



The Real Deal

CFOs in the real estate industry face a singular set of challenges.

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August 01, 2007

This is the first in a series of articles on CFOs in particular industries.

Financial skills are, as executive recruiters like to say, fungible. In fact, more than 50 percent of new CFO hires come from outside their industry. But sometimes, says Scott Simmons, vice president of executive recruiting firm Crist Associates, that's not possible — especially when the industry demands a level of specialization that only finance executives with experience in that sector can provide.

Case in point: real estate. With its ever-changing ownership and volatile cycles, real estate is one industry that "requires CFOs to be ahead of the curve," says Janette Marx, senior vice president of Ajilon Finance, who specializes in recruiting senior finance executives cross-industry. As with health care and financial services, real estate involves specialized reporting requirements, constantly evolving regulations, and complex tax and accounting issues. And whether you are talking about commercial, residential, or real estate investment trusts (REITs), real estate remains one of the "most complex sectors of our economy," adds Marx.

Deal or No Deal

Whether managing a portfolio of properties or monitoring new acquisitions, finance executives in real estate (particularly the commercial sector) perform a constant juggling act, says Marx. "They need to understand not only finance policy but also nitty-gritty real estate procedures," she explains. That includes staying current on the intricacies of mortgage banking, insurance, and property management.

At shopping centers, for instance, tenants usually pay for the upkeep of the building through a common-area maintenance (CAM) fee. While a CFO of a property-management firm doesn't directly manage the tenants, he still needs to understand how those fees are collected, says David Kaufman, an attorney with Duane Morris LLP. And, more important, since large retailers often dispute CAM fees or pay only a percentage, says Kaufman, the CFO must know how to account for the difference, or CAM slippage. In addition, because the industry is driven by the financing of deals, says Walt Williams, a partner at Battalia Winston International, "it relies heavily on a CFO's knowledge of specialized lending." That includes understanding partnership accounting, especially in the real estate development industry, where developers and owners often team up. Projects can take anywhere from months to years, and each phase requires its own

financing, he explains. "You need construction loans to build the project, bridge loans while you [find] tenants, and permanent equity to sustain it."

Larry Kreider, CFO of Cedar Shopping Centers Inc., a REIT specializing in supermarket and drugstore convenience centers, agrees. Mortgages are particularly tricky, he says, since lenders apply capitalization rates, which determine the estimated return on investing in a commercial income property, before underwriting a loan. And since cap rates are relatively low right now, more financing is needed to cover the full value of a property or project.

Valuing that property or portfolio is also complicated "since the information you need [to calculate it] isn't readily available," says Bill Leiser, CFO of The Staubach Co., a Dallas-based real estate advisory firm. "Unlike a share of Exxon, which is the same price anywhere," he says, "[a] building in New York City is not the same price as the same building in Texas."

And while most REITs do not qualify as taxable entities, sometimes they do. Consider what happened when Affordable Residential Communities decided to sell 40 of its properties last year. As a REIT, ARC could sell no more than 7 properties without incurring 100 percent taxation on gains. Therefore, it had to change its status from a REIT to an operating company — exposing it to Financial Accounting Standard 109's complicated income-tax disclosure requirements, and requiring then-CFO Kreider and his staff to take a refresher course in tax-accounting rules.

Breaking In Brokers

Internally, real estate CFOs deal with a distinct set of stakeholders. The industry is so deal-driven, says Staubach's Leiser, that "as CFO, you have to have a marketing and sales mentality." At the same time, however, "you have to understand what the salespeople are trying to accomplish in order to arm them with financial knowledge to get the deal done," he explains.

The task of assembling an optimal sales force often falls to the real estate CFO, so much so that Al Petrillo, CFO of commercial real estate firm Studley, has even developed a mathematical model to evaluate senior-level potential brokers. "When evaluating a broker's potential future value, you must consider his standing in a particular market, what clients he's worked with in the past, what deals he's done, his personality, his reputation, whether he works with a team of professionals or by himself, and so forth," says Petrillo. While he is mum on the specifics, Petrillo says that since the model was implemented in 2003, "Studley's management team has had a greater than 90 percent success rate in recruiting brokers able to meet their targeted goals."

Even though brokers do most of the deal legwork, some CFOs have the final say on transactions. When it comes to evaluating a deal at Cedar, for example, Kreider must decide whether it is feasible depending on its liquidity and financing. Others, like Leiser, get involved when the company is buying out a partner or acquiring one.

Newbies Need Not Apply

The complexity of the industry makes it tough to break into, says Williams. "Seldom are real estate companies willing to look at a candidate with no prior experience," he says. More often, new CFOs come from banking, where they have dealt with real estate firms; from an accounting firm where they serviced real estate clients; or from another real estate sector.

One possible exception, however, is the growing commercial real estate sector. In the first four months of 2007, that sector posted a record \$157 billion invested, up from \$97 billion in the same period in 2006, according to the National Association of Realtors. "As demand for talent increases, employers will be forced to look outside the industry for CFOs whose experience and core skills are transferable," says Ajilon Finance's Marx. It's an exciting industry, says Petrillo. "You're not making widgets; instead, you're molding ideas, making deals, and you definitely have a seat at the table."

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