FTI INSIGHTS

Report

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Executive Compensation News and Views

Is Europe Heading to Binding Say-on-Pay

On April 9th, the European Commission proposed a broad package of measures to improve shareholder oversight, one being a binding Say-on-Pay ("SOP") vote on executive compensation. Currently, SOP measures vary country by country and the new rules seek to create a level playing field for all EU members. The proposed measures are subject to a feedback period through spring 2015, leaving plenty of time for changes and preparation by EU public companies. But clearly the sentiment towards executive compensation (as well as director compensation) continues to elicit strong opinions from the EU public, especially with a very weak economy still in recovery. As a result, it is increasingly likely that over the next several years more countries will adopt SOP requirements, or strengthen current measures, regardless of the outcome on the measures proposed by the European Commission.

This is not the first time we have seen binding SOP make waves on the other side of the pond, with the U.K. already adopting such rules, which became effective for financial years ending after October 31, 2013. Countries around the world have SOP votes that are more and less onerous than the advisory vote required by U.S. companies. Below is a summary of Say-on-Pay rules from around the world:

- **Australia –** Non-binding SOP voting has been in place since 2005, but since 2011 shareholders have had a "two-strike" rule under which, if 25% of shareholders vote against a company's pay plan at two consecutive annual meetings, the entire board may have to stand for re-election within three months.
- **Canada** – There is no legislation requiring a SOP vote but the Canadian Coalition for Good Governance recommends that boards voluntarily include an advisory vote on executive compensation at their annual meetings. A large number of Canadian companies (over 120) have adopted an advisory SOP vote.
- **France** – The revised 2013 edition of the French Corporate Governance Code for Listed Companies includes a recommendation to hold an annual non-binding SOP vote. Any company that does not comply with the voluntary SOP vote is required to explain their rationale in their annual reports.
- **Germany** – Non-binding SOP vote since 2009. Recently a proposed law that would have required a binding vote starting in 2014 failed to pass the upper house of Germany's parliament.

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What's New – REIT Compensation

Shopping Center REITs Fight for Talent. The shopping center sector has seen a lot of activity recently. Both Simon Property and Vornado are spinning-off their shopping centers and Kite Realty and Inland Diversified have a merger pending. With all this activity, there has been some poaching of talent and increased efforts to retain key talent:

- Jeff Olson is set to leave Equity One at the end of 2014 to go run Vornado's shopping center spin-off.
- Simon has named Mark Ordan, former CEO of The Mills Corp., to run its new spin-off, Washington Prime Group
- Equity One has named its next CEO as David Lukes, who previously worked at Kimco Realty Corp. for many years. Mr. Lukes compensation will include the following:
  - Base salary of $850,000
  - Target bonus of 100%
  - $500,000 cash signing bonus
  - 200,000 stock options (estimated value of $1 million)
  - 68,956 time-vested restricted shares (valued at approximately $1.5 million)
  - 156,300 target shares under his new LTIP (valued at approximately $3.5 million), which may be earned over a four-year performance period based on TSR and FFO per share
  - The estimated annual value of Mr. Lukes' new contract is $3.7 million.
- Equity One, Inc. – Extended the CFO's contract, which included a $400,000 retention bonus.
- Acadia Realty Trust – Extended the CEO's employment agreement, which included a $3 million stock award and a non-compete clause.

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Update: Dismissal of Simon's CEO Pay Lawsuit

David Simon's $120 million stock grant not only drew headlines and resulted in a failed 2012 say-on-pay vote, but it also resulted in a shareholder lawsuit for Simon Property Group. The Louisiana Municipal Police Employees Retirement System and other investors accused the Company's directors of improperly raising the CEO's pay by amending its 1998 stock incentive plan to allow for the granting of such shares without shareholder approval. The pension fund also argued that the grant rewarded David Simon for simply remaining CEO, as the entire grant was time-vested over 8 years, rather than for achieving results for shareholders. A Delaware Court Judge dismissed the case because Simon had agreed to change the compensation plan that the suit was based upon.

In order to combat the pay lawsuit (and to help their Say-on-Pay vote since they failed in 2012 and only received a 56% approval rating in 2013), Simon Property Group meet with 58% of their shareholder and announced the following changes to its executive compensation program:

- On January 2, 2014, Simon announced that it amended the terms of David Simon's $120 million stock grant to include FFO performance criteria to earn the award. The Company must achieve a Compound Annual Growth Rate of at least: (i) 12% between 2010 and 2015; (ii) 11% between 2010 and 2016; and 10% between 2010 and 2017 to earn of the 100% award. Mr. Simon is still eligible to earn the same 1 million shares in the following tranches:

Performance Period (as of 12/31)	Target Units	FFO to Earn 50%	FFO to Earn 100%	Additional Time Vesting
2015	360,000	$8.07	$8.86	2 years
2016	360,000	$8.43	$9.40	2 years
2017	280,000	$8.62	$9.80	1.5 years

  The award also includes a "catch-up" feature, under which any unearned 2015 units may be earned in 2016 or 2017 if the Company's FFO is equal to or greater than the maximum FFO hurdle for 2016 or 2017 and any unearned 2016 units may be earned in 2017 if the Company's FFO is equal to or greater than the maximum FFO hurdle for 2017.

- The $120 million stock grant was also modified to include a double-trigger change in control provision.
- On February 13, 2014, Simon amended the 1998 stock plan to remove the language that would permit the Compensation Committee to make non-performance based grants and the Committee will not make any such grants without shareholder approval. The plan also limits the number of shares any one participant may receive in a given calendar year to 600,000 (which would currently be valued at approximately $100 million).
- Per the 2014 proxy statement, the Company also reduced Mr. Simon's annual performance-based LTIP award opportunity from approximately $11.5 million in 2013 to $10 million in 2014. Consistent with the equity granted to the entire executive management team, all annual stock grants are only earned based upon future TSR performance as measured on a relative and absolute basis.

While such modifications have appeased the courts, we will have to wait until May 15th to find out if shareholders share a similar opinion.

Compensation and Governance Ticker

2014 Say-on-Pay Failures. Say-on-Pay is in full swing and with that comes the bevy of headlines about who has failed. Making an early name for themselves is Cogent Communications Group who became a 3rd time failure with a 46% support level in 2014. The Company also failed in 2013 (34%) and in 2011 (39%). So far, CBL & Associated Properties, Inc. is the only REIT to fail its 2014 vote. As of May 9th, 13 companies in the Russell 3000 have failed and 801 companies have passed, with each of the failed companies receiving an "Against" voting recommendation from ISS. The 1.6% failure rate thus far is below last year's 2.5%, but there is still plenty of time before the end of this proxy season with the bulk of shareholder meetings taking place between mid-May and mid-June.

Supplemental Proxy Materials. As we have seen over the past several years, companies continue to respond to a negative voting recommendation from proxy advisors by filing supplemental materials often aimed at rebuking ISS and/or GlassLewis recommendations. This approach has been used by large and small companies alike, with S&P 500 companies such as CVS Caremark Corp and Apartment Investment and Management Co. filing supplemental proxy responses following a negative ISS report.

Eye-Popping Golden Parachute for Time Warner Cable CEO. Golden parachutes are one of the biggest culprits of creating negative compensation headlines in the news. Time Warner Cable's CEO, Robert Marcus' potential CIC payout of $80 million did just that, with about half of this amount representing immediate vesting of stock and options, mostly earned during his time prior to becoming CEO. The merger between Time Warner Cable and Comcast has a lot of hoops to get through before it can close, so whether this golden parachute will ever come to fruition has yet to be determined but regardless, the thought that a CEO may get an $80 million payout for less than a year of tenure in the top spot has already drawn ire from the media and main street.

Is Europe Heading to Binding Say-on-Pay

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- **Italy** – Since 2011, banks and insurance companies have a binding SOP vote and since 2012, all other companies have a non-binding vote.
- **Netherlands** – Shareholders have had a binding vote on executive pay since 2004 that applies only to a new plan or plan with significant changes.
- **Switzerland** – Switzerland has some of the toughest executive pay controls in the world. Although a proposal to cap executive pay at 12 times the pay of the company's lowest paid worker was rejected by Swiss voters, in March 2013 voters approved a referendum giving shareholders a binding SOP vote, banning golden parachutes and signing bonuses and requiring annual re-elections of directors, amongst other rules.
- **United Kingdom** – Advisory SOP vote went into effect in 2002 and beginning in October 2013, U.K. companies became subject to binding SOP votes on future pay policies at least every three years or when policy changes. If a company fails its SOP vote, it must revert to the last approved pay policy and cannot implement any proposed changes. Companies will also still be subject to an annual non-binding vote on compensation paid over the past financial year.

To date, the advisory SOP vote in the U.S. has generally been perceived as a positive step, with the majority of companies taking such votes seriously and being responsive to shareholders concerns and feedback. If the tide shifts and the market and the general public start to believe that the advisory votes are losing their effectiveness, the U.S. may follow in Europe's footsteps and increase the binding nature of the SOP vote.

What's New – REIT Compensation

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Changes for Health Care REIT, Inc. HCN has announced a few noteworthy compensation-related items this year, including:

- Long-time CEO, George Chapman, announced his retirement effective June 30, 2014 and entered into a three year consulting agreement that will include a consulting fee equal to an annualized amount of: $1.25 million for the first year; $750,000 for the second year; and $500,000 for the third year.
- HCN also announced that Thomas J. DeRosa, who has served on the Company's Board since 2004, will become the Company's next CEO. Mr. DeRosa's contract includes the following compensation-related terms:
  - Base salary of $825,000
  - Target cash bonus of 150%, with a maximum of 300% of base salary
  - Target stock award of $3.3 million
  - Special one-time $1 million stock award, which will vest over 3 years based on time and yet to be determined performance goals
  - Relocation allowance of $100,000
  - The estimated annual target value of Mr. DeRosa's new contract is $5.7 million.
- HCN implemented a new multi-year long-term incentive plan in early 2013, which was disclosed in the Company's 2014 proxy statement (the "2013-2015 Plan"). The plan is designed to cover a three-year performance period (plus two additional years of time-based vesting for any shares earned) and is tied to the Company's long-term strategic objectives. The 2013-2015 Plan uses an aggregate of 10 measures, within four categories as follows:
  - Earnings (30%): Relative metric using FFO and FAD per share.
  - Leverage (30%): Net debt to undepreciated book capitalization, net debt to EBITDA, fixed charge coverage and the Company's secondary unsecured debt spreads.
  - Dividends (30%): Rate of annual dividend growth and reduction of FFO and FAD payout ratios.
  - Other (10%): Maximize income generated from private pay sources (non-government reimbursement).

  The aggregate value that may be earned under the plan equals $14.1 million for the CEO and $3 million for other named executive officers.

  As Mr. Chapman is set to retire in June 2014, a portion of his allocation in the 2013-2015 Plan will vest upon his retirement. The remaining portion of his award may be earned if he fulfills his consulting agreement and will be based on the performance of the Company as determined at the end of the performance period. At this time the new CEO, Mr. DeRosa, has not been allocated any value under this plan.

Say Goodbye to Excise Tax Gross-up Payments. Public companies in the REIT and broader industry continue to eliminate excise tax gross-up payment obligations that would be paid in connection with a Change in Control. Both Taubman Centers, Inc. and HCP, Inc. modified their Change in Control agreements in March to eliminate the excise tax gross-up payment provisions.

Top Performers

Top 10 REITs Based on Year-to-Date Total Shareholder Return (TSR)[1]

	Company	Ticker Symbol	Year-to-Date TSR
1.	Winthrop Realty Trust, Inc.	FUR	31.65%
2.	Anworth Mortgage Asset Corp.	ANH	29.70%
3.	Ashford Hospitality Trust, Inc.	AHT	27.70%
4.	Essex Property Trust, Inc.	ESS	26.58%
5.	Camden Property Trust	CPT	26.56%
6.	Omega Healthcare Investors, Inc.	OHI	24.95%
7.	Healthcare Trust of America, Inc.	HTA	24.33%
8.	Hatteras Financial Corp.	HTS	23.70%
9.	American Capital Agency Corp.	AGNC	23.41%
10.	Health Care REIT, Inc.	HCN	23.40%

[1] Represents TSR data as calculated by SNL Financial LC through May 9, 2014.

Sector Performance

REIT Sector Year-to-Date Total Shareholder Return (TSR)[1]

	Index	Year-to-Date TSR
1.	MSCI US REIT	15.55%
2.	SNL Diversified	9.09%
3.	SNL Healthcare	19.26%
4.	SNL Industrial	11.70%
5.	SNL Hotel	2.69%
6.	SNL Finance REIT	10.66%
7.	SNL Multi-family	20.85%
8.	SNL Office	15.56%
9.	SNL Retail	14.16%

[1] Represents TSR data as calculated by SNL Financial LC through May 9, 2014.

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