REHDA

23 NOV, 2020

Complication of impairment

The Star, Malaysia

Complication of impairment

Pandemic has a serious impact on real estate valuations

By THEAN LEE CHENG
starbiz@thestar.com.my

PETALING JAYA: Of late, the accounting term impairment has cropped up quite a bit, with companies across the board reporting a rise in losses due to impairment.

Losses due to a fall in fair value is termed impairment, and it could have a negative impact on a company as it affected revenue, and consequently profit, said chartered surveyor Datuk Mani Usilappan, who heads VPC Alliance Kajang. He wrote two papers on the subject for a property-related association.

With the exception of certain industries, the Covid-19 pandemic has not spared most sectors of the economy. Mani's focus is on the real estate sector, where besides impairment, rising inventory of unsold completed uses is a big blemish on the sector.

Impairment and rising inventory are different issues. Impairment refers to the loss/profit in the asset an entity is holding. A developer's inventory rises with unsold properties.

There are various reasons why an asset is impaired. So impairment is a result of external and internal factors.

Property consultancy Rahim & Co's research head Sulaiman Saheh said companies make provisions for impairment all the time but the pandemic has amplified this issue.

> ***"Even before Covid-19, the oversupply of office space was an issue, and more so today as more office buildings are completed."***
>
> *Sulaiman Saheh*

PROPERTY

Covid-19 and the subsequent halt in business and economic activities affected all malls, whether they were doing well or not prior to the pandemic.

"In retail malls, rental yield and footfall are the determining factors. In the office space market, it is rental yield and occupancy that drives value. Even before Covid-19, the oversupply of office space was an issue, and more so today as more office buildings are completed," he said.

In a nutshell, the growth in supply is faster than the growth in demand. Covid-19 and its results amplified and magnified this issue. The uncertainty that follows exacerbates the issue.

When a mall or office block owner is not getting the rental they are supposed to get and when incentives like discounts/rebates or rent-free period are given, an impairment is involved. Rent drives property value.

The issue of impairment in residential is not so clear cut, Sulaiman said. When houses are completed but not sold, it is marked as inventory. The developer's inventory rises if he continues to build but is unable to sell them quickly enough. But inventories are not an impaired. Instead, it comes in a different form.

For example, a developer may have 1,000 units unsold inventory, each costing RM500,000. This RM500mil is not impaired. So impairment does not refer to unsold completed units.

These units are not written off, or impaired, because at some time in the future, a buyer may come along. Impairment refers to a write-off or a drop in the property prices. Here is where the complication comes.

Because developers had inflated prices during the boom market which lasted between 2010 and 2014/15, and gave rebates to offset those inflated prices, the question is, are these units booked at the real price or at the inflated price when developers finalise their accounts?

A developer may have 1,000 units of housing launched at RM500,000 a few years ago. But the real price is actually RM400,000. So it is RM400mil versus launched price of RM500mil. Does that difference of RM100mil fall into impairment?

This marketing strategy of opaque pricing affects bank and lending systems. The drop in the security of margin of the mortgage would affect the banks that gave a loan based on RM500,000 when the actual value is RM400,000.

Sulaiman said developers' inventory rose between 2014 and 2017. For background, the government banned developer interest bearing schemes on Jan 1, 2014. Inventories and work-in-progress, or units under construction, of about 10 developers collectively run into multi-billions.