2019 REIT Say-on-Pay Recap: Shareholders Find Their Own Voice

Key 2019 Say-on-Pay Highlights

- **REIT Say-on-Pay Results Slide But Still Fare Better Than Most Industries**
  While shareholder support and Say-on-Pay results stayed effectively flat for the general industry, self-managed REITs saw an increase in negative voting recommendations from Institutional Shareholder Services, or ISS (19 Against recommendations in 2019 vs. 15 in 2018) but a decrease in failed proposals (two failed REITs in 2019 vs. three in 2018). Overall self-managed REITs still have results that are slightly better than the Russell 3000 (average support of 90.73% for REITs vs. 90.48% for the Russell 3000), while externally managed REITs continue to be negatively targeted.

- **More Active Shareholder Voting**
  Institutional investors are becoming less reliant on the voting recommendations of proxy advisors and performing their own due diligence and research on executive pay matters, signaling to companies the need for active engagement with shareholders and meticulous compensation disclosure.

- **Increased Use of Supplemental Filings**
  REITs attempted to appeal more directly to shareholders in response to ISS criticisms by filing supplemental materials as a direct rebuttal, with results generally better than those that did not file such materials. In rare circumstances, these filings may even result in ISS re-evaluating and reversing their voting recommendations.

- **Problematic Severance Provisions Continue to Drive Negative Voting Recommendations**
  Companies that have a “Low” concern under the Pay-for-Performance model almost always receive a positive voting recommendation from ISS (the most influential of the proxy advisory firms). The main exception to this rule is at companies that renew employment contracts without modifying previously grandfathered “problematic” provisions, such as excise tax gross-ups or “excessive” severance provisions.

2019 vs. 2018 Say-on-Pay Results

While overall Say-on-Pay support stayed effectively consistent across industries, fewer REITs failed Say-on-Pay despite increased pressure from ISS, while the companies in the Russell 3000 had an increase in the number of failed companies despite relatively consistent voting recommendations from ISS:

- The number of self-managed REITs with negative ISS voting recommendations increased at a higher rate than companies in the Russell 3000 (a 2.0% increase from 2018 to 2019, compared to an increase of 0.7% decrease for the Russell 3000).
- After reviewing supplemental proxy filings, ISS reversed two negative voting recommendations, resulting in four additional Against recommendations compared to last year (would have been six additional without the two reversals).
- All REITs saw fewer failed proposals despite negligible change year-over-year in average support.

Despite receiving more Against recommendations on a percentage basis from ISS in 2019, REITs fared better in terms of failed Say-on-Pay proposals than companies in the Russell 3000.

Industry/Index	Year	Average Support	ISS Against Voting Recommendations		Failed Say-on-Pay Proposals	
			#	%[1]	#	%[1]
All REITs	**2019**	**89.74%**	**30**	**17.2%**	**2**	**1.1%**
	2018	90.00%	26	14.9%	4	2.3%
Self-Managed REITs	**2019**	**90.73%**	**19**	**13.0%**	**2**	**1.4%**
	2018	90.96%	15	9.9%	3	2.0%
Externally Managed REITS (EMIs)	**2019**	**84.57%**	**11**	**39.3%**	**0**	**0.0%**
	2018	84.23%	11	45.8%	1	4.2%
Russell 3000	**2019**	**90.48%**	**288**	**13.3%**	**50**	**2.3%**
	2018	90.58%	286	13.7%	47	2.3%

[1] Total number of Say-on-Pay proposals each year may vary based on reporting companies; accordingly, the percentage listed may not coincide with the increase (decrease) in the number of companies year-over-year.

Source: ISS Corporate Solutions for data available as of July 2, 2019.

Shareholder Voting Patterns

The guarantee of 90%+ shareholder support with a positive ISS recommendation is fading as investors and shareholders are more apt to formulate their own opinions on executive pay matters. Historically, a positive recommendation from a proxy advisory firm (e.g., ISS, Glass Lewis) signified that shareholders rarely examined a program before voting in favor. Over the past couple of proxy seasons, most large institutional shareholders have conducted their due diligence in conjunction with their own independent policy positions, even if the proxy advisory firms recommended "For" a Say-on-Pay proposal. The most notable example of this paradigm shift occurred during the 2018 proxy season, when CalPERS voted "Against" 43% of Say-on-Pay proposals for U.S. companies in the Russell 3000 while ISS had recommended "Against" only 14% of these companies.[1]

[1] The voting record for the 2019 proxy season has yet to be reported by CalPERS.

In 2019, the number of REITs that received 80% to 85% shareholder support for Say-on-Pay following a positive ISS voting recommendation increased to four (up from one the previous year), indicating the downward pressure experienced when deviating from policies of a particular institutional investor. While 80%-85%+ approval is still relatively high, the risk for these companies is that in future years, if ISS or Glass Lewis recommends against their Say-on-Pay proposal, obtaining majority shareholder support will likely prove to be much more difficult. Below is a snapshot of the shareholder approval distribution in 2018-2019:

	REITs with Positive ISS Recommendation	
Shareholder Approval	**2019**	2018
> 95%	**70**	75
90% - 95%	**40**	42
85% - 90%	**6**	8
80% - 85%	**4**	1
< 80%	**2**	2

Notwithstanding this new fact pattern, mid-sized and smaller institutional investors generally do not have the resources necessary to review proxy statements on a large scale, and they continue to rely on the proxy advisory firms to filter their workload by identifying the companies with potential compensation-related concerns. While some of these mid-sized and smaller institutional investors vote "blindly" with the recommendations of the proxy advisory firms, many conduct their own research and make their own independent decisions for those companies with an "Against" voting recommendation.

Use of Supplemental Filings

As shareholders continue to vote more independently from ISS and Glass Lewis, more REITs have found it worthwhile and advantageous to directly appeal to investors in response to a negative Say-on-Pay voting recommendation. While direct communication is typically preferred and most meaningful, given the limited window of time between the proxy advisory recommendation being made available and the shareholder meeting date, companies are responding with supplemental disclosure (typically a DEFA14A) to provide additional context to the compensation programs and to ensure all shareholders have the opportunity to hear their counter-arguments.

Filing Details	# of REITs[1]	Average Support	Failed Say-on-Pay Proposals
Add'l Disclosure	11	66%	1
None	8	64%	1

Of the 19 self-managed REITs that received a negative ISS voting recommendation, 11 filed supplemental proxy materials which resulted in slightly higher shareholder support.

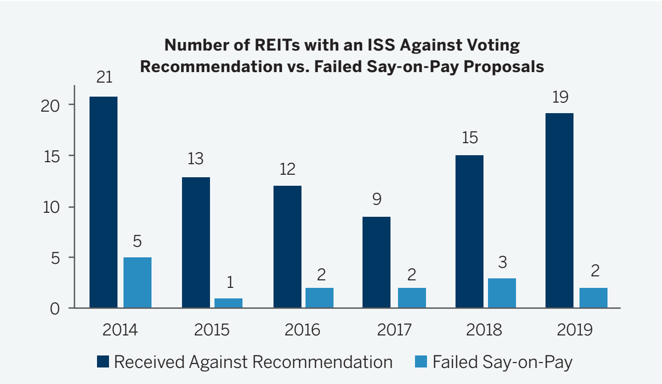
[1] Excludes two REITs whose ISS recommendations were reversed from "Against" to "For" following supplemental filings (total "Against" recommendations would have been 21 prior to the reversals).

While the ultimate success of these filings was mixed, it is important to note that the supplemental information can result in ISS re-evaluating its initial voting recommendations. In 2019, two REITs were able to "convince" ISS to reverse its Say-on-Pay voting recommendation from "Against" to "For" because of new "facts" being presented that mitigated some of their initial concerns.

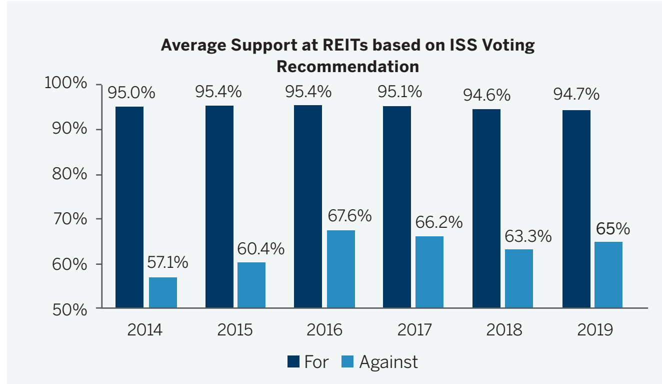
Snapshot of Say-on-Pay at Self-Managed REITs

Despite the negligible shift in average Say-on-Pay support at self-managed REITs, REIT Say-on-Pay proposals experienced a 27% increase in negative ISS voting recommendations – jumping from 15 to 19 Against voting recommendations from 2018 to 2019. Shareholder support is trending slightly upward regardless of whether a REIT received a For or an Against voting recommendation from ISS, challenging last year's downward trend.

19 Self-Managed REITs Received a Negative Say-on-Pay Voting Recommendation in 2019



Voting Results at REITs that Received a Negative ISS Voting Recommendation Remained Consistent



Spotlight on Equity Plan Proposals

During the 2019 proxy season, ISS added pressure on equity plan proposals to increase the number of shares reserved for compensation purposes. The foundation of ISS' equity plan review is based on the points earned under the Equity Plan Scorecard, which evaluates plan cost, grant practices and plan features. In select circumstances, ISS has now started to issue adverse voting recommendations on equity plan proposals even in situations when a company is above the 53-point threshold necessary under the Scorecard if:

- A pay-for-performance misalignment is identified in connection with the Say-on-Pay proposal; **and**
- Equity utilization is not considered "broad-based" and is heavily concentrated to grants made to the CEO and other NEOs (i.e., three-year average concentration ratio of grants greater than 30% for the CEO or 60% for all NEOs, inclusive of the CEO).

While ISS issued eight negative voting recommendations, **no REIT failed to approve an equity plan proposal based on pay-for-performance misalignment**, with the lowest support at 73.5%.

Factors Influencing ISS Voting Recommendations

A perceived pay-for-performance misalignment continues to be the main precursor of negative voting recommendations.

- 89% of self-managed REITs that received an Against recommendation were cited for pay-for-performance misalignment.
- Nine triggered a "High" and eight triggered a "Medium" pay-for-performance concern under ISS' quantitative evaluation.

An elevated score does not guarantee a negative recommendation, however. Additional factors outside the quantitative model are also necessary to trigger enough concern during ISS' qualitative review (e.g., rigor of incentive goals, one-time equity awards) to warrant an Against voting recommendation. In contrast, a "Low" concern will generally result in a positive recommendation, with one exception: an amended employment agreement containing problematic severance provisions can override the Low concern and result in an Against recommendation (two REITs with a "Low" concern triggered negative recommendations based on severance provisions).

63%
had **outsized equity awards**, either annual grants or **supplemental one-time awards**, often despite sustained total shareholder return (TSR) underperformance

21%
provided **significant perks** – automobile-related or large enhanced life insurance perks

26%
had **outsized STI targets** and/or **outsized base salary amounts** (or significant increases without compelling rationale)

58%
had **problematic STI (Cash Bonus) program design** features, including largely discretionary plans or lack of pre-set financial metrics

68%
were cited for the **rigor of their performance goals** (STI or LTI), including rTSR targets at or below median and uncapped payouts for negative absolute TSR

53%
had **problematic LTI (Equity) program design** features, including annual performance periods, insufficient performance-based awards or retesting features

58%
had **problematic severance-related provisions**, including excise tax gross-ups, excessive severance and single-trigger equity vesting

* All percentages are out of 19 that received an Against Say-on-Pay voting recommendation from ISS

About FTI Consulting Executive Compensation and Corporate Governance Practice

The Executive Compensation and Corporate Governance practice at FTI Consulting has the unique capability to advise our clients on both routine and complex compensation and other strategic matters by leveraging our in-depth knowledge of the real estate industry and the issues directly impacting REITs. Our team of professionals have experience providing practical guidance on deal structuring, tax structuring, value-add governance changes and implementing compensation programs that are aligned with each REIT's strategic plan and that rewards employees for creating tangible value.

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