



COVID-19: Valuing real estate amid uncertainty

Economic uncertainty during the COVID-19 outbreak is having an unprecedented impact on global real estate valuations and the immediate need to provide accurate quarterly and fiscal year-end financials amid the volatility.

Making 'fair' assessments in today's unusual and fast-changing environment has become extremely challenging. Access to timely marketplace insights and informed guidance are vital for businesses struggling to navigate uncertainty and ensure continuity. We are assuring our clients that maintaining close collaboration — both across KPMG's global network of professionals and with the clients we serve every day — is a key priority.

We are working closely with our valuation specialists to share the steps they are taking and the insights they can provide amid the alarming decline in transactions and its effect on values. We are also maintaining close contact with real estate industry trade bodies such as the European Public Real Estate Association (EPRA) to closely monitor the evolving global picture and share recommended best practices.



Reporting financials

For companies producing 31 December 2019 financial statements, it's important to know that COVID-19 is to be considered a non-adjusting post balance sheet event. Companies will likely need to add explanatory text in the 'subsequent events' reporting section to describe the impact of the crisis. We are advising that businesses clearly assess and disclose, as appropriate, how the crisis is significantly affecting their ability to continue as a 'going concern.' Should there be doubt, an 'emphasis of matter' paragraph is to be added to the audit opinion.

As for Q1 2020 reporting, COVID-19 will certainly impact valuations and companies will need to provide, to the best of their ability, up-to-date property valuations. They should consider the following steps:

1 Question and understand how valuers are dealing with the current conditions. We have seen the

Royal Institution of Chartered Surveyors (RICS), for example, issue a statement advising the addition of an 'uncertainty clause' to valuation reports. And based on our communication with valuers, we believe this is likely to continue for the time being.

2 If, for a significant portion of the portfolio valuation, valuers include such clauses, we are advising them to include additional disclosure notes to the financial statement, explaining the uncertainty they face and outlining the procedures being used to support the valuations provided.

3 In such cases, the auditor will likely include an 'emphasis of matter' paragraph in their comments in order to emphasize above-normal risk in the current valuations.

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Addressing uncertainty

Our view is that if the valuer can determine a fair value but includes the 'material uncertainty' clause, then we are dealing with increased estimation uncertainty, which should be dealt with through enhanced disclosures that detail how the valuation was performed and the relevant factors involved.

Depending upon materiality, we would then see fit to include an 'emphasis of matter' in our audit report to highlight the current disclosures. We would expect an 'emphasis of matter' on all audit opinions where material uncertainty clauses are invoked and the balance is material.

All major valuers have indicated their intention to introduce a material uncertainty qualification for valuations dated 31 March 2020 and onward. While a value will still be provided, it will be accompanied by a caveat and we believe that this approach is being implemented globally for all RICS Red Book valuations.

One immediate consequence will possibly involve all UK open-ended RE funds — typically unit trusts that invest in commercial property and offer investors the ability to buy new units or redeem existing units on a daily basis. We believe that we can expect 'gating' to be implemented for these funds in order to restrict redemptions or new investments.



Rental income challenges

In today's uncertain real estate environment, rental income is also a pressing issue. The UK government announced on 1 April 2020 that all tenants of commercial and residential properties could effectively default on their rent without fear of landlords taking action to terminate leases. We expect that a significant number of tenants in the retail, leisure and hospitality sectors will take advantage of rent deferrals while their businesses are disrupted or closed. Meanwhile, much to their credit, some UK landlords have already offered rent holidays or deferrals and we are seeing similar initiatives in other countries to support tenants.

It's worth noting that most UK commercial leases require rent to be paid quarterly in advance, with the latest payment due 25 March 2020. Unfortunately, landlords with significant debt in place are likely to face cashflow challenges and potentially default on their debt as current rents remain unpaid. This scenario will potentially impact landlords' 'going concern' considerations for March year-end reporting. And it seems highly unlikely that conditions will improve to the extent that affected tenants will be able to pay the next round of rent due 24 June 2020.

Given these challenging times and the rapidly changing environment, our advice is to continue to stay agile and informed as the conditions continue to evolve on a daily basis. Should you have any questions, please don't hesitate to reach out to us or your local KPMG advisors.

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