Large impending office completions

Total supply of office space reached 119 million sq ft at the end of 1H/2017, meaning that Greater Kuala Lumpur (KL) is the largest office market (in terms of floor space) in Southeast Asia.

Despite weak demand, particularly for premium buildings which historically have been occupied by Oil & Gas (O&G) firms, supply will continue to grow at a rapid rate, especially within the Golden Triangle. Even the 1996-1998 completion of the Petronas Twin Towers clustered with Menara Maxis and Menara ExxonMobil (4.1 million sq ft) is lower than the amount of space being completed over the next 4 years in KL City, which will see the completion of above 6 million sq ft in the period of 2019 to 2021.

Some of these major incoming developments include the Merdeka PNB, a 118-floor mega-tower (predicted to be the world’s fifth tallest building upon completion), three plots within KLCC, as well as several plots in the Tun Razak Exchange (TRX).

TRX, which spans over 70 acres in the city centre, is set to become KL’s leading international financial and business district. It has been identified as a strategic priority for the country, and is supported by various incentives to encourage financial services firms to locate their activities there. TRX will house some of the highest quality office space in the country going forward. Indeed, development picked up in earnest earlier this year, with HSBC becoming the first foreign bank to invest in TRX, committing RM1 billion to the forward purchase of its future Malaysia head office and branch (transaction advised by Savills).

Affin Bank Bhd (and its subsidiaries), have also begun work on their future headquarters, while Prudential has committed to a long-term lease for its new Malaysian HQ. The TRX MRT station, which will be a dual-line interchange station, is planned to be the largest and busiest in the city. Line 1 is already operational, whereas Line 2 is under construction and scheduled for a 2022 completion. This level of activity has drawn investors such as Lembaga Tabung Haji and WCT Bhd into the project.

Vacancy rates on the rise

Greater KL is currently experiencing its highest office vacancy rates over a decade, at 21.5%, as of 1H/2017. This is largely attributable to the mounting new supply over the past five years.

Vacancy rates are expected to continue to trend upwards, owing to the slower take-up of office space. As such, Landlords have been feeling the pinch due to weak tenant demand. With the current depressed global oil prices and economic uncertainties, the O&G sector is unlikely to recover in the immediate term. The overall Malaysian economy, as well as the higher-grade office market, particularly in KL City, depends heavily on this industry.

There is already evidence of numerous buildings affected by office space contraction or repositioning of O&G activity over the last 24 months:

- ExxonMobil downsized and handed back 40% of space previously occupied in Menara ExxonMobil. The space has since been filled up.
- Aker Solutions has downsized and surrendered close to 75,000 sq ft of office space in Integra Tower.
- Hess Oil and Gas surrendered a floor of office space in Menara 3 Petronas, approximately 25,000 sq ft.
- Ranhill Holdings surrendered about 15,000 sq ft of space in Wisma Perkeso.

While the above represent only a fraction of companies in the industry, they are all well-known major players and their actions indicate consolidation.

Rental rates

Demand has been outpaced by supply over the past five years, which has resulted in stagnant rental growths in most submarkets. The average numbers are slightly puzzling because
many of the newer completions are of a much higher specification than older buildings, and are therefore fetching higher rents.

Even within the Golden Triangle, the city’s leading office market, there exists a submarket which stands all on its own, comprising of the Petronas Twin Towers, Menara Maxis, and Menara 3 Petronas. Of these, the Twin Towers are nearly completely occupied by Petronas and Khazanah only; Menara 3 Petronas is only now starting to see some vacancies as a result of its location, which allows it to be the “next best option” for tenants unable to secure space in the other three towers. KLCC is popular as an office zone for the O&G sector, which has traditionally paid the highest rents of any industry in Malaysia, thanks to its demand drivers and complementary real estate uses within the integrated development.

Outside of this highly unique submarket, the only office building that averages over RM8 psf per month is Integra Tower. Located within the Intermark, this building offers some of the highest office building specifications of any building in the country. 

Only these top offices managed to attain premium rental rates, with the remaining Grade A buildings in KL City generally grossing between RM6.00-8.00 psf. KL prime office rental rates remain amongst the lowest in the region and also globally. With rising vacancy rates in view, we expect further rental reductions, although landlords would prefer to increase rental incentives in the first instance.

**Changing dynamics of office space demand**

In 2015, the e-commerce industry contributed 5.4% of the country’s GDP. With the recent launch of the world’s first Digital Free Trade Zone that includes collaboration plans between China’s e-commerce giant, Alibaba Group with the Malaysian government in setting up a regional eFulfillment hub, it is anticipated that this industry will develop at an accelerated rate. E-commerce players will require quality office space in key locations to house their customer support, analytics and software-led operations. Presently, some leading top e-commerce players have already committed to purpose-built office space in KL such as Lazada Malaysia, Garena Malaysia, Alibaba Cloud, Fave and Zalora Malaysia.

The growth of e-commerce has also resulted in digital wallet advancement. The Malaysian government’s recent partnership with Alibaba has also led to group efforts between China’s Ant Financial Services Group, CIMB Bank and Maybank to explore opportunities in e-payment (e.g. Alipay barcode payment) and financing services in Malaysia. Assuming such mobile payment systems continue to flourish, we hope for increased office demand from similar “fintech” start-ups.

**Market outlook**

2017 saw three en bloc office transactions in Greater KL with a total investment value of RM926 million. Of particular note was the sale of Wisma Selangor Dredging, for RM480 mil. This calculated to RM1,323 psf; 29% premium over the reported market value, making it one of the highest psf transactions of office space in KL. Furthermore, on a land area basis, this works out to slightly above RM4,500 psf, which is also a benchmark.

During the same period, Menara Prudential was sold for RM125 million (RM758 psf), significantly lower than the 2011 acquisition price of RM142 million (RM962 psf), while the Employees Provident Fund (EPF) acquired The Ascent @ Paradigm in Kelana Jaya for RM321 million (RM621 psf); we note that EPF was JV partner in the development itself.

Besides economic issues (particularly for the O&G sector), the currency remains weak, and the political situation is somewhat ambiguous with general elections due to be called by 2018. These factors may have an adverse impact on business confidence and thereby effect investment in future business growth.

However, e-commerce penetration in Malaysia could continue to grow thanks to new-fangled government impetus policies. Coupled with the bourgeoing of co-working spaces, driven by the trend of millennials who prefer to work in a flexible and collaborative work environment, these influences denote a change from the traditional workplace demand, and could signal a positive revolution in the way we use space.

**TABLE 1**

<table>
<thead>
<tr>
<th>Building</th>
<th>Area (sq ft)</th>
<th>NLA (sq ft)</th>
<th>RM million</th>
<th>RM psf</th>
<th>Buyer</th>
<th>Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Ascent @ Paradigm</td>
<td>Selangor</td>
<td>516,633</td>
<td>321*</td>
<td>621</td>
<td>EPF</td>
<td>Jelas Puri Sdn Bhd (a 70:30 JV between WCT Land Sdn Bhd and EPF)</td>
</tr>
<tr>
<td>Menara Prudential</td>
<td>Kuala Lumpur</td>
<td>164,706</td>
<td>125</td>
<td>756</td>
<td>KL 33 Properties Sdn Bhd (a subsidiary of Plaza 33 Sdn Bhd)</td>
<td>OCBC Properties (M) Sdn Bhd</td>
</tr>
<tr>
<td>Wisma Selangor Dredging</td>
<td>Kuala Lumpur</td>
<td>362,782</td>
<td>480</td>
<td>1,323</td>
<td>Golden Eagle Realty Sdn Bhd (a subsidiary of Nation Venue Sdn Bhd)</td>
<td>Selangor Dredging Bhd</td>
</tr>
</tbody>
</table>

*excluding the elevated car parks"