

Pay Versus Performance Proxy Disclosure: Takeaways From Major Players In Three REIT Sectors

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In this article, the authors explain that, after they analyzed proxy statements of the top ten lodging/resorts real estate investment trusts (REITs), retail REITs and mortgage REITs, they believe that the new “pay versus performance rule” has not resulted in investors receiving a better picture of executives’ pay.

At Nareit’s REITwise: 2023 Law, Accounting & Finance Conference in February, before many registrants had filed proxy statements for this year’s annual meetings, one of the hot-test topics at formal and informal¹ gatherings alike was how best to comply with Item 402(v) of Regulation S-K. In other words, a mere 13 years after the Dodd-Frank Act added Section 14(i) to the Exchange Act to direct the Securities and Exchange Commission (SEC) to adopt rules requiring registrants to provide disclosure of pay versus performance, registrants and their advisors were excitedly swapping war stories and lessons learned about developing an entirely new section for those proxy statements.

We remained curious throughout the proxy season, while both advising our clients in their drafting and reviewing the filings of others, how real estate investment trusts (REITs) in

particular would address the new pay versus performance rule. Among many questions, we wondered whether, beyond strict compliance, what commonalities and differences there would be within each sector and across sectors. We also wondered whether and how registrants would disclose their views of the information’s value to shareholders or to their boards.

Following the proxy season, we decided to thoroughly satisfy our curiosity. We conducted a short study of what the largest National Association of Real Estate Investment Trusts (Nareit) members of three important REIT sectors disclosed in accordance with the new rule.

After analyzing proxy statements of the top ten lodging/resorts REITs, retail REITs and mortgage REITs, we believe that the new “pay versus performance rule” or the “PvP Rule”² has not resulted in investors receiving a better

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picture of executives' pay for several reasons, including:

- CAP does not convey actual compensation,
- Boards have affirmatively said they do not use the PvP Rule information,
- CAP to SCT Total is not correlated to size of SCT Total, and
- Negative CAPs do not mean what they appear to mean.

Further, based on the results of our analysis and discussions with clients and REIT investors, we believe that the variety of approaches the REITs took and the information they provided may lead to disclosure changes by registrants next proxy season or additional guidance from the SEC, or both. The appendix to this article provides the list of REITs surveyed, the selection process and a summary of the PvP Rule.

SURVEY FINDINGS

Amount of “Compensation Actually Paid” Does Not Equal Actual Amount of Compensation Paid

The SEC drafted the PvP Rule so that, among other things, registrants would “provide investors with more transparent, readily comparable and understandable disclosure of a registrant’s executive compensation, so that they may better assess a registrant’s executive compensation program when making voting decisions.”³ Generally speaking, it was intended for “compensation actually paid” to provide investors with better information about how much executive officers were being

compensated than the SCT and related tables and discussion already provided.

We believe that “compensation actually paid” (as defined by the PvP Rule, CAP) does not provide investors with a better sense of what registrants actually paid their executives.

A number of the REITs hold similar views, and over 25% of the REITs essentially stated so in their proxy statements. Four of the Lodging/Resorts REITs, two of the Retail REITs and two of the Mortgage REITs wrote that the amounts shown as CAP for their named executive officers (NEOs) “do not reflect the actual amount of compensation earned by or paid to [the NEOs]” (or similar statement).

Two of the 30 REITs (in two different sectors) went further. Each provided a table labeled “Realized Pay vs Compensation Actually Paid” or “2022 Realized Compensation.” In both cases, it was the first year these REITs presented such tables in their proxy statements.

Moreover, we understand anecdotally that several major institutional investors have conveyed to some of the REITs their focus on realized pay and their lack of interest in CAP as defined by the PvP Rule.

In our view, more registrants will consider providing a realized or realizable pay table to combat potential misimpressions that investors can have from reading the PvP Rule disclosure. (In fact, even prior to the PvP Rule, a realized or realizable pay table has been a common practice by other registrants.)

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Some REITs Affirmatively Stated That Their Boards Did Not Use the PvP Rule Information

It was not common for the REITs to state whether they used the information presented in the table specifically prescribed by the PvP Rule (the PvP Table) and section to structure or determine any component of their compensation programs, and frequency varied by sector. Half of the Lodging/Resorts REITs affirmatively stated that their boards (or committees thereof) did not incorporate the PvP information when making compensatory decisions. Three of the Mortgage REITs, but only two of the Retail REITs, made similar disclosure.

It was rarer for the REITs to state whether they would use the information in the future for such purposes. Just one of the 30 REITs, in addition to stating that its board did not consider the historical information shown when making compensation decisions for the years presented, implied that it would not use the information going forward by stating that the section's disclosure did not necessarily align with its board's views on the link between performance and pay.

None of the REITs directly said that the PvP Table information would, or would not, be useful to investors.

As a proxy for the general level of interest in the new disclosure, we have also heard anecdotally that neither investors nor analysts are asking questions or making any comments about the new PvP Rule disclosure when speaking with the registrants.

CAP to SCT Total - Enormous Range and No Correlation With Size of SCT Total

To calculate each CAP, a registrant begins with the corresponding total compensation amount set forth in its Summary Compensation Table (the SCT Total). We looked at CAP as a percentage of the corresponding SCT Total (a measure we call CAP to SCT Total).

Although the range of CAP to SCT Total among REITs within the same sector and across sectors alike proves that the PvP Rule has succeeded in providing information that is appreciably different from information investors have been seeing for years, a question remains as to whether the additional information is useful to investors.

Chart 1 illustrates the range of dissimilarity both within each sector and across all three sectors.

Chart 1

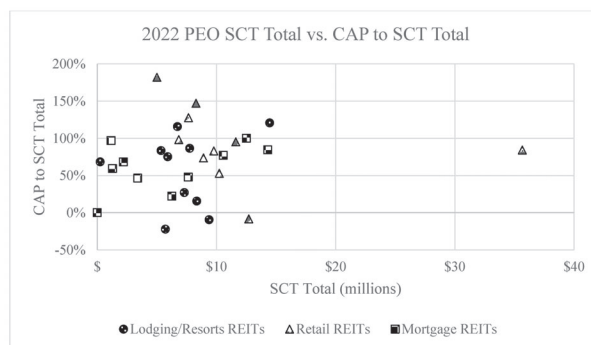


Chart 1 also illustrates that CAP to SCT Total is not correlated with the size of SCT Total, regardless of REIT sector. CAP to SCT Total can be nearly the same for both large and small SCT Totals, and CAP to SCT Total can be large or small relative to nearly the same SCT Total (i.e., the distance between coordinates of any two data points along approximately the same horizontal or vertical line can be large).

Negative CAP? Inconceivable!

Whether or not conceivable at the time of the PvP Rule’s promulgation, the negative percentages shown in Chart 1 stemmed from negative CAPs. Four of the REITs (across all three sectors) disclosed negative CAP for their principal executive officers (each a PEO) in 2022. A negative CAP suggests that an executive had to pay more to the company than the company paid to the executive. But, of course, no executive would pay to work, and no company would seek repayment from executives absent malfeasance (such as might trigger a claw-back policy).

A negative CAP can occur based on the required method of calculation. Negative values resulted primarily from significant changes in fair value of unvested equity awards from period to period, particularly when equity awards with multi-year measurement or vesting periods comprise a sizable portion of executive compensation.

Frequent Cross-References to CD&A for More Complete Discussion

Many of the REITs decided it would be appropriate in the PvP section to refer shareholders back to the compensation discussion and analysis section of the proxy statement

(CD&A), sometimes just generally and other times for specifics. But this practice, too, varied by sector, as seen in Table 1.

Table 1

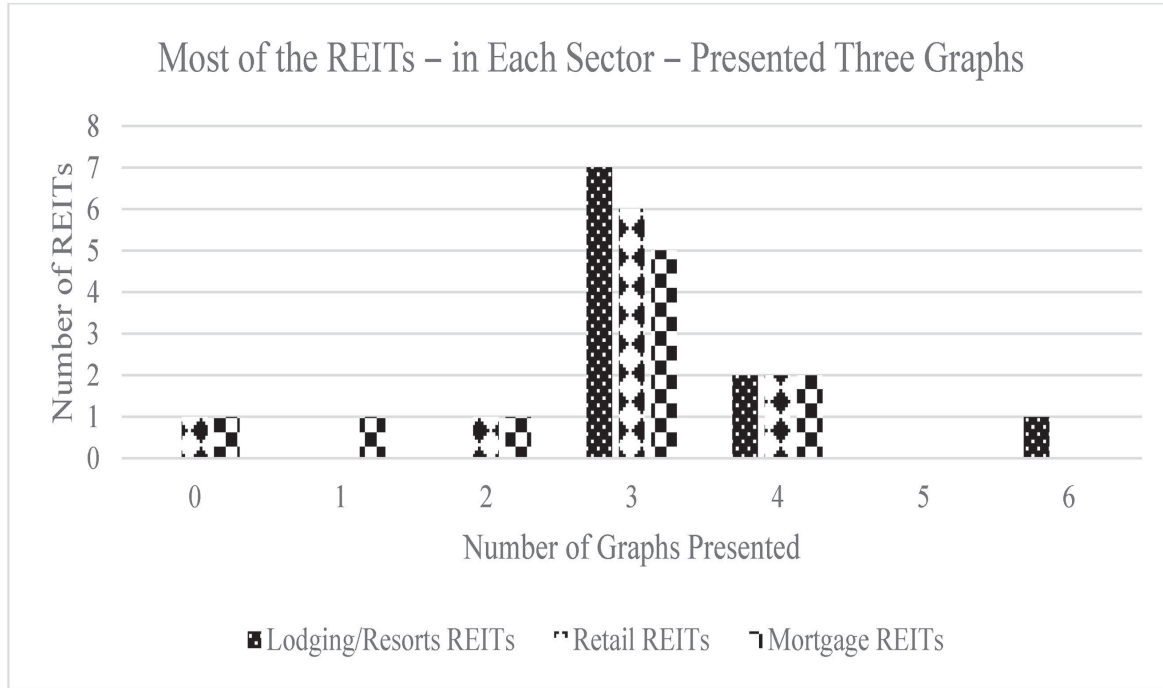
	Lodging/ Re-sorts	Retail	Mort-gage
Percent referring shareholders back to the CD&A	60%	50%	30%
Percent of such references at the beginning of the PvP section	83%	40%	100%

A Good Sketch Is Better Than a Long Speech

Whether any of the registrants had in mind this Napoleon Bonaparte belief that drawings convey information better than talk or Fred R. Barnard’s advertisement a hundred years later asserting the value in words of a single picture, the vast majority of the REITs chose to present graphs in lieu of narrative descriptions of the three relationships between certain data from the PvP Table. Given the choice to present graphs rather than narrative descriptions to show or describe the prescribed relationships, 28 of the 30 REITs across all three sectors opted for graphs (presenting from one to six). Moreover, 22 of the 28 did not provide any commentary with the graphs (beyond merely stating that the graphs would follow).

Inspired by Bonaparte and Barnard, Chart 2 conveys the above information with fewer words:

Chart 2



For Peer Group TSR, Published Indexes Predominated

For amounts in the Peer Group TSR column of the PVP Table (which are calculated based on total shareholder return (TSR) figures), the PVP Rule permits registrants to use information from either “the same peer group used for purposes of Item 201(e) of Regulation S-K or a peer group used in the CD&A for purposes of disclosing registrants’ compensation benchmarking practices.”

Given the PVP Rule’s flexibility for registrants to use an index or to generate peer group data for the new table, all but two of the 30 REITs used a published industry index, even in cases where the registrant specified a peer group in its CD&A whether for benchmarking purposes or calculating compensation based on relative TSR performance.

Table 2 shows the variety of published industry indexes used (and their frequency) by the REITs for the PVP Table, by sector.

Table 2

Lodging/Resorts	Retail	Mortgage
Dow Jones U.S. Hotel & Lodging REITs (2)	MSCI US REIT (1)	Bloomberg REIT Mortgage (8)
Dow Jones U.S. Select Real Estate Hotels (1)	Bloomberg REIT Shopping Center (2)	FTSE NA-REIT Mortgage REITs (2)
FTSE NA-REIT Equity Lodging/Resorts (2)	FTSE NA-REIT Equity REITs (5)	
FTSE NA-REIT Equity REITs (3)	FTSE NA-REIT Equity Shopping Centers (1)	

Lodging/Resorts	Retail	Mortgage
MSCI U.S. REIT/Hotel & Resort REIT (1)		

CSMs Were Uniformly Present, But Uniformity Within Sectors Varied by Sector

The PVP Table must also include one other financial performance measure of the registrant’s choosing, known as the Company-Selected Measure (CSM).

CSMs were uniformly present in the PVP Tables, with one exception. However, within each sector, and, not at all surprisingly given the different business models of each sector, across the three sectors, there was little to no uniformity of CSMs used. Among the Lodging/Resorts REITs, there were eight unique CSMs for the nine Lodging/Resorts REITs that presented CSMs.

Table 3 sets forth each CSM used, and its frequency, by sector.

Table 3

Lodging/Resorts	Retail	Mortgage
AFFO / [Diluted] Share (2)	AFFO / [Fully] [Diluted] Share (5)	Distributable Earnings (8)
Hotel Adjusted EBITDA (1)	[Nareit] FFO / [Diluted] Share [Adjusted] (3)	Relative Annual Economic Return (1)
Company Adjusted EBITDAre (1)	Core FFO / Share (1)	Total Economic Return (1)
Adjusted EBITDA (1)	Comparable FFO / Share (1)	

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Lodging/Resorts	Retail	Mortgage
Hotel EBITDA / Key (1)		
Comparable Hotel EBITDA (1)		
Relative TSR (1)		
Modified FFO / Share (1)		

Whether and how registrants disclosed their rationale for selecting their CSMs varied considerably. In all three sectors, some registrants disclosed their selection rationale (some of which was quantitative), but just over one-third of the REITs did not, as can be seen in Table 4.

Table 4

	Lodging/Resorts	Retail	Mortgage
Percent providing a CSM	90%	100%	100%
Percent disclosing CSM selection rationale	78%	50%	60%
Of selection rationale disclosed, percent providing quantitative basis	29%	0%	0%

Additional Performance Measures Provided

The PVP Rule's flexible requirement to present a tabular list of at least three but not more than seven performance measures (including at least one financial measure but optionally

including non-financial measures) resulted in a range of responding disclosure.

From a low of none (two externally managed REITs) to a high of six (five of the REITs), the number of performance measures set forth averaged 4.2.

Almost all performance measures presented were identified as (or seemed clearly to be) *financial* performance measures, as seen in Table 5.

Table 5

	Lodging/Resorts	Retail	Mortgage
Financial performance measures as percent all performance measures listed	97%	87%	91%
Of performance measures listed:			
Largest number	5	6	6
Smallest number	3	3	3
Average number	4.0	4.6	3.9

CONCLUSION

We are hard-pressed to see how investors have appreciably benefitted from the new PVP Rule disclosure. Our analysis revealed that, among other things, CAP does not equate to realized compensation, boards and institutional investors seem not to be using the information, and CAP to SCT Totals for companies having the same SCT Total can be wildly different (and vice versa). As with other significant SEC rulemakings on executive compensation, we may see additional Staff guidance

about the PVP Rule and market practice coalescing around certain commonalities going forward.

Appendix

The REITs Surveyed

(30 U.S. publicly listed members of Nareit, by Nareit-designated sector)

Table 6

Lodging/Resorts	Retail	Mortgage
Apple Hospitality REIT, Inc.	Agree Realty Corporation	AGNC Investment Corp.
DiamondRock Hospitality Company	Brixmor Property Group Inc.	Apollo Commercial RE Finance, Inc.
Host Hotels & Resorts, Inc.	Essential Properties Realty Trust, Inc.	Arbor Realty Trust, Inc.
Park Hotels & Resorts	Federal Realty Investment Trust	ARMOUR Residential REIT
Pebblebrook Hotel Trust	Kimco Realty Corporation	Blackstone Mortgage Trust, Inc.
RLJ Lodging Trust	Kite Realty Group Trust	Claros Mortgage Trust, Inc.
Ryman Hospitality Properties, Inc.	National Retail Properties, Inc.	Franklin BSP Realty Trust Inc.
Service Properties Trust	Phillips Edison & Co.	Ladder Capital Corp
Sunstone Hotel Investors, Inc.	Simon Property Group, Inc.	MFA Financial, Inc.
Xenia Hotels & Resorts, Inc.	Spirit Realty Capital	Starwood Property Trust, Inc.

REIT Selection Methodology

As of May 10, 2023, 223 registrants with

SIC code 6798 (real estate investment trusts) or 7011 (hotels and motels) and a December 31 fiscal year-end had filed definitive proxy statements for their annual meetings in 2023. We analyzed 30 of those proxy statements.

To select the 30, we determined the market capitalizations, as of March 31, 2023, of all of the entities in Nareit's REIT Directory in three of the 13 sectors it identifies - Lodging/Resorts REITs, Retail REITs and Mortgage REITs - and selected the top ten by market capitalization in each of those sectors.

Collectively, their total market capitalization as of March 31, 2023 was over \$156 billion. To provide a sense for the range and relative size of the 30 REITs surveyed, market capitalization statistics by sector (\$ in billions) is shown in Table 7.

Table 7

	Lodging/Resorts	Retail	Mortgage
Average	\$3.3	\$9.9	\$2.3
Highest	\$11.7	\$41.3	\$5.8
Lowest	\$1.5	\$3.7	\$1.0
Total	\$33.3	\$99.4	\$23.4

We refer to Item 402(v) Regulation S-K, related amendments to Schedules 14A and 14C and Regulation S-T and related SEC guidance collectively as the "pay versus performance rule" or "the PVP Rule." We refer to the 30 REITs we surveyed as "the REITs" and to the REITs by sector as "the Lodging/Resorts REITs," "the Retail REITs" or "the Mortgage REITs," as applicable. We make no claim that the REITs are a representative sample of the entities in their sectors or of all REITs generally.

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Though one of the Lodging/Resorts REITs and seven of the ten Mortgage REITs are externally managed or advised, all eight of their proxy statements included a section addressing the PvP Rule and we were therefore able to gather data from them for this article. However, when analyzing certain data within and across sectors, we had to account for the following circumstances for three of the Mortgage REITs: one conducted its initial public offering in November 2021, one did not pay its officers before 2022, and one does not pay its PEO any compensation directly. To compensate for the resulting lack of compensation amounts for 2021 and 2020 for the former two REITs, we excluded them from our analysis that required those amounts (i.e., discussion of SCT Totals and CAPs from 2021 and 2020 below do not include those two REITs), and to compensate for the lack of compensation amounts for any year for the latter REIT, we instead used the amounts it disclosed as the averages for its non-PEO NEOs.

A Brief Description of the PVP Rule's Requirements

Several organizations have published excellent descriptions and guidelines for how to comply with the PvP Rule. Solely for context for this article, we provide the following summary of the rule's key and most pertinent requirements:⁴

- A precisely prescribed table (the PvP Table) setting forth five years (initially just three) of data, including the Summary Compensation Table's Total Compensation amount (the SCT Total) for the PEO and the average for the non-PEO NEOs and the Compensation Actually Paid amount (the CAP) as defined by and calculated in accordance with the PvP Rule for the PEO and the average for the non-PEO NEOs;
- Clear descriptions - whether by graphs or text, or both - of the relationships between three certain sets of data from the PvP Table; and
- A list of three to seven registrant-selected performance measures (financial measures are required, and non-financial measures are optional).

NOTES:

¹Guilty as you may have just charged. Lawyers, accountants and registrants can care deeply about new disclosure requirements, however mundane.

²We refer to Item 402(v) Regulation S-K, related amendments to Schedules 14A and 14C and Regulation S-T and related SEC guidance collectively as the "pay versus performance rule" or "the PvP Rule."

³Adopting Release No. 34-95607, page 7.

⁴Summarized and quoted from Adopting Release No. 34-95607.