



**REIT vs. Non-REIT CEO**  
**Compensation – Competitive or**  
**Constrained?**

2Q 2003

James B. Wright  
President – ***THE BRADFORD GROUP***  
Los Angeles

11925 Wilshire Blvd. 3<sup>rd</sup> Floor  
Los Angeles, CA 90025  
(310) 575-0250 (310) 575-0253 Fax

## **REIT vs. Non-REIT CEO Compensation – Competitive or Constrained?**

Examining REIT and Non-REIT CEO compensation generates insightful perspective into performance, risk management and effective governance.

---

As this year's Proxy season emerges, it may be an appropriate time to examine the often-held industry perception that REIT CEOs and Senior Management compensation is higher than that of their peers in Non-REIT industries of similar size. This truth, or myth, stems from many factors, including the perceived expertise and knowledge required for real estate transactions, value creation and management success, a legacy of risk, reward and ruin, and the structure of much of the public industry – emerging from private asset ownership, and incorporating CEO founders with significant ownership.

Recent research by **THE BRADFORD GROUP** would support the myth side of this perception, demonstrating that REIT CEO's and Senior Executives receive lower cash compensation than their Non-REIT counterparts. In fact, the differentials seem larger than sampling error, and enough to raise questions about REIT performance-based compensation, cash/equity mix, peer groups and risk management, at a time when the industry's has out performed the S&P 500 (by a differential of 25.7% in total return in 2001), and using similarly sized companies from a random sample of Non-REIT companies in seven industries with characteristics similar to real estate and REITs. For REITs greater than \$1.0 billion in market capitalization, and based on cash compensation reported for 2001, CEOs showed cash compensation of only two-thirds that of Non-REIT companies – a 50% differential. CEOs in smaller REITs (under \$1.0 billion in market cap) also show a similar, but smaller differential, 22% below Non-REIT. COOs and CFOs of large REITs both reflected less cash compensation than Non-REIT companies (25% to 30%), but smaller REIT COO and CFOs did not exhibit this pattern, perhaps reflecting the complexities of real estate management operations, asset geography and multi-level financing requirements.

As this article discusses, although incorporating estimates of total compensation (cash + equity) may alter these REIT differentials (2002 compensation is expected to confirm the cash trend), important questions arise about the maturing REIT industry, investor acceptance of REIT diversification in portfolios, REIT performance and compensation, out-of-industry peer comparison, retention of executives, and the appropriate perspective for effective governance. Are we constraining cash compensation by narrowing the view of our competitive "peers?" Would adding long-term compensation to this analysis significantly change the outcome? The impact of our tendency to stay within real estate product groups, and within the REIT industry, for our compensation peer groups may need reconsideration, and is an important question for the long-term understanding of the industry by investors as well, for it may have significant implications on the future of REITs and their leaders.

As the REIT industry matures, the knowledge and expertise requirement for public company real estate executives is growing broader and more sophisticated. In addition, unique factors inherent in managing a REIT entity add complexity and risk to sustaining and increasing shareholder value – non-GAAP financial measures, dividend management, capital formation constraints, performance often counter to broader markets, and the overall creditability of real estate investment – all of which could also argue for higher compensation than in Non-REIT companies. But all industries have their "special factors" and they are arguably "accounted for" in the marketplace for executive compensation, despite its many inefficiencies. So why such differentials?

If REIT CEOs and Senior Management do earn more than their Non-REIT peers, is this in part a reflection of truly higher risks of success? If they don't earn more, should they, especially based

on recent performance? If REIT CEOs are compensated more than their Non-REIT counterparts in similarly sized companies, then how does this factor into REIT volatility differentials with other industries? Is there anything that should “index” this systemic risk differential? As investors’ acceptance of REITs’ role in portfolio diversification advances, these questions will loom larger.

Although special business factors may influence the compensation of certain REIT executives, they arguably may not have the same influence on CEO compensation, where leadership and effective formation/execution of strategy are the fundamentals of success, and are broadly valued over a wide market. Those convinced of generic CEO skills requirements would argue that CEO talent is independent of industry – GE is a portfolio of business, as REITs are portfolios of properties – and an effective CEO does not have to be an industry expert. For an industry thought to be one with special skill requirements, this philosophy would (and will) be a bold step/challenge for the REIT industry. Unlike other industries, and likely due to its youthful term of existence, REITs are only recently advanced into leadership and strategic initiatives where non or indirect real estate skills sets are being tapped.

### **Peer Groups and Governance**

Appropriate independent governance of public companies is in the spotlight, and CEO/Board/Compensation Committee decision rationale related to executive compensation will increasingly be scrutinized, and potentially challenged. Potential vulnerabilities of compensation governance practices are an important aspect of Board responsibility. One consequence of this changing environment will be the requirement for greater definition of the linkage between performance and compensation, and the rationalization of the overall structure of the risk/reward of CEO/Senior Management compensation. Out-of-industry comparisons to REIT compensation may well help to frame these relationships for Boards of Directors, and give a further perspective to CEOs and Compensation Committees. But, it is not enough to compare compensation alone. The real question is not

whether REIT compensation is greater than Non-REIT, but rather is it higher given consistent measures of performance and over similar time frames.

Although the assumption of higher REIT compensation than those in other industries prevails, it is not often tested. In addition to scrutiny of award levels, the utilization of appropriate peer groups for comparison, and to peer performance, may also be an area of investor challenge. From a broad perspective, most companies use comparable pay levels from outside their industry to provide diversity to compensation benchmarking. With the exception of the REIT giants, as well as several other progressive REITs, market compensation assessments of REIT executives are usually limited to REIT peers. This approach assumes that the unique financial structure of this asset class and the risks of the real estate business are indeed a “closed” market. The “REIT only” market peer group approach avoids the risk of dilution in the “market” findings of compensation levels from positions in industries perceived as lower paying. However, examination of this long-held assumption reveals surprising conclusions, and further, insight into the risk/reward considerations for REIT compensation decisions, as well as REITs within the larger market for executive compensation.

### **REIT vs. Non-REIT Cash Compensation**

**THE BRADFORD GROUP** examined cash compensation of REIT and Non-REIT companies using three (3) specific senior positions (CEO, COO and CFO), and aggregate compensation for the five (5) highest paid officers, for approximately 45 companies of a size range similar to the bulk of the REIT industry (\$0.4 billion to \$6.0 billion market capitalization), Table 1. An upper range of \$6.0 billion in market cap was used to be conservative in selecting a sample of Non-REIT companies. To utilize consistent data, the baseline of information for both REIT and Non-REIT was mid-year 2002, reporting salary and annual bonus for 2001. Non-REIT companies were selected randomly in seven (7) industries that have characteristics similar to components of real estate and REIT business.

Non-REIT Industry	% of Co.'s	Rationale for Inclusion
(1) Electric Utilities and (2) Gas Utilities	32%	Fixed Infrastructure, capital intensive, income/high dividend yield investment, low market volatility.
(3) Health Care Facilities	11%	Capital intensive, location/market critical, and tenant property operations oriented.
(4) Financial/Investment Services	14%	Access and liquidity for a large-scale and diverse regional/national real estate investment class.
(5) Recreation Facilities and (6) Restaurants	18%	Location dependent, operations intensive, significant property leasing/development requirements.
(7) Retail	25%	Strong location based economic relationship, space/lease, tenant mix, and mixed use dependent.

The composite market cap for these 44 companies is very close (albeit, marginally lower) to that of the 78 REITs used for comparison. To further segregate the analysis to reflect differences of portfolio size, operations and management responsibility, REIT and Non-REIT companies were divided into two groups based on market capitalization. A group of eight (8) public REOCs (Real Estate Operating Companies) were also selected for comparison, with average market cap in the same range as the REIT and Non-REIT groups.

As can be seen in Table 2, REIT cash compensation (salary and annual bonus) for REITs greater than \$1.0 billion market cap is significantly below that of Non-REITs for Senior Officers (CEO, COO and CFO), as well as for the aggregate of all 5 of the highest paid officers. For smaller REITs only CEO cash compensation is below the Non-REIT comparison group, while COO and CFO positions are higher than their Non-REIT peers. The overall result is interesting, given the industry's tendency to believe that REIT company pay is higher than Non-REIT. More so, REIT returns (total return) in 2001 were 13.8% (SNL – All Equity REITs) vs. the S&P 500 return of –11.9%, the second year of significant REIT market performance variance of the last three. This result would argue that a sample of REIT executives should reveal greater compensation than their Non-REIT counterparts. Non-REIT companies may have shifted to greater cash compensation, but the REIT/Non-REIT differences in Table 2 seem wider than this factor alone. Despite the fact that compensation sampling can often vary by +/- 25% or more, other factors must be part of the explanation. Comparing the much riskier business model of REOCs to the Non-REIT sample reveals the cash compensation of REOC Senior Management to be higher, particularly in the larger market cap group, but from a small sample.

## Conclusions

So, should the long-held assumption about REIT CEO compensation be altered based on this sample and comparison? Or, is there more to the explanation and analysis. The value of long-term compensation awards – Restricted Shares and Stock Options (perhaps other vehicles as well) – is an important part of the equation. Clearly, there are differences in the cash/equity mix of executive compensation practices among industries. However, fair market valuation or timing of equity award realization may only further complicate the distinction demonstrated with cash compensation, particularly in a period of market decline and bias toward cash compensation.

But, if REITs have outperformed Non-REITs over the last three years then should there not be greater evidence of performance-based compensation in the assessment herein? The answer has many facets, including the reality of the natural “stickiness” of any decline in Non-REIT compensation post stock market bubble, general lags in performance and compensation reporting for any company, REIT executive founders with large ownership interests and cash compensation inconsistent with title/responsibilities, and the importance of multiple years of analysis to discern trends and relationships between performance and compensation.

Discussion of REIT CEO compensation always leads to the question of founder/large ownership dividends. Dividends are not compensation in the strict definition, and this issue is mostly a reflection of the youth of the industry, and the nature of its public emergence. CEOs must perform despite the extent of their ownership position, even if it can create perceived potential conflict with governance decisions.

Although this exercise sheds some light on the long-held perceptions of REIT vs. Non-REIT peer groups and comparative compensation levels, it more importantly points out its role in adding clarity to the evaluation framework utilized to make effective compensation decisions, and providing appropriate governance. Most compensation review is more comparative than performance based, and metrics may play a role in advancing the assessment of compensation. Presented in Table 2 are ratios calculated using both performance (market cap) and compensation (cash) for the groups analyzed, showing more stability between REIT/Non-REIT in the smaller size group than the larger. Perhaps larger REITs are more out of balance when it comes to cash compensation, or cash/equity mix.

This assessment points out the potential vulnerability of an industry myth and the compensation methods it has likely reinforced. As the REIT industry matures, gains broader institutional and individual investor acceptance, and proves itself a long-term reliable portfolio diversification and income vehicle, appropriate and respected corporate governance will require a broadening of compensation peer comparisons and peer group definition to frame decisions.

Above all, REIT CEO compensation must remain competitive in the broad marketplace, in or out of the industry, not constrained. Although the talents of the current generation of REIT CEOs is substantial and proven, the skill sets needed for REIT strategy and growth in the next decade may well incorporate many from leadership now outside the industry. The economic and shareholder value breakthroughs in large-scale real estate operational efficiency, technology applications, investment marketing, brand development, international platforms and investor relations may well be derived from out-of-industry sources. Out-of-industry compensation comparisons may be important justification for near-term compensation decisions – but are not enough - as the investment market demands and responds to clarity regarding REIT business risk factors, effective leadership, governance and the relationship between performance and executive compensation awards. Company performance over time, and the relationship of performance to compensation relative to the broad market for executive talent is the appropriate approach to compensation design, and investor confidence.

---

**James B. Wright** - has been a management consultant to the real estate industry for over 25 years, and is President of **THE BRADFORD GROUP** a Los Angeles based advisory firm focused on "Strategic Compensation Management" – for further information please contact at 310-575-0250 or [jbw@bradfordgroup1.com](mailto:jbw@bradfordgroup1.com).

**Table 1 - Summary of Industries**

	# Companies	Average Market Cap	Average Beta
	4Q '01 Mkt. Cap = \$0.4 to \$6.0 billion	4Q '01 (\$ billions)	4Q '02
<b>REITs</b>			
Over \$1.0 Billion Market Cap	42	2,700	0.18
From \$0.4 to \$1.0 Billion Market Cap	36	723	0.13
<b>Composite/Average</b>	<b>78</b>	<b>1,751</b>	<b>0.17</b>
<b>REOCs</b>			
<b>Composite/Average</b>	<b>8</b>	<b>1,621</b>	<b>0.56</b>
<b>Non REIT/REOC</b>			
Electric Utilities	9	2,296	0.25
Gas Utilities	5	1,948	0.43
Financial/Investment Services	6	1,540	0.94
Health Care Facilities	5	1,506	0.76
Recreation	3	833	0.53
Restaurants	5	1,268	0.44
Retail (Apparel/Drug/Specialty/Dept./Disc.)	11	1,147	1.10
<b>Composite/Average</b>	<b>44</b>	<b>1,560</b>	<b>0.67</b>

Source: THE BRADFORD GROUP

**Table 2 - Comparison of REIT and Non- REIT Cash Compensation**

**Total Cash Compensation**

Mkt. Cap =	Over \$0.4 < \$1.0 Billion			Over \$1.0 Billion < \$6.0 Billion		
	REIT	Non-REIT	REOC	REIT	Non-REIT	REOC
CEO	\$743,773	\$906,378	\$1,422,964	\$1,041,278	\$1,564,221	\$2,097,502
COO	\$549,066	\$365,522	\$992,560	\$753,066	\$975,471	\$1,182,684
CFO	\$409,626	\$396,786	\$491,091	\$584,617	\$728,139	\$697,335
<b>Sum of 5</b>	<b>\$2,413,067</b>	<b>\$2,501,494</b>	<b>\$5,030,050</b>	<b>\$3,599,654</b>	<b>\$4,620,953</b>	<b>\$5,068,265</b>

**Differentials vs. Non-REIT Sample**

Mkt. Cap =	Over \$0.4 < \$1.0 Billion			Over \$1.0 Billion < \$6.0 Billion		
	REIT	Non-REIT	REOC	REIT	Non-REIT	REOC
CEO	-21.86%	-	36.30%	-50.22%	-	25.42%
COO	33.43%	-	63.17%	-29.53%	-	17.52%
CFO	3.13%	-	19.20%	-24.55%	-	-4.42%
<b>Sum of 5</b>	<b>-3.66%</b>	<b>-</b>	<b>50.27%</b>	<b>-28.37%</b>	<b>-</b>	<b>8.83%</b>

**Ratio of Cash to Market Capitalization - Sum of 5 Positions**

Mkt. Cap =	Over \$0.4 < \$1.0 Billion			Over \$1.0 Billion < \$6.0 Billion		
	REIT	Non-REIT	REOC	REIT	Non-REIT	REOC
<b>Ratio</b>	<b>0.334%</b>	<b>0.340%</b>	<b>0.682%</b>	<b>0.133%</b>	<b>0.209%</b>	<b>0.202%</b>

Source: THE BRADFORD GROUP