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ADVISOR BLOG

Real Estate Executive Compensation Data Show Some Hope Amidst Industry Challenges

AUTHOR

Jon Boba
Managing Director

Like many industries, real estate has been rocked by COVID-19. While several industry categories such as homebuilding, industrial, and self-storage have proven resilient, most have been left reeling due to the ongoing effects of the pandemic and its impact on their tenants. The material decline in demand, and hence value, hitting hospitality and retail has not abated, but in some areas there are seeds of hope for a better 2021 with a vaccine on the horizon.

Given so many unexpected and varied challenges, how are firms addressing compensation and related issues as we head into a new year? The 2020 Pearl Meyer National Real Estate Survey sheds some light and suggests a path for 2021. A brief look at the prospects for the real estate industry by product segment follows, from the most to the least negatively affected by the pandemic.

Retail

No segment of real estate has been hit harder in recent years than retail. The increase in online shopping led by giant Amazon and an oversupply of assets has put the retail space in an increasingly dire position. Some analysts propose that online retail could account for over 25% of total sales, putting many retailers teetering on solvency at further risk. COVID-19 was a body blow to the sector that it could ill afford. More recent statistics show that over one in five retail businesses have declared bankruptcy and/or closed. Furthermore, it's estimated that over half of the job losses experienced in 2020 are retail-related. The online shopping trend is here to stay and will likely remain increasingly strong post-pandemic. Real estate firms poised to remain and outperform are looking for avenues to turn shopping experiences into destination events where wide-ranging dining and entertainment options co-exist with retailers. A more vibrant, diverse mix is essential to continue to capture market share. Those saddled with aging assets with limited options for a shift in orientation of the retail site will continue to lose market share.

Our compensation study paints a similar picture. With almost no increase in base pay for top executives (CEO, COO, and CFO) year-over-year, as well as a 4% reduction in target short-term incentives for 2020, survey data indicate that even in the early stages of the pandemic pay stagnation and incentive reductions were already being implemented. Going forward the industry will continue to contract and prove challenging for owner/operator/investors until valuations shrink to the point that the assets make attractive targets for new equity into the space. We expect to see continued challenges for this sector in 2021 that will more dramatically effect compensation than what was experienced in 2020.

Hospitality

Like retail, hospitality has been beset with extended difficulties in recent years, all of which have been greatly exacerbated in 2020. Over-building in the past several years has led to greater occupancy challenges even before the current health crisis essentially torpedoed travel and leisure, cutting off the hopes of profitability. With hotels at between 20% and 40% of typical capacity, there are increasing signs of bankruptcies and massive consolidation ahead.

Pearl Meyer's Real Estate Compensation Survey numbers illustrate the current situation. With little room to adapt their business models in response to the pandemic, incentives have taken an even larger hit than observed in retail with short- and long-term incentives nosediving a combined 24% and 13% respectively for top executives, leading to an overall expected decrease in total year-over-year direct compensation of 21% in 2020.

All is not lost for hospitality, however. If a vaccine can be successfully deployed by mid-year 2021, it is expected that a pent-up demand for travel will lead to a much stronger second half of 2021. As such, establishing short-term compensation targets that take into account an expected rebound is warranted.

Commercial Office

Like retail, commercial office space is in the midst of a sea change in tenant behavior that has only accelerated in 2020. The industry is rife with examples of class-A office towers in major markets experiencing building occupancy rates of under 20%. Furthermore, lingering social distancing measures will continue to put a greater emphasis on remote work going forward. Post-pandemic, many are estimating that over half of the current commercial office tenants will elect to remain committed to remote working. If realized, this trend, will dramatically increase office vacancy rates. While the long-term nature of most office leases provides more short-term cushion to absorb some additional vacancy, the changing nature of work spaces and demand for all to be located in one space is irrevocably changing. Long-term, the forecast is one of challenge for the commercial office sector and compensation increase expectations will remain modest and increasingly tied to occupancy rates for most players.

Seniors Housing

This sub-sector, while resilient in some respects was also beset with unanticipated challenges due to COVID-19. Here, things went beyond occupancy rates and related issues, affecting the literal life and death health of client-residents and each companies' front-line facility staff entrusted to care for them. The cost of ensuring the health of its workforce and end-users has been significant and the decrease in demand of their product during the height of the pandemic has made 2020 a real challenge. However, the need-based aspect of seniors housing real estate coupled with the coming "silver tsunami" (when more and more from the baby boomer generation consider moving to these facilities) bodes well for an ultimate rebound and long-term outperformance versus other asset classes.

Correspondingly, our survey shows a resiliency and overall optimism with respect to compensation. Despite the challenges of 2020, base salaries for top executives have risen 5% with total direct compensation increasing 4% indicating a positive long-term outlook on performance.

Successful roll out of the vaccine is critical for the short-term improved prospects in seniors housing. There is a unique opportunity to add talent over the next 12 months. Given the troubling times for hospitality and restaurants, adding human capital "at a discount" will seldom be more attractive to owner/operator/managers in this space. The time to recruit and train new talent is now and will be a major theme of 2021 as firms look to differentiate by upgrading their leadership and operations-focused personnel.

Multifamily

For the multifamily industry, the challenge for 2020 has been rent collection and the protections granted to tenants that have compromised the sector's access to needed capital. Continued and possible worsening unemployment rates also serve to undermine multifamily as an increasing percentage of tenants become unable to pay rent while out of work. It is anticipated that vacancies will climb in 2021, even as a vaccine becomes available, because jobs in hardest-hit industries may never come back. With falling occupancy issues facing apartment owners, progressively deeper rent concessions will need to be made as well as likely increasing sales and marketing budgets to attempt to drive demand.

For 2021, expect markets that were already struggling with oversupply to remain challenged while secondary and tertiary markets with less overbuilding and longer term, high-growth potential proving to be more resilient to the current market challenges.

Homebuilding

Homebuilding remains strong as we head into 2021. While worsening unemployment may damper demand, the sector sees millions of potential homeowners with more disposable income due to restrictions on other forms of spending seeking to lock in near historic low mortgage rates. Furthermore, the current "stay at home" environment has fueled demand for new homes with more amenities, including space for home offices. Labor and materials may add constraints but will not curtail the overall growth.

Our survey supports the optimism in this space. A growth in base salaries of 9% among top executives indicates increased competition for talent in homebuilding. Expect another strong year in 2021.

Industrial

This segment of the real estate industry has weathered the pandemic extremely well. With a materially growing demand for online shopping, warehouses are essentially becoming the new retail storage house for goods. Furthermore, as supply-chain issues have arisen in 2020, there has been a push for additional distribution center development, particularly in major markets near transportation hubs where access to goods to satisfy orders in a timely fashion is more acute. On the whole, it is expected that industrial real estate will be among the best performing among asset classes. This is reflected in the Pearl Meyer 2020 National Compensation Survey as well where we see anticipated increases in total direct compensation to be just over 9% for top executives.

Niche Sectors

In 2021 we will see a material increase in demand in several niches within real estate. These will include the development of additional cold-storage, life-science facilities, and new or expanded medical retail. How such pandemic-driven new markets, their longevity, and the compensation arrangements for those executives pans out remains to be seen.

In Conclusion

The real estate industry, while compromised in 2020, should show strength and some rebound across several areas in 2021. This optimism is shown in the compensation data gathered earlier this year while in the midst of the pandemic. The greatest challenge will remain with retail, hospitality, and commercial offices where oversupply and a change in consumer habits have left these sectors and long-term asset values increasingly vulnerable. Those equipped to up the user experience will fare best in 2021 and beyond, and are likely to see market share and compensation growth as a direct result.

About the Author

Jon Boba is a managing director in the Chicago office of Pearl Meyer. Over his 25+ years in real estate consulting, Jon has successfully completed more than 500 engagements representing a wide range of firms in the real estate and financial services industries. He also has developed an industry specialization in seniors housing, where he is a recognized leader, respected conference speaker, and author of several published articles.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Baltimore, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Raleigh, and San Jose.

Pearl Meyer

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BALTIMORE
(410) 494-4100
baltimore@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LONDON
+44 (0)20 3384 6711
london@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

RALEIGH
(919) 644-6962
raleigh@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.