directly with REIT stock gains of three percent in 2015 (compared to five to 13 percent from 2010-2014). The modest pay increase and modest total returns are both at the lowest level since the financial crisis. Based on this, we expect to see a modest increase reported for 2016 since REIT stocks are relatively flat year-to-date.

This correlation reflects the more recent trend to pay executives more or less based on short-term performance, even though the historic focus of shareholder return has been over longer periods of time.

2. Pay for performance models show particular focus on performance-based equity compensation.

Performance-based equity—most commonly awarded in time-vested restricted stock shares—has continued to increase. Approximately 82 percent of REITs granted performance shares for 2015, a slight increase over the prior year (79 percent in 2014). A three-year horizon is the most prevalent vesting and performance period.

For REIT CEOs, approximately 48 percent of equity was allocated to performance shares in 2015. This equity allocation reflects continued board sensitivity to total shareholder return (TSR) and pay-for-performance compensation philosophies. This illustrates a clear trend of the REITs' aim of striking a balance between executive retention and motivating management to increase shareholder value (shares earned contingent upon TSR performance).

Conversely, awarding stock options has been and will continue to be a declining trend. This is in spite of the fact that prices for stock options have settled, related accounting costs have dropped slightly and they also have a 10-year horizon.

3. Transparency regarding cash bonus plans is key for most investors.

There is continued scrutiny by investors over CEO pay, the organization's compensation structure, and the rigor of performance goals. Approximately 80 percent of REITs have a formulaic cash incentive plan. Fewer than 20 percent have a plan that is strictly discretionary but we anticipate that percentage will further decrease in the coming year or two.

It is no wonder there is a strong interest among investors about this transparency issue, given that:

a) The median annual bonus target for CEOs was $1 million (equal to 131 percent of base salary, a six percent increase over the prior year), and
b) Recent revelations in other industries have shed a negative light on certain employee performance motivations.

4. Simply having performance goals is not enough.

During the last proxy season there was a notable increase in the interest from investors and Institutional Shareholder Services (ISS) on the goal-setting process and on benchmarks that made the goals meaningful and challenging. The study's results showed that the metrics behind annual incentives plans—how executives are being paid—is paramount to how much they are compensated. This speaks to the growing importance of shareholders' need to understand compensation programs first and foremost. There is a trend toward shareholders developing their own individual policies around compensation that meets their best practices and aligns with their goals.

5. Board compensation continues to grow in correlation to members' increased responsibility and risk.

More than half (51 percent) of REITs surveyed increased their board compensation in 2015; the median increase was 13 percent. This is an upward trend compared to 2014, when 46 percent of REITs increased board compensation. This increase acknowledges the risks and responsibilities that board members undertake in guiding REITS. In addition, the number of REITs that pay committee member fees continues to increase, with the fee generally equal to 50 percent of the chairperson fee.

Given the patterns that are settling in around REIT executive compensation, it is likely that future reports will continue to show that shareholder transparency and alignment as well as performance metrics will continue to play a major role in how those plans are structured. The full 2016 REIT Executive Compensation report goes into more detail about year-over-year changes in NEO pay, compensation trends by position and REIT sector, cash incentive plans and more. ■

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