

STRATUS PROPERTIES INC

Form DEF 14A

March 31, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
Filed by a Party other than the Registrant o

Check the appropriate box:

- o Preliminary Proxy Statement
- o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- x Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to §240.14a-12

Stratus Properties Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- x No fee required.
- o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

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SEC 1913 (01-05)

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**Notice of Annual Meeting of Stockholders
May 12, 2005**

March 31, 2005

Date: Thursday, May 12, 2005

Time: 1:30 p.m., Central Time

Place: Barton Creek Resort
8212 Barton Club Drive
Austin, Texas 78735

Purpose: To elect one director,
To ratify the appointment of our independent auditors,
To vote on a new stock incentive plan, and
To transact such other business as may properly come before the meeting.

Record Date: Close of business on March 16, 2005.

Your vote is important. Whether or not you plan to attend the meeting, please complete, sign and date the enclosed proxy card and return it promptly in the enclosed envelope. Your cooperation will be appreciated.

By Order of the Board of Directors.

Kenneth N. Jones
General Counsel & Secretary

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Information about Attending the Annual Meeting

If you plan to **attend** the meeting, please bring the following:

1. Proper identification.
2. Acceptable Proof of Ownership if your shares are held in Street Name.

Street Name means your shares are held of record by brokers, banks or other institutions.

Acceptable Proof of Ownership is a letter from your broker stating that you owned Stratus Properties Inc. stock on the record date or an account statement showing that you owned Stratus Properties Inc. stock on the record date.

Only stockholders of record on the record date may attend or vote at the annual meeting.

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**Stratus Properties Inc.
98 San Jacinto Boulevard, Suite 220
Austin, Texas 78701**

The 2004 Annual Report to Stockholders, including financial statements, is being mailed to stockholders together with these proxy materials on or about March 31, 2005.

This proxy statement is furnished in connection with the solicitation of proxies by the board of directors of Stratus Properties Inc. for use at our Annual Meeting of Stockholders to be held on May 12, 2005, and at any adjournments (the meeting).

Who Can Vote

Each share of our common stock that you held on the record date entitles you to one vote at the meeting. On the record date, there were 7,210,604 shares of our common stock outstanding.

Voting Rights

Inspectors of election will count votes cast at the meeting. Directors are elected by plurality vote. All other matters are decided by majority vote present at the meeting, except as otherwise provided by statute, our certificate of incorporation or our by-laws.

Brokers holding shares of record for customers generally are not entitled to vote on certain matters unless they receive voting instructions from their customers. When brokers do not receive voting instructions from their customers, they notify the company on the proxy form that they lack voting authority. The votes that could have been cast on the matter in question by brokers who did not receive voting instructions are called broker non-votes.

Abstentions and broker non-votes will have no effect on the election of directors. Abstentions as to all other matters to come before the meeting will be counted as votes against those matters. Broker non-votes as to those other matters will not be counted as votes for or against and will not be included in calculating the number of votes necessary for approval of those matters.

Quorum

A quorum at the meeting is a majority of our common stock entitled to vote, present in person or represented by proxy. The persons whom we appoint to act as inspectors of election will determine whether a quorum exists. Shares of our common stock represented by properly executed and returned proxies will be treated as present. Shares of our common stock present at the meeting that abstain from voting or that are the subject of broker non-votes will be counted as present for purposes of determining a quorum.

How Your Proxy Will Be Voted

Our board of directors is soliciting a proxy in the enclosed form to provide you with an opportunity to vote on all matters scheduled to come before the meeting, whether or not you attend in person.

Granting Your Proxy. If you properly execute and return a proxy in the enclosed form, your stock will be voted as you specify. If you make no specifications, your proxy will be voted:

in favor of the proposed director nominee,

for the ratification of the appointment of the independent auditors, and

in favor of the proposed 2005 Stock Incentive Plan.

We expect no matters to be presented for action at the meeting other than the items described in this proxy statement. By signing and returning the enclosed proxy, however, you will give to the persons named as proxies therein discretionary voting authority with respect to any other matter that may properly come

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before the meeting, and they intend to vote on any such other matter in accordance with their best judgment.

Revoking Your Proxy. If you submit a proxy, you may subsequently revoke it or submit a revised proxy at any time before it is voted. You may also attend the meeting in person and vote by ballot, which would cancel any proxy that you previously submitted. If you wish to vote in person at the meeting but hold your stock in street name (that is, in the name of a broker, bank or other institution), then you must have a proxy from the broker, bank or institution in order to vote at the meeting.

Proxy Solicitation

We will pay all expenses of soliciting proxies for the meeting. In addition to solicitations by mail, arrangements have been made for brokers and nominees to send proxy materials to their principals, and we will reimburse them for their reasonable expenses. We have retained Georgeson Shareholder Communications Inc., 17 State Street, New York, New York to assist with the solicitation of proxies from brokers and nominees. It is estimated that the fees for Georgeson's services will be \$6,500 plus its reasonable out-of-pocket expenses. We may have our employees or other representatives (who will receive no additional compensation for their services) solicit proxies by telephone, telecopy, personal interview or other means.

Stockholder Proposals

If you want us to consider including a proposal in next year's proxy statement, you must deliver it in writing to: Secretary, Stratus Properties Inc., 98 San Jacinto Boulevard, Suite 220, Austin, Texas 78701 by December 2, 2005.

If you want to present a proposal at the next annual meeting but do not wish to have it included in our proxy statement, you must submit it in writing to our corporate secretary, at the above address, by January 13, 2006, in accordance with the specific procedural requirements in our by-laws. If you would like a copy of these procedures, please contact our corporate secretary. Failure to comply with our by-law procedures and deadlines may preclude the presentation of your proposal at the next meeting.

Corporate Governance

Ethics and Business Conduct Policy

Our Ethics and Business Conduct Policy is available at <http://www.stratusproperties.com/policy.htm>. We intend to post amendments to or waivers from our Ethics and Business Conduct Policy, if any, made with respect to any of our directors and executive officers on that website.

Board Structure and Committee Composition

Our board consists of four members, and has primary responsibility for directing the management of our business and affairs. Our board held four regular meetings and one special meeting during 2004. Non-employee directors meet in executive session at the end of each board meeting. The chair of executive session meetings rotates among the chairpersons of the two standing committees (discussed below), except as the non-employee directors may otherwise determine for a specific meeting.

To provide for effective direction and management of our business, our board has established an audit committee and a corporate personnel committee. Our board does not have a nominating committee. The entire four-person board, three members of which are independent as discussed below, acts as our nominating committee. During 2004, each of our directors attended at least 75% of the aggregate number

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of board and applicable committee meetings. Directors are also invited to attend annual meetings of our stockholders. Mr. Armstrong and Mr. Leslie attended the last annual meeting of stockholders.

Audit Committee Members	Functions of the Committee	Meetings in 2004
Michael D. Madden, Chairman Bruce G. Garrison James C. Leslie	please refer to the Audit Committee Report	5

Corporate Personnel Committee Members	Functions of the Committee	Meetings in 2004
James C. Leslie, Chairman Michael D. Madden	please refer to the Corporate Personnel Committee Report on Executive Compensation	3

Board and Committee Independence and Audit Committee Financial Experts

On the basis of information solicited from each director, the board has determined that each of Messrs. Garrison, Leslie and Madden has no material relationship with the company and is independent within the meaning of the National Association of Securities Dealers Automated Quotations System (Nasdaq) director independence standards, as currently in effect. In making this determination, the board, with assistance from the company's legal counsel, evaluated responses to a questionnaire completed annually by each director regarding relationships and possible conflicts of interest between each director, the company and management. In its review of director independence, the board and the company's legal counsel considered all commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships any director may have with the company or management. The board determined that three directors are independent.

Further, the board has determined that each of the members of the Audit Committee has no material relationship with the company and is independent within the meaning of the Nasdaq independence standards applicable to audit committee members. In addition, the board has determined that each of the members of the Audit Committee qualifies as an audit committee financial expert, as such term is defined by the rules of the Securities and Exchange Commission (SEC).

Consideration of Director Nominees

In evaluating nominees for membership on the board, the board takes into account many factors, including personal and professional integrity, general understanding of our industry, corporate finance and other matters relevant to the successful management of a publicly-traded company in today's business environment, educational and professional background, independence, and the ability and willingness to work cooperatively with other members of the board and with senior management. The board evaluates each individual in the context of the board as a whole, with the objective of recommending nominees who can best perpetuate the success of the business, be an effective director in conjunction with the full board, and represent stockholder interests through the exercise of sound judgment using their diversity of experience in these various areas. A majority of the independent directors then serving on the board must approve any nominee to be recommended by the board to the stockholders.

The board regularly assesses whether it is the appropriate size, and whether any vacancies on the board are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the independent directors consider various potential candidates for director, who may come to their attention through professional search firms, stockholders or other persons. Each candidate brought to the attention of the board, regardless of who recommended such candidate, is considered on the basis of the criteria set forth above.

As stated above, the board will consider candidates proposed for nomination by our stockholders. Stockholders may propose candidates for consideration by the board by submitting the names and supporting information to:

Secretary, Stratus Properties Inc., 98 San Jacinto Boulevard, Suite 220, Austin,

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Texas 78701. Supporting information should include (a) the name and address of each of the candidate and proposing stockholder, (b) a comprehensive biography of the candidate and an explanation of why the candidate is qualified to serve as a director taking into account the criteria identified above, (c) proof of ownership, the class and number of shares, and the length of time that the shares of our common stock have been beneficially owned by each of the candidate and the proposing stockholder, and (d) a letter signed by the candidate stating his or her willingness to serve.

In addition, our by-laws permit stockholders to nominate candidates directly for consideration at next year's annual stockholder meeting. Any nomination must be in writing and received by our corporate secretary at our principal executive offices no later than January 13, 2006. If the date of next year's annual meeting is moved to a date more than 90 days after or 30 days before the anniversary of this year's annual meeting, the nomination must be received no later than 90 days prior to the date of the 2006 annual meeting or 10 days following the public announcement of the date of the 2006 annual meeting. Any stockholder submitting a nomination under our by-laws must include (a) all information relating to the nominee that is required to be disclosed in solicitations of proxies for election of directors pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (including such nominee's written consent to being named in the proxy statement as a nominee and to serving as a director if elected), and (b) the name and address (as they appear on the company's books) of the nominating stockholder and the class and number of shares beneficially owned by such stockholder. Nominations should be addressed to: Secretary, Stratus Properties Inc., 98 San Jacinto Boulevard, Suite 220, Austin, Texas 78701.

Communications with the Board

Individuals may communicate directly with our board (or any individual director) by writing to the director or the Chairman of the Board of Stratus Properties Inc., c/o 98 San Jacinto Boulevard, Suite 220, Austin, Texas 78701. The company or the Chairman will forward the stockholder's communication to the appropriate director.

Director Compensation

Cash Compensation

Each non-employee director receives \$500 for attendance at each board committee meeting as well as an annual fee consisting of (a) \$10,000 for serving on our board, (b) \$1,000 for each committee on which he serves, and (c) \$1,000 for each committee of which he is the chairman. Each director receives a fee of \$500 for attendance at each board meeting and is also reimbursed for reasonable out-of-pocket expenses incurred in attending our board and committee meetings.

Stock Option Plan for Non-Employee Directors

The company provides equity compensation to the non-employee directors through the 1996 Stock Option Plan for Non-Employee Directors, which was approved by our stockholders. Pursuant to the plan, on September 1st of each year, each non-employee director receives a grant of options to acquire 2,500 shares of our common stock. The options are granted at fair market value on the grant date, vest ratably over the first four anniversaries of the grant date and expire on the tenth anniversary of the grant date. Accordingly, on September 1, 2004, each non-employee director was granted an option to purchase 2,500 shares of our common stock at a grant price of \$13.0605.

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Our board of directors has fixed the number of directors at four. The table below shows the members of the different classes of our board and the expiration of their terms.

Class	Expiration of Term	Class Member
Class I	2005 Annual Meeting of Stockholders	Michael D. Madden
Class II	2006 Annual Meeting of Stockholders	Bruce G. Garrison James C. Leslie
Class III	2007 Annual Meeting of Stockholders	William H. Armstrong III

Our board has nominated the Class I director named above for an additional three-year term. The persons named as proxies in the enclosed form of proxy intend to vote your proxy for the election of the Class I director, unless otherwise directed. If, contrary to our present expectations, the nominee should become unavailable for any reason, your proxy will be voted for a substitute nominee designated by our board, unless otherwise directed.

Information About Nominee and Other Directors

This table provides certain information as of March 16, 2005 with respect to the director nominee and each other director whose term will continue after the meeting. Unless otherwise indicated, each person has been engaged in the principal occupation shown for the past five years.

Name of Nominee or Director	Age	Principal Occupations, Other Directorships and Positions with the Company	Year First Elected a Director
William H. Armstrong III	40	Chairman of the Board & Chief Executive Officer of the Company since 1998. President since 1996.	1998
Bruce G. Garrison	59	Director REITs and Real Estate Investments, Pinnacle Trust Company, since 2003, and Vice President from 2000 to 2003. Principal of Harris, Webb & Garrison Inc., an investment banking firm, from 1996 to 2000.	2002
James C. Leslie	49	Private investor. Chairman of the Board of Ascendant Solutions, Inc. Director, President and Chief Operating Officer of The Staubach Company, a commercial real estate services firm, from March 1996 until March 2001.	1996
Michael D. Madden	56	Partner of Questor Management Co., merchant bankers, since March 1999. Chairman of the Board of Hanover Capital L.L.C., investment bankers, since 1995.	1992

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This table shows the amount of our common stock each of our directors and named executive officers beneficially owned on March 16, 2005. Unless otherwise indicated, all shares shown are held with sole voting and investment power. This table also shows the number of shares of our common stock each of our directors and named executive officers could acquire as of May 15, 2005, upon the exercise of options granted pursuant to our stock incentive plans.

Name of Beneficial Owner	Number of Shares Not Subject to Options	Number of Shares Subject to Exercisable Options	Total Number of Shares Beneficially Owned	Percent of Class
William H. Armstrong III(1)	27,718	358,591	386,309	5.4%
John E. Baker	4,427	69,114	73,541	1.0%
Bruce G. Garrison(2)	137,040	1,875	138,915	1.9%
James C. Leslie	35,500	23,750	59,250	*
Michael D. Madden		23,750	23,750	*
All directors and executive officers as a group (6 persons)	204,685	477,080	681,765	8.9%

* Ownership is less than 1%

(1) Includes 3,250 shares held in his individual retirement account.

(2) Includes 127,040 shares held by an investment company with respect to which Mr. Garrison, as an executive officer, shares voting and investment power, but as to which he disclaims beneficial ownership.

Stock Ownership of Certain Beneficial Owners

This table shows the beneficial owners of more than 5% of our outstanding common stock based on filings with the SEC. Unless otherwise indicated, all information is presented as of December 31, 2004, and all shares indicated as beneficially owned are held with sole voting and investment power.

Name and Address of Person	Number of Shares Beneficially Owned	Percent of Class
William H. Armstrong III 98 San Jacinto Boulevard, Suite 220 Austin, Texas 78701	386,309(1)	5.4%
Carl E. Berg 10050 Bandle Drive Cupertino, California 95014	1,405,000(2)	19.5%
High Rise Capital Advisors, L.L.C. 535 Madison Avenue, 26th Floor New York, New York 10022 Ingalls & Snyder LLC	419,458(3)	5.8%

Robert L. Gipson 61 Broadway New York, New York 10006	1,357,125(4)	18.8%
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- (1) Reflects beneficial ownership as of March 16, 2005.
- (2) Based on an amended Schedule 13G filed with the SEC on February 13, 2002.
- (3) Based on an amended Schedule 13G filed with the SEC on February 11, 2005, High Rise Capital Advisors shares voting and investment power over all shares beneficially owned.

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- (4) Based on an amended Schedule 13G filed with the SEC on February 14, 2005, Ingalls & Snyder has no voting power but shares investment power with respect to 1,205,125 of these shares, and Robert L. Gipson has sole voting and investment power with respect to 152,000 of these shares and shares investment power with respect to 974,777 of these shares.

Executive Officer Compensation

This table shows the compensation paid to our chief executive officer and chief financial officer in 2004, 2003 and 2002 (collectively, the named executive officers), the only two executive officers whom we employed in 2004. The named executive officers did not receive any perquisites in 2002, 2003 or 2004 that exceeded the threshold for disclosure under the SEC rules.

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation		Long-Term Compensation Awards		
		Salary	Bonus	Restricted Stock Awards(1)	Securities Underlying Options	All Other Compensation(2)
William H. Armstrong III Chairman of the Board, President & Chief Executive Officer	2004	\$ 280,000	\$ 263,000	\$ 400,375	70,000	\$ 33,200
	2003	280,000	263,000	147,770	46,000	33,200
	2002	280,000	258,000	241,997	91,455	36,700
John E. Baker Senior Vice President & Chief Financial Officer	2004	170,000	136,000	160,150	25,000	27,822
	2003	170,000	136,000	52,775	15,000	27,822
	2002	170,000	136,000	83,746	30,152	27,822

- (1) On December 30, 2004, 25,000 restricted stock units (RSUs) were granted to Mr. Armstrong and 10,000 RSUs were granted to Mr. Baker under the 2002 Stock Incentive Plan. The RSUs will ratably convert into shares of our common stock over a four-year period on each grant date anniversary. Dividends are not currently being paid on our common stock; however, dividend equivalents would be accrued on the RSUs on the same basis as dividends would be paid on our common stock plus market rate interest. The market value of the RSUs as of December 31, 2004 and as of their grant dates are as follows:

Name	RSUs	12/31/04 Market Value	Grant Date Market Value
Mr. Armstrong	25,000	\$ 400,750	\$ 400,375
Mr. Baker	10,000	160,300	160,150

As of December 31, 2004, based on the \$16.03 market value per share of our common stock as of such date, (a) Mr. Armstrong held 49,318 RSUs, the aggregate value of which was \$790,568, and (b) Mr. Baker held 18,522 RSUs, the aggregate value of which was \$296,908.

- (2) Consists of contributions to defined contribution plans, payments for life insurance policies, and director fees as follows:

Name	Date	Plan Contributions	Life Insurance	Director Fees
Mr. Armstrong	2004	\$ 28,000	\$ 2,700	\$ 2,500
	2003	28,000	2,700	2,500
	2002	31,000	2,700	3,000
Mr. Baker	2004	25,500	2,322	
	2003	25,500	2,322	
	2002	25,500	2,322	

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This table sets forth all of the stock options that we granted to each of the named executive officers in 2004.

Option Grants in 2004

Name	Number of Securities Underlying Options Granted(1)	Percent of Options Granted to Employees in 2004	Exercise or Base Price	Expiration Date	Grant Date Present Value(2)
William H. Armstrong III	70,000	63.6%	\$ 16.015	December 30, 2014	\$ 728,700
John E. Baker	25,000	22.7%	16.015	December 30, 2014	260,250

- (1) Unless otherwise noted, the stock options will become exercisable over a four-year period. The stock options will become immediately exercisable in their entirety if, under certain circumstances, (a) any person or group of persons acquires beneficial ownership of shares in excess of certain thresholds, or (b) the composition of the board of directors is changed after a tender offer, exchange offer, merger, consolidation, sale of assets or contested election or any combination of these transactions.
- (2) The Black-Scholes option pricing model was used to determine the grant date present value of the stock options that we granted to the listed officers. The grant date present value was calculated to be \$10.41 per option. The following facts and assumptions were used in making this calculation: (a) an exercise price for each option of \$16.015; (b) a fair market value of \$16.015 for one share of our common stock on the grant date; (c) a term of ten years for the stock options; (d) a stock volatility of 48.7% based on an analysis of historical weekly closing prices of our common stock over the 512-week period commencing March 3, 1995; and (e) an assumed risk-free interest rate of 4.39%, this rate being equivalent to the yield on the grant date on a zero coupon U.S. Treasury note with a maturity date comparable to the expiration date of the options. No other discounts or restrictions related to vesting or the likelihood of vesting of the options were applied.

This table sets forth all outstanding stock options held by each of the named executive officers as of December 31, 2004. Mr. Armstrong did not exercise stock options in 2004.

Aggregated Option Exercises in 2004 and Options at December 31, 2004

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at December 31, 2004	Value of Unexercised In-the-Money Options at December 31, 2004
			Exercisable/Unexercisable	Exercisable/Unexercisable
William H. Armstrong III			347,227/150,228	\$2,584,765/\$515,902
John E. Baker	20,000	\$ 100,275	65,326/ 51,326	417,987/ 169,475

**Corporate Personnel Committee Report on Executive Compensation
Compensation Philosophy**

The Corporate Personnel Committee, which is composed of two independent directors, determines the compensation of our executive officers and administers our annual performance incentive and stock

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incentive plans. The committee met three times during 2004. Our committee's executive compensation philosophy is to:

emphasize performance-based compensation that balances rewards for short- and long-term results

tie compensation to the interests of the company's stockholders, and

provide a level of total compensation that will enable the company to attract and retain talented executive officers.

In 2001, we commissioned a compensation consulting firm to perform a comprehensive review of our executive compensation practices. Based on our consideration of the consulting firm's reports and discussions with such firm regarding the appropriate level of compensation for our management team, we determined that the base salaries, as well as annual and long-term incentive awards, paid to the company's management team should approximate the median of the community and land developer peer group. We continue to administer our compensation program based on this philosophy, and we believe the total compensation paid to each of our Chief Executive Officer and our other named executive officer is reasonable and appropriate. In 2005, we intend to retain a compensation consulting firm to perform another comprehensive review of our executive compensation practices.

Components of Executive Compensation

Executive officer compensation for 2004 included base salary, annual incentive awards, stock options and restricted stock units.

Base Salaries

The base salaries of our executive officers have remained at the current levels since 2002. Although we annually evaluate each executive officer's level of responsibility and conduct annual performance assessments, we have not increased our executive officers' base salaries in an effort to stay within our target compensation range relative to the community and land developer peer group.

Annual Incentive Awards

We provided annual cash incentives to our Chief Executive Officer, Mr. Armstrong, and the company's other officers for 2004 through the company's performance incentive awards program. We used the same guidelines from 2003 for use in awarding cash incentives for 2004. Under this approach, we determined each officer's award based on a combination of overall corporate performance and individual performance, with the specific allocation reflecting the primary focus of the officer's position and the officer's ability to impact the variables associated with each. Accordingly, we allocated 80% of Mr. Armstrong's potential award to overall corporate performance and 20% to individual performance. In assessing overall corporate performance, we focused on the following four measures, which were weighted according to our determinations as to the impact each has on overall corporate performance: asset value enhancement, fee services growth, capital structure and overhead management.

Each person selected to participate in the program was assigned a target award based on level of responsibility, which served as a guideline amount. We determined the individual awards to the participants based on our assessment of the performance measures described above and the relative individual allocations. After consideration of the factors described above, we determined that the level of corporate and individual performance achieved in 2004 warranted the payment of a cash bonus to Mr. Armstrong and our other named executive officer in the amounts shown in the Summary Compensation Table.

Stock Options and Restricted Stock Units

In 2002, we established long-term incentive award guidelines intended to reinforce the relationship between compensation and increases in the market price of the company's common stock and align the

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officer's financial interests with those of the company's stockholders. Pursuant to this plan, we established target levels based upon the position of each participating officer and granted long-term incentive awards within those levels based upon our assessment of corporate and individual performance. Participating officers received approximately two-thirds of their long-term incentive awards in the form of stock options and approximately one-third in the form of restricted stock units. Using these guidelines, we granted stock options and restricted stock units to the participating officers in December 2004. The exercise price of each stock option granted in 2004 is equal to the fair market value of a share of our common stock on the grant date. The restricted stock units will ratably convert into shares of our common stock over a four-year period on each grant date anniversary. For further information on the stock options and restricted stock units granted to the named executive officers, see the Summary Compensation Table and the Option Grants in 2004.

Section 162(m)

Section 162(m) limits to \$1 million a public company's annual tax deduction for compensation paid to each of its most highly compensated executive officers. Qualified performance-based compensation is excluded from this deduction limitation if certain requirements are met. Our policy is to structure compensation that will be fully deductible where doing so will further the purposes of the company's executive compensation programs.

Dated: March 29, 2005

James C. Leslie, Chairman

Michael D. Madden