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# Homebuilder Industry Perspectives:

## 2020 COMPENSATION

The housing industry is one of the sectors most sensitive to changes in the economic climate, from interest rates and unemployment rates to the cost of goods and materials and now the disruption associated with a pandemic. In the midst of the COVID-19 pandemic, Ferguson Partners engaged leadership at publicly traded homebuilders to gather their perspectives on the pandemic's impact on their business and the effectiveness of their compensation program to withstand the cyclical nature of the housing market. Below are our key findings based on these conversations.

### Overall Program Structure

For 2020, compensation programs are not expected to be modified materially as a direct result of COVID-19, but sensitivity is being considered for certain markets that were more severely impacted by the pandemic, including, but not limited to, Las Vegas and Orlando. Though some markets have rebounded, many expressed that modifications may still need to be made for operators in more negatively impacted cities.

### Overemphasis on Total Shareholder Return

Some companies are assessing the effectiveness of their long-term incentive programs as it relates to total shareholder return (TSR) metrics. Proxy advisors and shareholders have pushed for a greater emphasis for TSR in long-term programs (particularly on a relative basis). However, given the cyclical and long-term nature of investments in the industry, many believe that the market does not reward winners and losers consistently. There seems to be a general agreement that return on invested capital (ROIC) over the longer term is a better measure of performance, but that does not immediately nor directly translate into returns for shareholders. Following the widespread adoption of long-term TSR metrics, companies are now reconsidering the most effective way to incorporate these measures; possibilities include:

- Incorporating TSR as a secondary performance metric or as a performance modifier that can only partially adjust payouts at the end of the performance period.
- Modifying performance periods to be more flexible and longer term in nature, such as the use of performance-based stock options with exercise periods of 7-10 years.

## Pay-for-Performance Timing

Several homebuilders highlighted the difficulty in aligning pay for performance given the long-term nature of the investment cycle, particularly in their short-term incentive programs. While most bonuses are paid based on current year profits, management is often being rewarded for capital allocations made three years prior. This can make goal setting challenging given that goals are often tied to the company's budget which already "bakes in" the likely results of these investments and may have the unintended consequence of good decisions being under rewarded and bad decisions being over rewarded.

## Diversity and Inclusion

Many executive teams are reluctant to directly incorporate diversity and inclusion (D&I) metrics into compensation programs, but virtually all believe that these initiatives are an important strategic priority. Some companies are looking to invest in analytics to ensure that the overall compensation program supports their D&I efforts while not directly linking pay to D&I factors. Such data analytics may include looking at different pay ratios throughout the organization and conducting broad-based compensation reviews to ensure that relative pay positioning throughout the organization is equitable.

## Simplicity

A central theme in our conversations was the desire for compensation programs to remain simple, while considering the various strategic, financial and governance initiatives at the forefront for each homebuilder. Trying to solve for too many hurdles simultaneously tends to lead to overly complex programs that make it difficult for management teams to completely understand and appreciate.

# Contact

*Thank you for taking the time to participate in our survey. We truly value the information and insight you have provided. Should you have any questions or if we can be of further assistance, please do not hesitate to contact us:*

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