FTI CONSULTING

SEPTEMBER 2017

2017 EXECUTIVE COMPENSATION REPORT:
HOMEBUILDERS ANNUAL AND LONG-TERM INCENTIVE PRACTICES

ANNUAL AND LONG-TERM INCENTIVE PRACTICES FOR EXECUTIVES IN THE HOMEBUILDER INDUSTRY

EXPERTS WITH IMPACT ™

Table of Contents

Methodology

The FTI Consulting, Inc. Homebuilders Annual and Long-Term Incentive report provides a summary of annual incentive plan ("AIP") and long-term incentive ("LTI") compensation practices at publicly-traded homebuilders. Any reference in this report to "homebuilder(s)" only denotes the publicly-traded homebuilders included in the study.

The following information is based on our extensive review and analysis of compensation-related disclosure obtained through public documents filed with the Securities and Exchange Commission. FTI Consulting has specifically analyzed the most forward-looking annual and long-term incentive information disclosed within the most-recently filed proxy statements. Our goal is to provide the most timely and accurate information available for a more in-depth understanding of the AIP and LTI vehicles used in the homebuilding industry.

Executive Summary and Key Findings

Key findings from our study include:

Annual Incentive Plans

- The majority of homebuilders (95%) include a formulaic component as part of the AIP, with payouts determined based on pre-established goals. Only one homebuilder uses a completely discretionary plan, under which no awards were made for 2016.
- Most annual incentive plans use three performance metrics.
- Pre-tax income/EBITDA is the most prevalent AIP performance metric and is used by all homebuilders with a formulaic AIP component.
- AIP performance is typically measured on an absolute basis (i.e., without regard to the relative performance of comparators).

Long-Term Incentive Plans

- The majority of homebuilders (95%) grant equity compensation to their executive officers.
- Homebuilders generally implement a balanced LTI program with the majority of companies utilizing a combination of two or more equity compensation vehicles.
- Performance shares are the most commonly utilized equity vehicle, with 75% of homebuilders granting such awards.
- A significant number of homebuilders utilize time-vested shares, with 65% granting such awards.
- Time-based vesting periods are generally three years for time-vested shares, while stock options/SARs generally use a period of four or more years.
- Three years is by far the most prevalent performance period in the homebuilding industry and generally represents a cumulative (or aggregate) three-year period.
- While total shareholder return ("TSR") continues to be the most prevalent performance metric and is utilized by 69% of homebuilders, fewer companies are using TSR and instead, are incorporating a profit metric that provides a more direct line-of-sight for management between company results and payout.
- A select homebuilder peer group or the executive compensation peer group are the most prevalent relative comparator groups for performance.

Annual Incentive Plan Design Features

All of the publicly-traded homebuilders included in the study utilized an annual incentive plan in 2016 to reward and motivate their executives. The following section highlights the key design features of these plans.

Description of Annual Incentive Plan Types

Formulaic Plans: Formulaic plans consist exclusively of corporate performance metrics, (i.e., Pre-tax Income, EBITDA, Return Metrics, etc.). Such plans do not incorporate any discretionary or subjective components.

Formulaic with a Subjective Component: Formulaic plans with a subjective component are similar to a traditional formulaic plan; however, a portion of the bonus is discretionary and tied to a subjective evaluation. For example, 75% allocation based on formulaic corporate metrics and 25% based on subjective metrics was the most prevalent allocation.

Formulaic Bonus Pool: In general, a formulaic bonus pool is designed as a company-wide bonus pool that is calculated using a pre-determined formula (often based on a set percentage of pre-tax income, EBITDA, etc.). Allocations of the bonus pool are often determined on a discretionary basis.

Discretionary Plans: Discretionary plans are based on the discretion of the Compensation Committee of the Board. Some discretionary plans specify certain corporate metrics that influence the discretionary payout; however, the bonus is not tied to specific performance hurdles, but rather, a subjective evaluation. Additionally, a subjective evaluation can be made based on non-disclosed factors or individual executive performance.

A detailed summary of AIP plan types utilized by the top 20 homebuilders in 2015 and 2016 is shown below. The current trend is that the homebuilding industry is shifting towards entirely formulaic AIP plans, eliminating subjective/discretionary evaluation.

Plan Type	2016	2015
Formulaic	55%	40%
Formulaic with a Subjective Component	25%	45%
Formulaic Bonus Pool	15%	15%
Discretionary	5%	0%

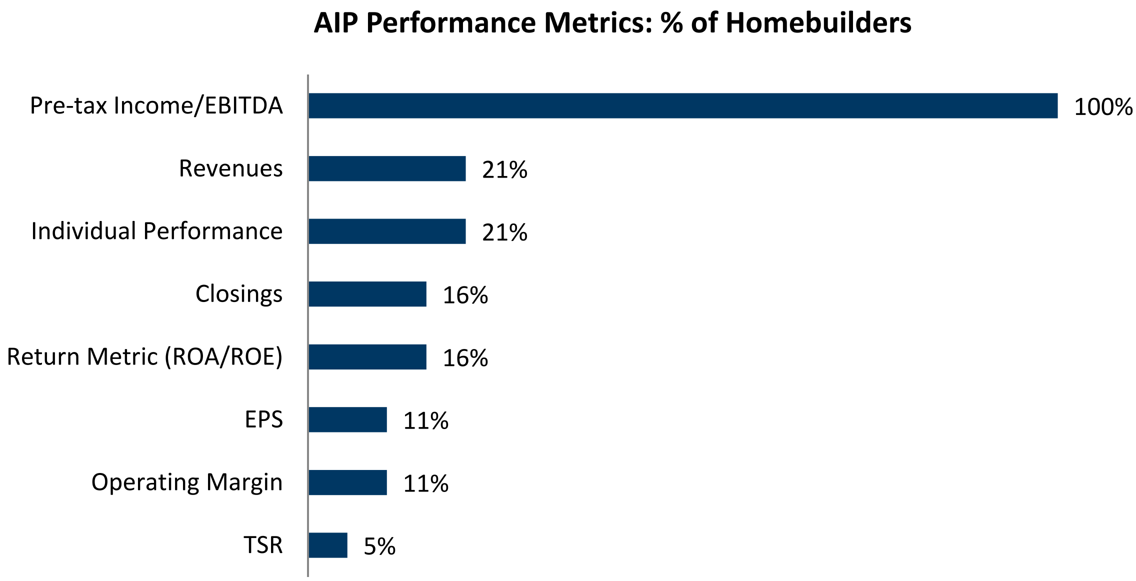
Number of AIP Performance Metrics

Most homebuilders use multiple metrics to measure performance, with 74% using two or more metrics. The most common approach is to use three metrics (32%), which represents a significant change from 2015 when only 5% of homebuilders elected to use three metrics. This change was fueled by the reduction in the use of two and four or more metrics as compared to 2015.

Number of Metrics	2016	2015
1	26%	20%
2	26%	45%
3	32%	5%
4+	16%	30%

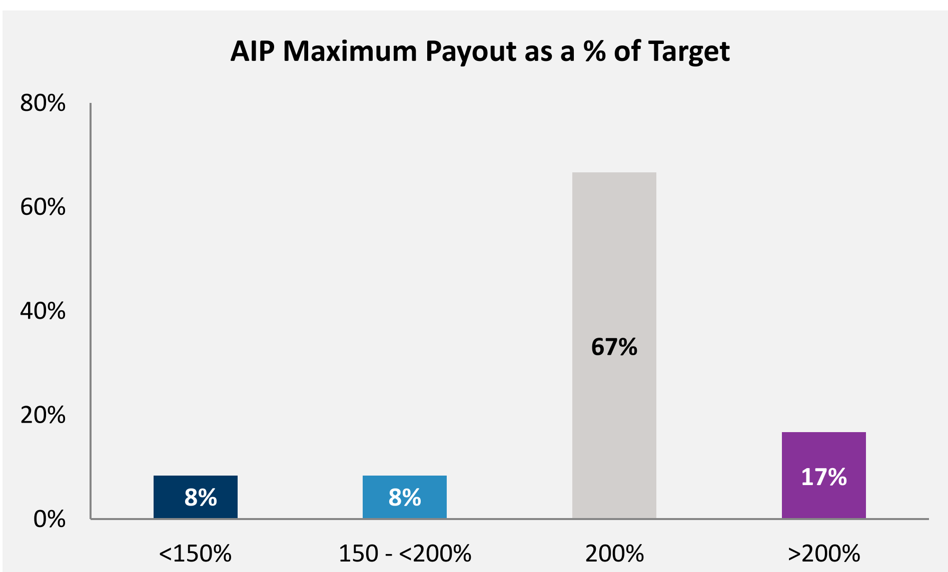
Types of Performance Metrics

Pre-tax income/EBITDA are again by far the most common AIP performance metrics; all companies with a formulaic component used this metric in their 2016 AIP. Revenues were also frequently utilized. Additionally, 21% of homebuilders used individual performance as a factor in setting cash bonus payouts (down from 35% in 2015). The most commonly used AIP performance metrics for homebuilders include the following:



Payout Leverage

The majority of homebuilders (75%) have clearly stated target bonus opportunities, with the median target bonus for CEOs at 150% of base salary. Among those with stated threshold and maximum leverages, the vast majority (67%) set the maximum payout at 200% of the target payout. Leverage generally shifted upwards in 2016: three homebuilders set maximum payout at less than 150% of the target amount in 2015, and only one did in 2016. A detailed illustration is depicted in the graph below.



Long-Term Incentive Vehicles and Utilization

Description of Long-Term Incentive Vehicles

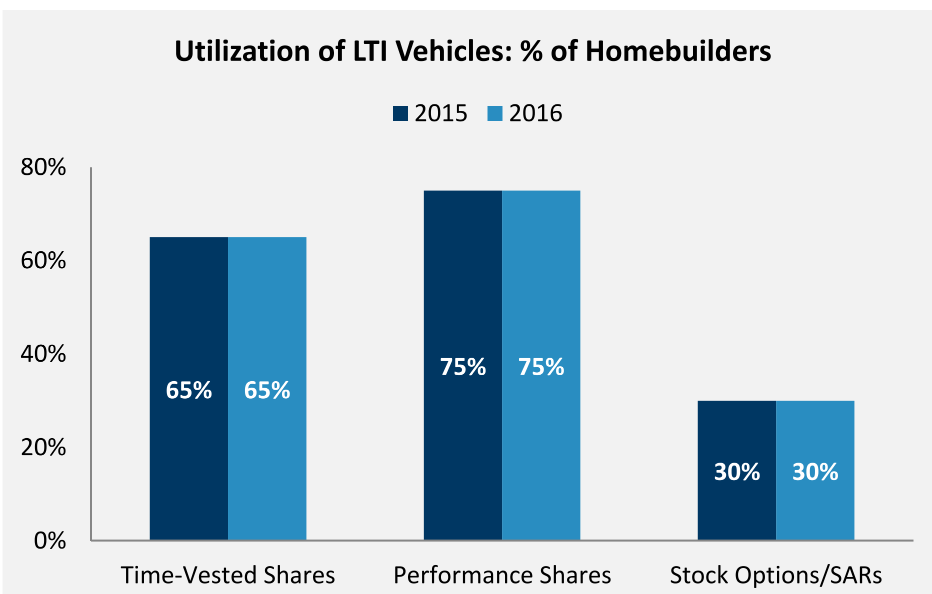
Stock Options/Stock Appreciation Rights ("SARs"): Represents the right to purchase shares of company stock at a specified price (generally the stock price on the grant date) over a specific period of time (Stock Options) or the right to receive the increase in stock price between the grant date and exercise date (SARs). Dividends or dividend equivalents are generally **not** granted in conjunction with stock options/SARs.

Time-Vested Shares: Grant of an actual share of stock or "unit" that is subject to restrictions and risk of forfeiture until vested over a specified period of time. Time-vested shares are generally entitled to receive dividends or dividend equivalents during the vesting period.

Performance Shares: Represents shares or units of stock that may be earned based on the achievement of specified performance hurdles over a pre-determined time period (performance period or measurement period). Any shares that are not earned are forfeited by the recipient. Performance shares are generally **not** entitled to receive dividend or dividend equivalents during the performance period: rather dividends would accrue during the performance period and would be issued on any earned performance shares.

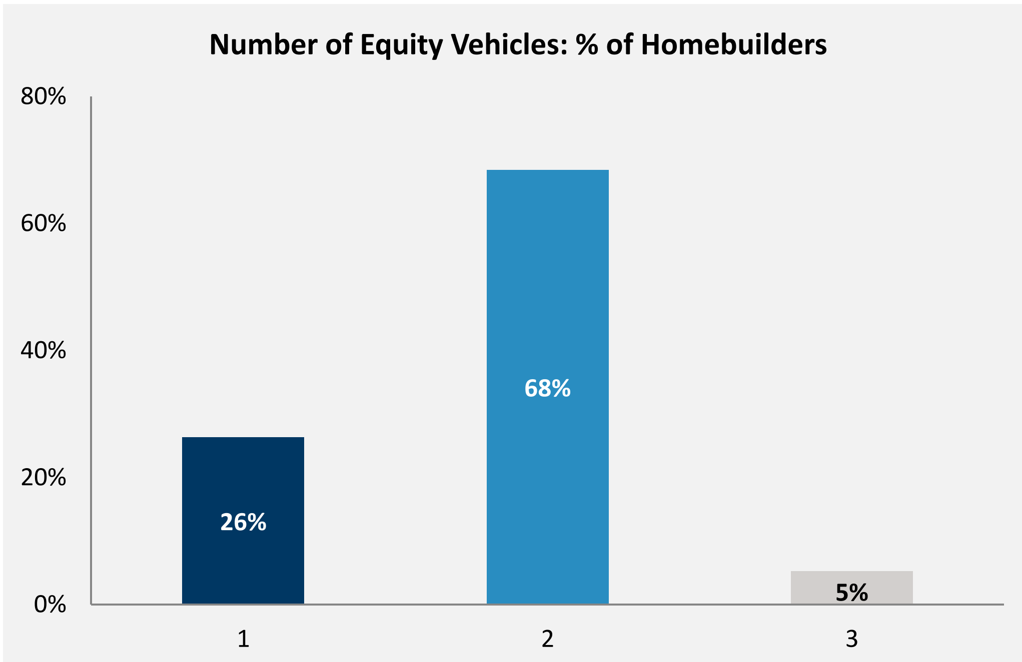
Utilization by Long-Term Incentive Vehicle

Performance shares continue to be the most predominant LTI vehicle in the homebuilding industry and are indicative of the focus on a pay-for-performance philosophy. Additionally, the utilization of a performance-based equity element is preferred by investors and proxy advisory groups. Time-vested shares are also popular as they help mitigate retention concerns and provide shoulder-to-shoulder alignment between management and shareholders, as management is then subject to the same fluctuations in the company's stock. Stock options/SARs are less prevalent among homebuilders, with a utilization rate of 30%.



Number of Long-Term Incentive Vehicles Granted

The majority (68%) of homebuilders employ a balanced LTI approach that includes two equity vehicles in their LTI program, with a minority (26%) electing to use only one LTI vehicle. Only one of the top 20 homebuilders (Taylor Morrison Home Corporation) chooses to utilize all three incentive vehicles, while another (Comstock Holding Companies, Inc.) did not grant any equity compensation in 2016.



Time-Vested Long-Term Incentives

Vesting Period

Three years is the most common vesting period for time-vested shares in the homebuilding industry at 85%, while stock options/SARs generally have a longer vesting period with 67% utilizing four years and 17% at five years or more. The detailed summary is shown in the chart below.

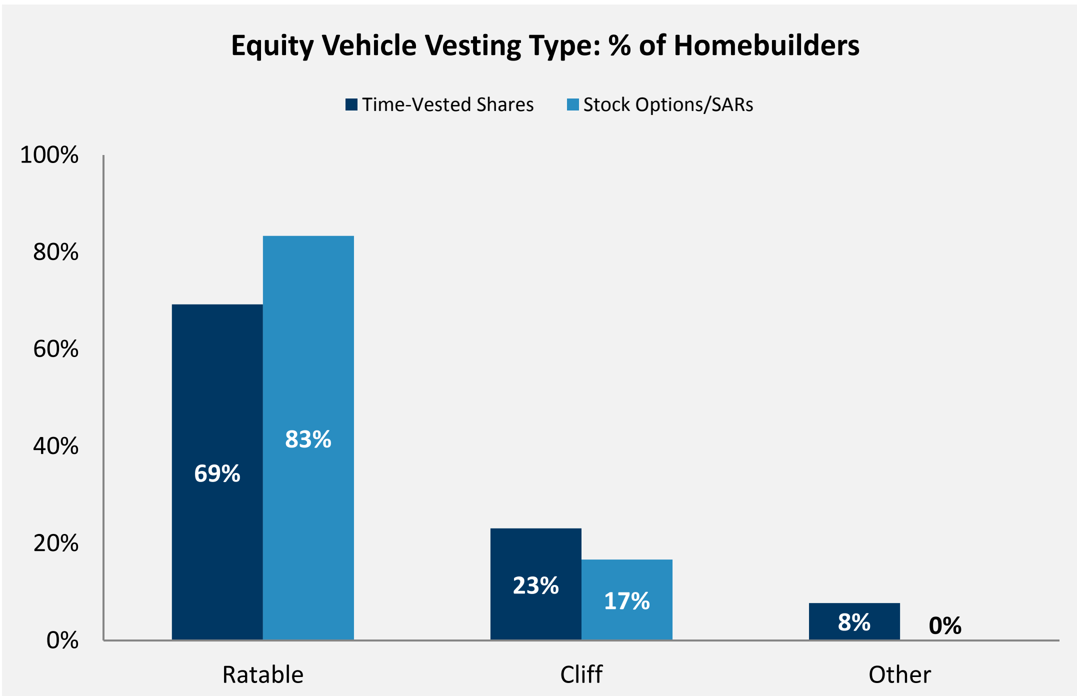
Vehicle Type	3 Years	4 Years	5 Years or More
Time-Vested Shares	85%	15%	0%
Stock Options/SARs	17%	67%	17%

Vesting Type

Time-vested shares and stock options/SARS generally vest using one of the following schedules:

- Ratable: Vest in equal tranches over a set number of years;
- Cliff: All shares or units vest 100% at the end of the vesting period, or
- Other: Shares or units may vest using an uneven vesting schedule (e.g., 25% in year one, 25% in year two and 50% in year three).

Ratable vesting schedules are the most predominant in the homebuilding industry. A detailed summary of the percent of homebuilders using each LTI vesting type is shown in the graph below.



Performance Shares

Performance Period

Three years is the most common performance (or measurement) period in the homebuilding industry.

Performance Period*	1 Year or Less	2 Years	3 Years	4 Years or More
% of Homebuilders	13%	0%	88%	13%

*Select homebuilders utilize different performance periods for different performance shares and are included in more than one performance period.

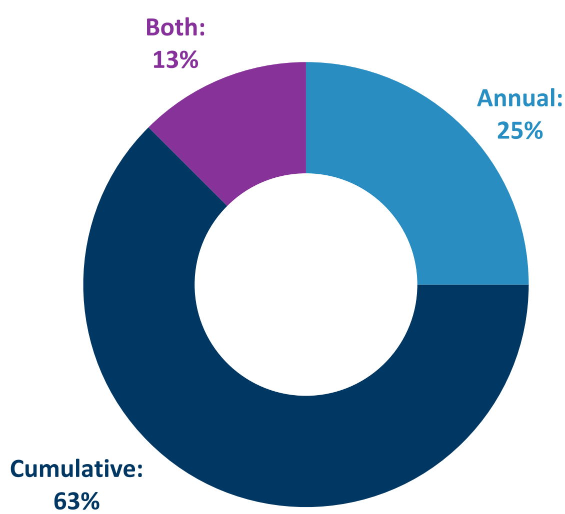
Vesting Tail Following the Performance Period

The vast majority (81%) of homebuilders grant performance shares without a vesting tail (or additional time-based vesting requirement) after the performance period.

Vesting Tail (Years)	None	1 Year	2 Years	3 Years or More
% of Homebuilders	81%	0%	13%	6%

Annual and Cumulative Performance Periods

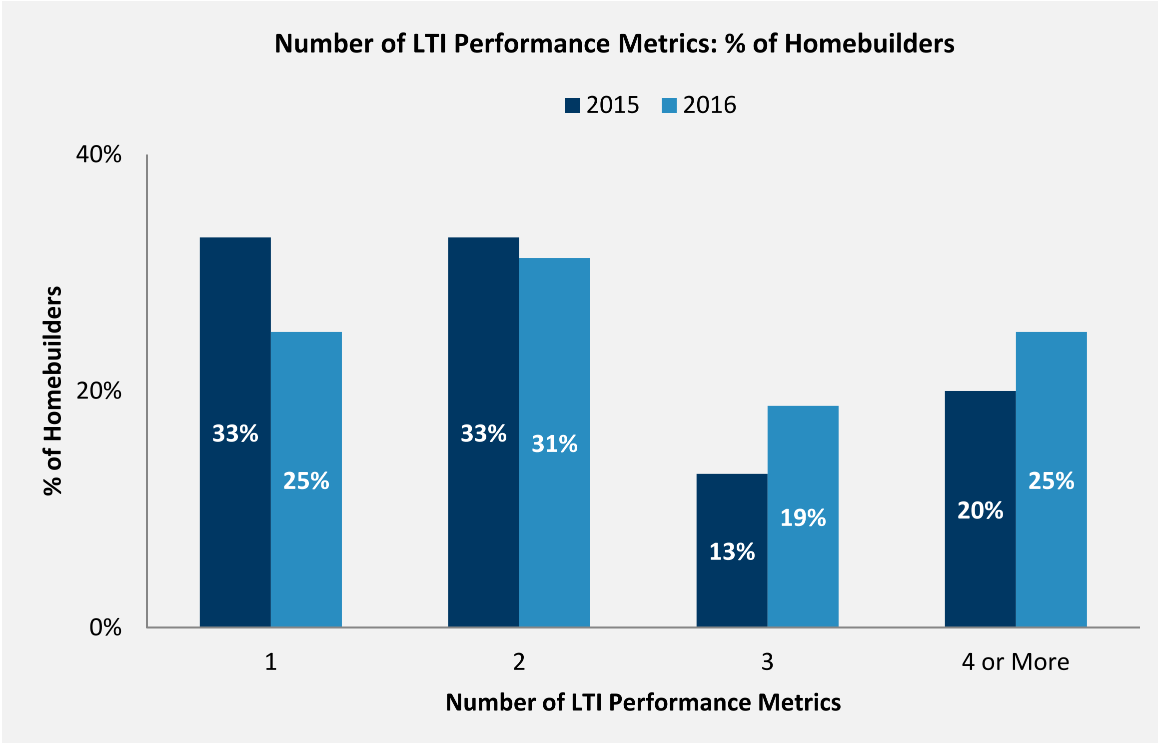
The majority of homebuilders (63%) utilized a cumulative performance period exclusively, while 13% combined the annual and cumulative evaluation methods (i.e., cumulative performance period for certain metrics, annual performance period for others). This is likely the result of the increasing influence of proxy advisory firms that have a stated preference for longer performance periods.



Performance Metrics

Number of LTI Performance Metrics

The homebuilding industry mostly uses only one or two metrics to determine if performance shares have been earned, but the predominant practice is to utilize multiple LTI performance metrics. It has become the preference of proxy advisory firms (Glass Lewis, in particular) to use more than one performance metric.



Types of Performance Metrics

Total Shareholder Return (TSR) is the predominant performance metric as a result of the following:

- Provides for fixed equity accounting under ASC 718.
- Directly links management compensation with shareholders' interest.
- Is more easily explained and justified to investors and proxy advisory firms.

Notwithstanding the fact that TSR is heavily utilized, operational metrics, particularly a profit metric (such as pre-tax income, EPS, etc.), are becoming more prevalent. Operational performance shares provide a more direct line-of-sight for management between company results and payouts.

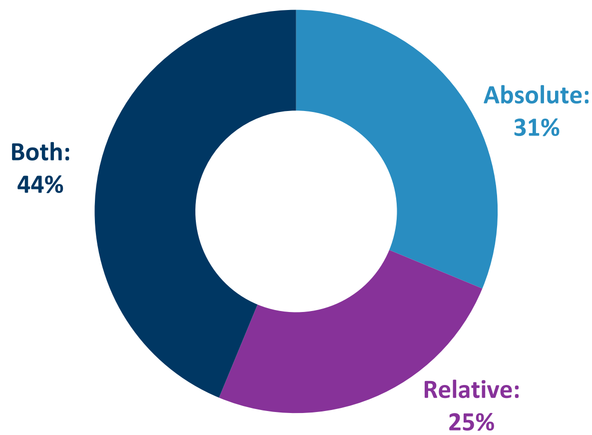
A detailed summary of the LTI performance metrics utilized is as follows:

Performance Metric	2016*	2015*
TSR (Total Shareholder Return)	69%	80%
Profit (Pre-tax Income, EPS, etc.)	69%	47%
Capital Efficiency (Return on Asset/Equity/Invested Capital)	38%	40%
Revenue	19%	27%
Leverage	19%	13%
Other	25%	13%

*Most homebuilders use more than one performance metric.

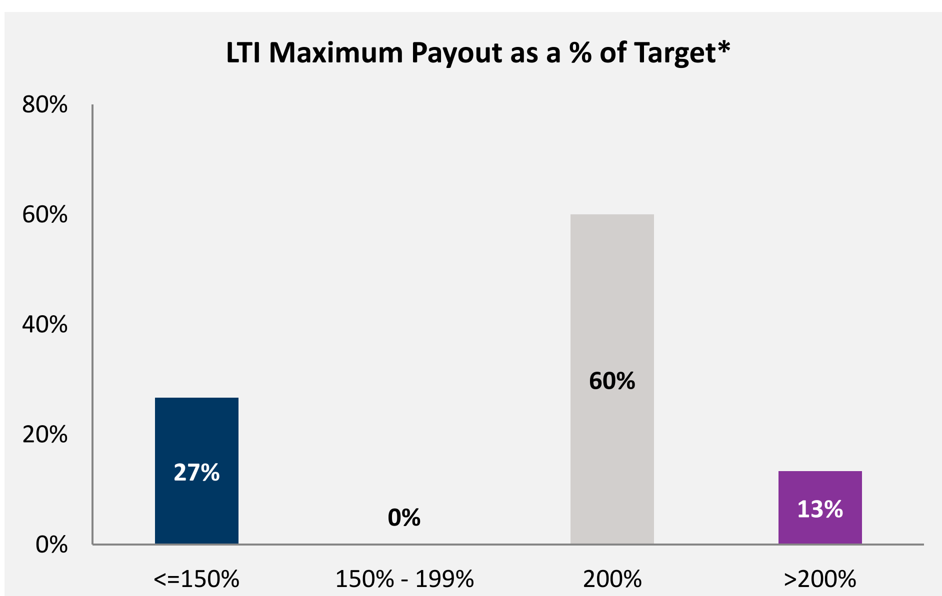
Absolute or Relative Performance Hurdles

Performance metrics may be based on an absolute hurdle, a relative hurdle or a combination of both. The majority of homebuilders (75%) use an absolute performance metric. The utilization of an absolute metric alone increased slightly from 25% in 2015 to 31% in 2016; this coincides with the increased utilization of operational metrics, which are more likely to be measured based on an absolute goal. A detailed summary of the percent of homebuilders using absolute or relative performance hurdles is shown in the graph below.



Performance Share Payout Leverage

The majority of homebuilders award between 0% and 50% of target performance shares at the threshold level. Maximum awards are primarily paid out at 200% of target as seen below. All (100%) homebuilders that award performance shares utilize linear interpolation for payout measurement between performance points.



*All target payouts have been normalized to 100%.

Relative Performance Benchmarks

Nearly 70% of homebuilders use performance shares that are earned based upon the achievement of predetermined relative benchmarks as follows:

- Most homebuilders utilize an executive compensation peer group, with a few using a select group of homebuilders as direct comparators.
- One homebuilder uses the S&P 500 Index, while another uses the S&P Homebuilders Select Industry Index.

A detailed summary is shown in the chart below:

	% of Homebuilders	
Relative Benchmark*	**2016**	**2015**
Executive Compensation Peer Group	64%	55%
Homebuilders Peer Group	27%	55%
S&P Index	18%	9%

*Some plans include more than one performance metric.

Post-Vesting Holding Periods

Over the past couple of years, there has been a marked increase in the number of companies that incorporate a post-vesting holding period (or no-sell provision) that restricts an individual from selling stock awards after the vesting period has elapsed (generally for an additional one to three years). Many companies adopt post vesting holding periods in consideration of the following factors:

- Proxy advisory firms (such as ISS) have clearly illustrated that the mandatory holding periods are a form of good compensation governance;
- Provides a mechanism for the recoupment of incentive-based compensation if a clawback policy ever needed to be enforced, and
- One of the biggest benefits is that such provisions often result in a 5% to 20% accounting discount under ASC 718. This discount results in a reduction in stock-based compensation expense for the financial statements, as well as reduces the compensation value that will be reported in the Summary Compensation Table and Grants of Plan-Based Awards Table in the annual proxy statement.

Generally, such provisions only apply to restricted shares or performance shares granted to executive officers and in many cases, are limited to only the CEO. One of the factors often overlooked in adopting post-vesting holding periods is the tax considerations. Restricted shares are taxed upon vesting (notwithstanding if an 83(b) election was made), while restricted stock units are subject to income tax when the award is distributed (although FICA/FUTA taxes are still due upon vesting). Thus, it is often appropriate to permit individuals to sell stock to cover taxes and only subject the post-tax shares to the additional holding period.

List of Publicly-Traded Homebuilders

- AV Homes, Inc.
- Beazer Homes USA, Inc.
- Cal Atlantic Group, Inc.
- Century Communities, Inc.
- Comstock Holding Companies, Inc.
- D.R. Horton, Inc.
- Hovnanian Enterprises, Inc.
- KB Home
- Lennar Corporation
- LGI Homes, Inc.
- M.D.C. Holdings, Inc.
- M/I Homes, Inc.
- Meritage Homes Corporation
- The New Home Company Inc.
- NVR, Inc.
- PulteGroup, Inc.
- Taylor Morrison Home Corporation
- Toll Brothers, Inc.
- TRI Pointe Group, Inc.
- William Lyon Homes

About FTI Consulting Executive Compensation and Corporate Governance Solutions

FTI Consulting Executive Compensation and Corporate Governance Solutions provides objective advice to design and implement a comprehensive executive compensation program that attracts and retains top talent that effectively rewards and motivates management and employees for the right kind of performance. This results in closely aligning the interests of employees with those of the company's shareholders and investors. Our dedicated team has practical hands-on experience partnering with compensation committees and management teams to design custom-tailored compensation programs around the key drivers and unique dynamics of each client. We have served as the compensation consultants and corporate governance advisors to over 100 public and private companies on a range of compensation and corporate governance related matters, including:

Executive Compensation and Corporate Governance Solutions	
Compensation Plan Design and Implementation Services	Corporate Governance Services
• Annual compensation program and peer group review • Annual bonus program design • Long-term compensation program design • Employment agreement review and analyses • Proxy drafting and shareholder outreach support • Equity incentive plan review and upsizing • Compensation tax and accounting consulting services	• Corporate governance policy review • Compensation-related risk assessments • Board and executive performance evaluations • Succession planning guidance

The views expressed herein are those of the authors and are not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, affiliates or other professionals.

FTI Consulting, Inc., including its subsidiaries and affiliates, is a consulting firm and is not a certified public accounting firm or a law firm.

Larry Portal
973-852-8147
larry.portal@fticonsulting.com

Katie Gaynor
704-972-4145
katie.gaynor@fticonsulting.com

Jarret Sues
973-852-8109
jarret.sues@fticonsulting.com

EXPERTS WITH IMPACT ™

About FTI Consulting

FTI Consulting is an independent global business advisory firm dedicated to helping organizations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centers throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities. For more information, visit www.fticonsulting.com and connect with us on Twitter (@FTIConsulting), Facebook and LinkedIn.