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## News Focus: Proposed DBKL assessment hike could impact REITs

First Read

Written by Janice Melissa Thean of theedgemalaysia.com

Friday, 29 November 2013 16:20

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2

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**MALAYSIAN REAL ESTATE INVESTMENT TRUSTS (REITs)** with property in the city centre may see some impact on their bottom lines next year if a proposed assessment hike by Kuala Lumpur City Hall (DBKL) materialises.

Various reports have it that DBKL has proposed to increase the annual value of properties, of which the assessment rate is based, by between 100% and 300%.

This will be another stumbling block for the property sector that was also on the receiving end of cooling measures announced in the recent Budget 2014 such as higher real property gains tax.

There have been many complaints since the news broke last week, but DBKL has yet to provide clarity on the matter. Attempts made by The Edge to contact DBKL were unsuccessful.

For REITs, a higher assessment would translate into higher operating expenditure, which would impact net profit, says an executive with a locally-listed REIT (see table).

Presently, residential properties are taxed at 6% and commercial ones at 12% on the annual value.

Industry players and property analysts believe that DBKL does not intend to raise the tax rates but rather, revise the valuation of properties on which the assessment tax is levied.

This implies that the expectation is for the annual value to be restated by as high as 100% to 300% on existing valuations.

"Those impacted will be existing projects where the market value has not been updated recently. So, newer developments should be fairly insulated," an analyst with a local research house tells The Edge.

Checks with REIT players reveal that many have already received their assessment statements for the first half of 2014. This tax will be payable in February 2014.

"From the statements we have collected so far, there seems to be an increase ranging from 25% to 300% on annual valuations," an executive with a locally-listed REIT tells The Edge.

But she notes that such increases vary from lot to lot and requires a complex process to evaluate its fairness. "We will have to evaluate and then we will definitely submit our objections to DBKL."

Analysts and industry players alike lament that such a move would be too drastic and would impact bottom lines negatively, suggesting that a progressive increase would be easier to stomach.

### Impact of assessment rate hike on profits (FY2012)

|                                  | SUNWAY REIT | PAVILION REIT | IGB REIT* | AXIS REIT |
|----------------------------------|-------------|---------------|-----------|-----------|
| Quit rent & assessments (RM mil) | 9.47        | 8.74          | 2.96      | 0.84      |
| Net property income (RM mil)     | 230.67      | 245.29        | 76.17     | 116.12    |
| Percentage (%)                   | 4.11        | 3.56          | 3.89      | 0.72      |

### Tenancy agreements to insulate earnings

However, a manager at another Bursa Malaysia-listed REIT believes that companies will only see minimal impact on earnings, attributing it to a common clause in most tenancy agreements. "The clause says that should utility or assessments increase, that cost can be



|                                                          |       |       |       |       |
|----------------------------------------------------------|-------|-------|-------|-------|
| Minimum scenario – 100% hike                             | 18.94 | 17.48 | 5.92  | 1.674 |
| Maximum scenario – 300% hike                             | 37.88 | 34.96 | 11.84 | 3.348 |
| Minimum scenario – percentage of net property income (%) | 8.21  | 7.13  | 7.77  | 1.44  |
| Maximum scenario – percentage of net property income (%) | 16.42 | 14.25 | 15.54 | 2.88  |
| * Based on half year financial data                      |       |       |       |       |

transferred to the tenant," he tells The Edge. "So, we should be able to transfer the additional cost. Thus, it will not affect net profits and dividends significantly."

"In the case of Axis REIT, there is a provision in our tenancy or lease agreements where we can recover any increase in our assessment from our

tenants should it be raised by the local councils," says Stewart Labrooy, chief executive and executive director of Axis REIT. As such, he says it will not impact Axis REIT.

Labrooy is also chairman of the Malaysian REIT Managers Association (MRMA).

"As chairman of the MRMA, I assume that the other REITs have a similar practice," he says, adding that therefore the proposed assessment hike is projected to have minimal impact on the sector's operations.

Similar clauses are applied to the Goods and Services Tax (GST) that will be implemented in 2015, he adds.

Labrooy concedes, however, that a hike in assessments would increase the overall cost of doing business and could add to the burden of inflation.

Similarly, another REIT manager says that even with such clauses in the tenancy agreements, the cost cannot simply be passed on to tenants without considering their ability to absorb it. "Don't forget when GST comes into play, that is an extra cost that tenants will look to pass on to consumers and I don't know whether consumers are able to take it," she adds.

"If the cost for tenants to occupy a space is too high, then they may not be able to sustain [the business] and that might backfire [on us] if they are unable to renew the tenancy agreements," the manager warns.

#### How the assessment works

The assessment tax rate is levied on the annual value of a property on a semi-annual basis.

"This annual rental value is determined by the Valuation and Property Services Department of the Ministry of Finance," explains Labrooy. "The local authorities then apply the valuations made by the department to set the assessment rates in their areas."

These rates vary for different types of residential properties in different localities and is payable in two instalments annually.

DBKL has the right to review the assessment once every five years but has not done so for 21 years. The chargeable rates are at the discretion of the local councils as long as the rates are less than 35%.

"It appears that DBKL has not exercised the right to review the assessments for over 20 years, which is baffling, as it is normally tied into the cost of providing the required services to the communities in their jurisdiction, which has been on a steady rise over the last 20 years," says Labrooy.

This article first appeared in *The Edge Malaysia Weekly*, on November 25, 2013.

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