

The many challenges of Australia's REIT CFO

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As one of the most securitised real estate markets, Australia is also one of the most transparent. This makes the REIT CFO's challenges and opportunities especially visible.

In the early part of this decade, Australian REIT CFOs spent their time building integrated real estate businesses. Developers acquired fund managers, and REITs took development risk to increase yield. The REIT sector became complex and risky – yet investors accepted decreasing yields and benefited from increasing asset values. Leverage was ramped up, and good profits and bonuses were enjoyed.

How the world has changed! In 2009 we face many challenges; macroeconomic conditions are poor, and investor confidence and wealth are shattered. To make matters worse, banks are increasingly risk-averse and demanding – and staff are increasingly disengaged, with remuneration schemes no longer calibrated to retention and incentive objectives. The CFO is caught in a perfect storm – not only faced with solving immediate problems but also focused on developing sustainable strategies.

Immediate challenges

The most immediate challenges relate to asset valuations, which have fallen by as much as 20% in mid 2009. This threatens loan-to-value ratio covenants, allowing lenders to demand asset sales, facility repayments and increased margins – resulting in lower profits and 'de-risked' businesses with slower growth.

De-leveraging requires re-assessing derivatives needs and unwinding complex investment structures. Many of these structures were well suited for a growth environment but are difficult to deconstruct, particularly as there is every chance that currency and interest rate movements are adverse, and tax liabilities can be easily triggered. Management requires surgical precision.

Ordinarily tenant credit quality is not an area of concern, but the economic environment is causing rents to be renegotiated and leases are not being renewed. This is leading to lower forecast rental income, declines in asset values and difficulty in funding assets. Investors

and lenders are increasingly demanding regular and more accurate financial forecasts, and equity is increasingly difficult to source. Indeed, some REITs are considering issuing bonds that rank pari passu with secured lenders, which may help encourage investors to move out of cash.

For many years, REITs have distributed 100% of cash earnings, sometimes more, but this is no longer the case. For many retired investors, a distribution cut is the last straw. For other investors, it is the responsible thing to do. For the CFO, how much cash is left to pay distributions is the last piece of the puzzle.

A sustainable strategy

The best CFOs are focused not just on surviving, but thriving. They see competitors who are relatively more distressed, and see opportunities that others cannot pursue. They see the return of syndicates and extensive consolidation, capital raisings, de-staplings⁷ and 'take private' transactions. But most of all they continue to see real estate as an attractive asset class, albeit in a simpler world with lower margin product for risk-averse investors.

Articulating a strategy which responds to tomorrow's opportunities is the first step. The strategy needs to address the changes above, as well as to allow for potential regulatory change and prolonged or further economic deterioration. The best CFOs are no longer focused on budgets, but on scenario planning, and are more regularly speaking to investors and financiers.

While still navigating through the storm, the best prepared are already looking towards the horizon and planning for what might come next. Indeed, the optimists see clearing skies and opportunities inherent in any crisis. The best and the strongest will have first mover advantage.



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⁷ The uniquely Australian practice in which two or more units or shares that have been traded together are separated.

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