

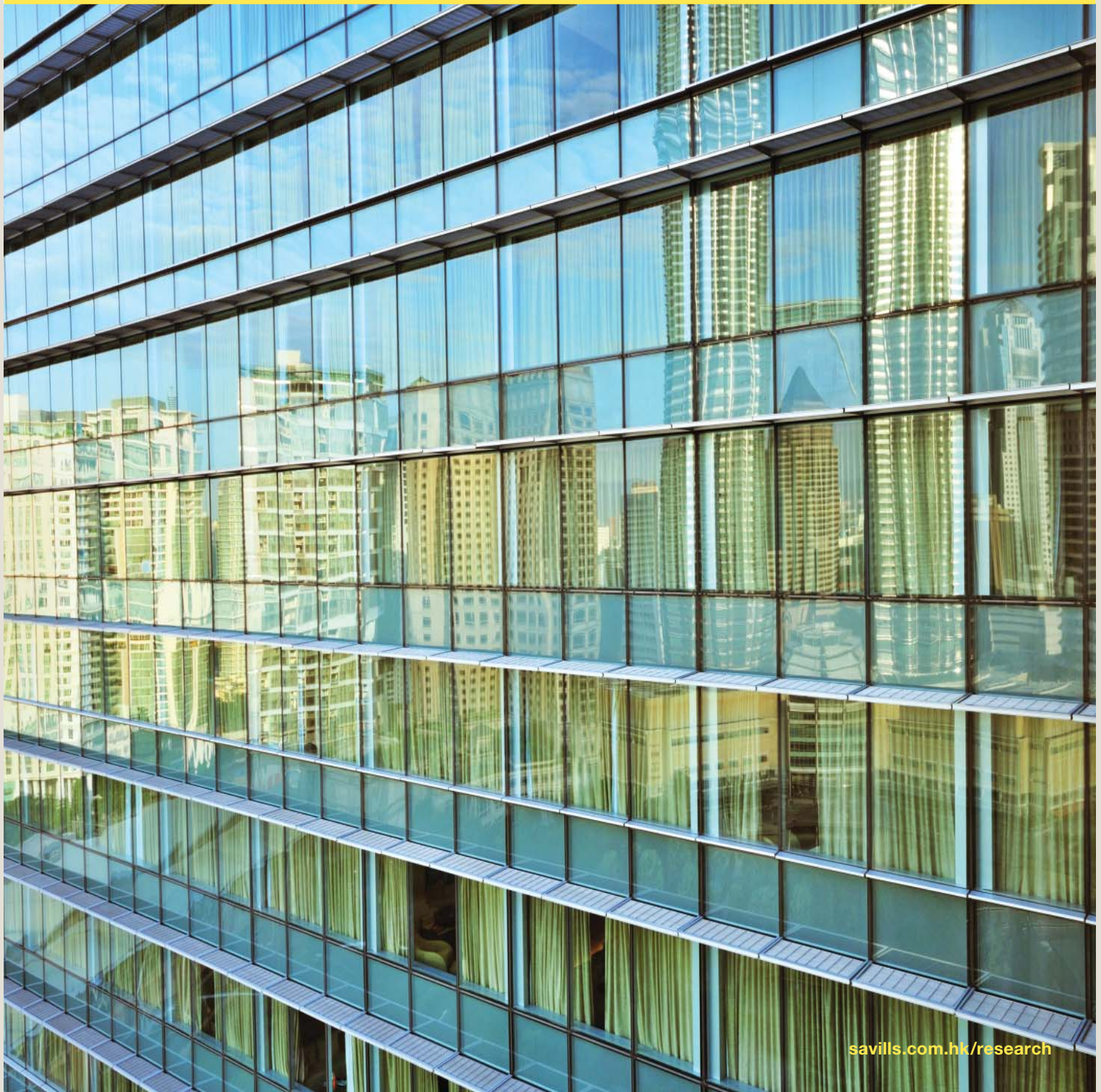


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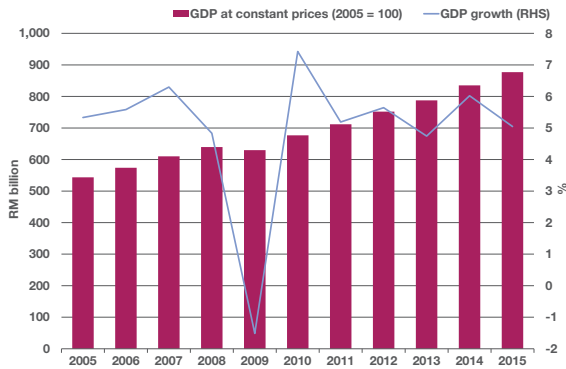
Asian Cities Report **Kuala Lumpur Office**

1H 2016



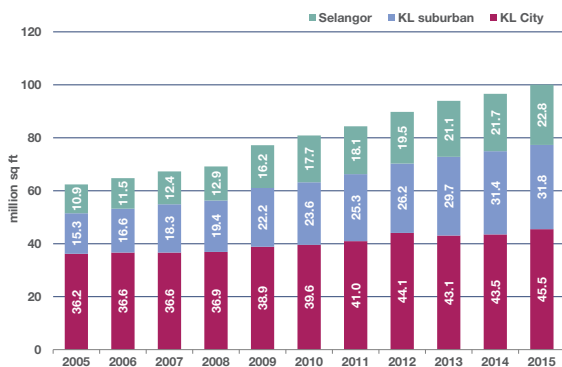
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GRAPH 1
GDP and growth rate, 2005–2015



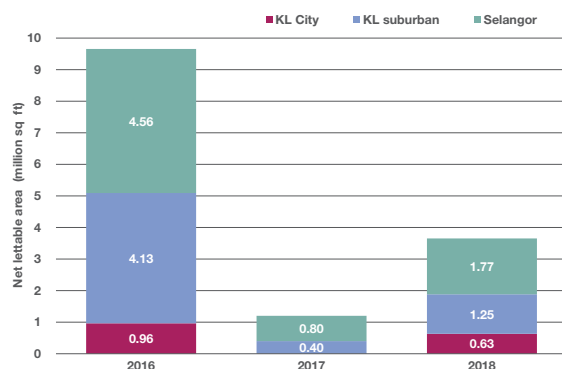
Source: Bank Negara Malaysia

GRAPH 2
Greater KL office stock, 2005–2015



Source: Savills Research Malaysia

GRAPH 3
Greater KL office stock forecast, 2016E–2018E



Source: Savills Research Malaysia

Boundary of Greater Kuala Lumpur

Greater Kuala Lumpur is defined as the combination of Kuala Lumpur City, Kuala Lumpur suburban and Selangor. Kuala Lumpur City (KLC) comprises the Golden Triangle (GT) and Central Business District (CBD). Suburban Kuala Lumpur refers to the KL city fringe areas such as Damansara Heights, Bangsar, KL Sentral/Brickfields, Mid Valley, Pantai/Kerinchi, Mont Kiara, and KL North. Selangor encompasses the geographical state boundary, encircling the towns of Petaling Jaya, Shah Alam, Klang, Seri Kembangan, Puchong and Subang Jaya among others.

Economic overview

Malaysia's real gross domestic product (GDP) registered a growth of 5.0% in 2015 compared with 6.0% in 2014 and 4.7% in 2013. This is also within the Ministry of Finance's 2015 real GDP growth forecast of 4.5% to 5.5%. This was largely accounted for by domestic demand. The recalibrated Budget 2016 has targeted a revised growth of 4.0% to 4.5% in 2016. According to Bank Negara Malaysia, growth in 2016 is expected to be driven by domestic demand with support from net exports.

Due to the reduced fixed asset spending by the Federal Government, the public investment growth dwindled from 1.8% in Q3/2015 to 0.4% in Q4/2015. Nevertheless, public consumption recorded a sustained growth of 3.3% when compared with the previous quarter (Q3/2015: 3.5%). This was due to higher emoluments, which outpaced a slower growth in the supplies and services expenditure.

During Q4/2015, private consumption grew by 4.9% compared with 4.1% in the previous quarter, supported by stable wage growth and labour market conditions. During the same period, private investment expanded by 5.0%, driven by capital spending in the manufacturing and services sectors. Consumer spending is expected to be subdued due to the effects of the Goods and Services Tax (GST) implementation which was introduced in April 2015, together with lower crude oil prices and a weaker Ringgit that is expected to impact negatively on Malaysia's near-term growth prospects resulting in a decrease in its current account surplus.

Market supply

The cumulative stock of office space (all grades) in Greater Kuala Lumpur as at Q4/2015 stands at approximately 100.1 million sq ft of net lettable area (NLA). Out of this supply, 45.5 million sq ft is located in KL City, followed by KL Suburban at 31.79 million sq ft and Selangor at 22.8 million sq ft. 2H/2015 saw seven completed new office developments in Greater KL with an additional 3.10 million sq ft of office space. Approximately two-thirds of the new supply is located in KL Suburban (i.e. Q Sentral, The Vertical Block 1 & 2 and Menara Guocoland), followed by 29.0% from KL City (The Crest, Ilham Tower and Trillion KL) and 3.3% in Outer KL (IDCC Corporate Office Tower).

It is estimated that a substantial impending office supply of at least 18 developments, representing 9.65 million sq ft of NLA, will be completed in Greater Kuala Lumpur by the end of 2016. Most of these buildings are located in KL suburban (42.8% of total net lettable area) and Selangor (47.3% of total net lettable area) with the remaining 10.0% of total NLA in KL City. Some of the large-scale developments topping the list include UOA Business Park (formerly Kencana Square) and Phase 2 of The Vertical @ Bangsar South as well as the Phase 1 of KL Eco City by SP Setia.

On the contrary, 2017 will only see three new office developments, accounting for about 1.20 million sq ft of NLA. These are Phase 2 of KL Eco City in KL suburban as well as the office developments @ Pacific Star and HCK Tower @ Empire City in Selangor.

Upon review of the proposed buildings which are still being planned and those under-construction, the current forecast reveals that a total of over 3.65 million sq ft of office space would be completed in 2018. However, a few of these have been in the planning stages for a number of years now, and may not be implemented or will be delayed.

Vacancy, absorption & leasing activity

The vast office completions in 2015 pushed up the overall vacancy rate in Greater KL to 17%, the highest seen in the past 15 years. This was primarily

impelled by the slower take-up of new office space completed in KL City. Moreover, the supply growth in KL Suburbs has also benefited tenants with far more choices than in the past, with most companies which may now choose to locate their shared services, back office or secondary space to the outskirts of the city centre.

The market absorption in KL (excluding Selangor) was much less active in 2015, compared with the past three years. Only 1.12 million sq ft of Grade A offices was taken up in 2015, approximately 50% of the average annual absorption recorded from 2012 to 2014.

Low global oil prices, along with the sluggish financial markets in particular the banking industry has triggered a revision or consolidation of office space requirements for the affected tenants, as part of their cost-cutting measures. ExxonMobil is reportedly looking at shedding up to half of its space upon the expiry of its tenancy agreement with KLCCP in January 2017. Financial institutions such as RHB Cap, CIMB Group and Hong Leong Bank have also recently trimmed their workforce, signalling a possible downscaling of their office space as well.

To date this year, the leasing market witnessed some relocations by corporations from across different sectors such as engineering, manufacturing and pharmaceuticals. The French Embassy, which sold its coveted 7.98-acre land parcel along Jalan Ampang, relocated to Integra Tower during the review period. Other industries which underwent expansions include the insurance, IT and property development companies which have all required additional floor space.

Rental market

Over the last 10 years, the average asking rents for selected office buildings in Greater Kuala Lumpur have increased at a gradual pace, with the exception of a substantial rise in 2008, when vacancy rates were at their lowest for the decade.

A noteworthy observation of the Greater Kuala Lumpur office market reveals an apparent lack of pronounced cycles and volatility

which seem are evident in the more developed office markets regionally, such as Singapore, Hong Kong and Tokyo. Even developing markets such as Manila and Ho Chi Minh City have shown greater volatility over the past 10 years.

Instead, the rent cycle formation of Greater KL's office market shows an approximate stepped plateau shape, with lengthy periods of very gradual growth (CAGR of 3.4% over 10 years from 2005 to 2015). As such, office tenants and investors are typically not able to take advantage of the benefits which can come from correctly 'predicting' office cycles.

In 2015, asking rents in certain areas, especially in the Selangor and KL Suburbs, rose slightly while those in the city-centre areas, both CBD and GT, decreased. Overall, landlords appear to be unable to pass on the increase in costs due to inflation and GST to tenants in this highly competitive market, resulting in reduced net returns experienced by the landlord.

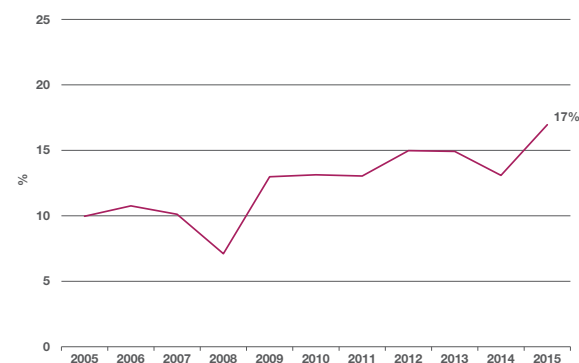
Office investments

Major property transactions were more limited during 2H/2015 when compared with 1H/2015. A couple of significant acquisitions includes the stratified Office Tower A @ Damansara City by Hong Leong Group (for RM582 million or RM1,150 per sq ft) and Menara Shell en bloc by MRCB-Quill REIT (for RM640 million or RM1,188 per sq ft), which are both located in KL's fringes. 2015 recorded at least 13 office buildings transactions for a total investment sum of RM4.36 billion.

Market outlook

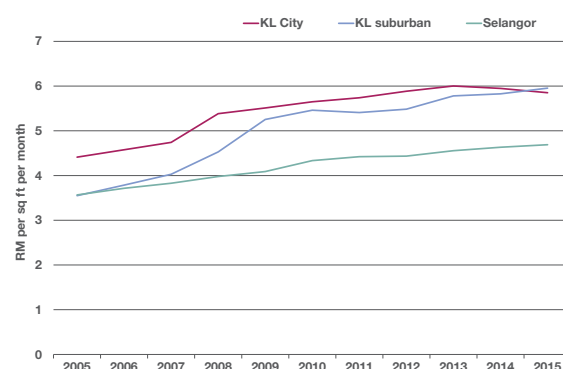
Demand for offices is traditionally driven by the oil & gas and finance sectors which typically require extensive office space located in the central or strategic areas of KL City. However, in the wake of declining crude oil prices, the oil & gas and financial players remain cautious about expanding or relocating in 2016. The vast upcoming supply of office developments over the next three years is of concern, with the overall vacancy rate expected to see an ascending trend. ■

GRAPH 4 Greater KL office vacancy rate, 2005–2015



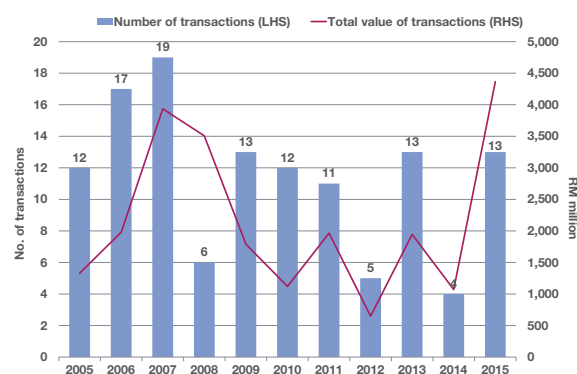
Source: Savills Research Malaysia

GRAPH 5 Greater KL office gross asking rents, 2005–2015



Source: Savills Research Malaysia

GRAPH 6 Major office building transactions in Greater KL, 2005–2015



Source: Savills Research Malaysia

ASIA PACIFIC HEADQUARTERS

23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4400 Fax: (852) 2868 4386

Robert McKellar - CEO, Asia Pacific
Raymond Lee - CEO, Greater China
Chris Marriott - CEO, South East Asia
Christian Mancini - CEO, North East Asia
Charles Chan - MD, Valuation & Professional Services, Greater China



HONG KONG SAR

Savills (Hong Kong) Limited

23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4534 Fax: (852) 2869 6738
Contact: Raymond Lee E-mail: rlee@savills.com.hk
EA Co. Licence: C-002450

Savills Valuation and Professional Services Limited

28/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2801 6100 Fax: (852) 2501 5810
Contact: Charles Chan E-mail: ccchan@savills.com.hk
EA Co. Licence: C-023750

Savills Property Management Holdings Limited

8/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2534 1628 Fax: (852) 2508 1883
Contact: Johnnie Chan E-mail: jckchan@savills.com.hk
EA Co. Licence: C-002955

Savills Guardian (Holdings) Limited

7/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2512 1838 Fax: (852) 2887 3698
Contact: Peter Ho E-mail: peterho@savillsguardian.com.hk
EA Co. Licence: C-004089

MACAU SAR

Savills - Macau

Savills (Macau) Limited
Suite 1309-10, 13/F Macau Landmark, 555 Avenida da Amizade, Macau
Tel: (853) 8506 6288 Fax: (853) 2878 1805
Contact: Franco Liu E-mail: fliu@savills.com.mo

CHINA

Savills - Shanghai

20/F Shanghai Central Plaza, 381 Huaihai Middle Road, Shanghai 200020, China
Tel: (86) 21 6391 6688 Fax: (86) 21 6391 6699
Contact: Albert Lau E-mail: Albert.Lau@savills.com.cn

Savills - Beijing

2101 East Tower, Twin Towers, B-12 Jianguomenwai Avenue, Chaoyang District
Beijing 100022, China
Tel: (86) 10 5925 2288 Fax: (86) 10 5925 2299
Contact: Billy Chau E-mail: Billy.Chau@savills.com.cn

Savills - Guangzhou

Room 906, R & F Centre, 10 Hua Xia Road, Zhu Jiang New Town
Guangzhou, 510623, China
Tel: (86) 3892 7168 Fax: (86) 3892 7030
Contact: Woody Lam E-mail: Woody.Lam@savills.com.cn

Savills - Shenzhen

Unit A, 5/F, Anlian Plaza, 4018 Jintian Road, Futian District, Shenzhen 518026, China
Tel: (86) 755 8828 5707 Fax: (86) 755 8828 5676
Contact: Woody Lam E-mail: Woody.Lam@savills.com.cn
Offices in Chengdu, Chongqing, Dalian, Hangzhou, Nanjing, Qingdao, Shenyang, Tianjin, Xiamen, Zhuhai

ASIA

Savills - Indonesia

PT Savills Consultants Indonesia
Panin Tower – Senayan City
16th Floor, Unit C
Jl. Asia Afrika Lot. 19
Jakarta 10270, Indonesia
Tel: +62 (21) 293 293 80 Fax: +62 (21) 293 293 81
Contact: Jeffrey Hong Email: jeffrey.hong@propertyconnection.co.id

Savills - Japan

Savills Japan Co., Ltd
15/F Yurakucho ITOCiA
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: (81) 03 6777-5150 Fax: (81) 3-6777-5105
Contact: Christian Mancini E-mail: cmancini@savills.co.jp

Savills - Korea

Savills Korea
13/F Seoul Finance Center, 84 Taepyungro-1-ga
Chung-gu, Seoul, Korea 100-768
Tel: (82) 2 2124 4201 Fax: (82) 2 2124 4188
Contact: K.D. Jeon E-mail: kdjeon@savills.co.kr

Savills - Malaysia

Savills (Malaysia) Sdn Bhd
Level 9, Menara Milenium, Jalan Damanlela, Bukit Damansara
50490 Kuala Lumpur, Malaysia
Tel: +603 2092 5955
Contact: Christopher Boyd Email: chris.boyd@savills.com.my

Savills - Myanmar

Savills Myanmar Limited
192 Bo Myat Htun Street (Middle Block)
Pazundaung Township, Yangon, Myanmar
Tel: +95 1 122 3341
Contact: Richard Emerson Email: remerson@savills.asia

Savills - Philippines

KMC MAG Group
8/F Floor Sun Life Centre, 5th Ave
Bonifacio Global City 1634, Philippines
Tel: (632) 403-5519
Contact: Michael McCullough Email: michael@kmcmaggroup.com

Savills - Singapore

Savills (Singapore) Pte Ltd.
30 Cecil Street, #20-03 Prudential Tower, Singapore 049712
Tel: (65) 6836 6888 Fax: (65) 6836 2668
Contact: Chris Marriott E-mail: cjmarriott@savills.asia

Savills - Taiwan

Savills (Taiwan) Limited
17F-1, Exchange Square, 89 Sung Ren Road
Xin-Yi District, Taipei, Taiwan
Tel: (886) 2 8789 5828 Fax: (886) 2 8789 5929
Contact: Cynthia Chu E-mail: cchu@savills.com.tw
Office in Taichung

Savills - Thailand

Savills (Thailand) Limited
26/F Abdulrahim Place, 990 Rama IV Road
Silom, Bangkok, Bangkok 10500, Thailand
Tel: (66) 2 636 0300 Fax: (66) 2 636 0339
Contact: Robert Collins E-mail: rcollins@savills.co.th
Office in Pattaya

Savills - Vietnam

Savills Vietnam Ltd. Co.
18/F, Fideco Tower, 81-85 Ham Nghi Street
District 1, Ho Chi Minh City, Vietnam
Tel: (84) 8 3823 9205 Fax: (84) 8 3823 4571
Contact: Neil MacGregor E-mail: nmacgregor@savills.com.vn
Office in Hanoi

AUSTRALIA

Savills - Australia

Savills (Aust) Pty Ltd.
Level 7, 50 Bridge Street, Sydney, Australia
Tel: (61) 2 8215 8888 Fax: (61) 2 8215 8899
Contact: Paul Craig E-mail: pcraig@savills.com.au
Offices throughout Sydney, Parramatta, Canberra, Melbourne, Notting Hill, Adelaide, Perth, Brisbane, Gold Coast and Sunshine Coast.

NEW ZEALAND

Savills - New Zealand

Level 8, 33 Shortland Street, Auckland NZ 1010
Tel: (64) 9 951 5910 / (64) 9 951 5911
Contact: Doug Osborne E-mail: dosborne@savills.co.nz
Contact: Paddy Callesen E-mail: pcallesen@savills.co.nz

NORTH AMERICA

Savills - New York

Savills Studley
399 Park Avenue, 11th Floor, New York, NY 10022
Tel: (1) 212 326 8610 Fax: (1) 212 326 1034
Contact: Mitchell Steir E-mail: msteir@savills-studley.com

UNITED KINGDOM / EUROPE / SOUTH AFRICA

Savills - Europe

33 Margaret Street, London W1G 0JD
Tel: (44) 207 499 8644 Fax: (44) 207 495 3773
Contact: Jeremy Helsby E-mail: jhelsby@savills.com
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