

Asian Cities - 2H 2022

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SPOTLIGHT
Savills Research

Kuala Lumpur Offices



Flight-to-quality persists in the Greater KL office market

ECONOMY

2022 witnessed the relaxation of COVID-19 restrictions and the reopening of various economic sectors as Malaysia transitioned to the endemic phase. As a result, the Gross Domestic Product (GDP) in Q3/2022 recorded a significant YoY growth of 14.2% to RM383.8 billion, an increase of RM47.6 billion from Q3/2021. Such accelerated growth rates will help in returning the economy to pre-pandemic levels, and noticeable

improvements in the labour market will positively encourage domestic demand. The unemployment rate in Q3/2022 stood at 3.7%, an improvement from Q3/2021 (4.7%). This translates to a YoY reduction of 134,400 unemployed persons from Q3/2021.

Malaysia's economic production gained momentum from the implementation of the National Recovery Plan (NRP) by the Government to mitigate the negative economic impact of COVID-19, which

translated into the significant upward trend recorded in the nation's economic performance. In this case, the services sector remained the biggest contributor to the country's GDP at 57.9%, with a YoY growth rate of 16.7%. This is followed by the manufacturing sector, with a GDP share of 24.1% and a yearly growth rate of 13.2%. Overall, the positive GDP growth is supported by Budget 2022 provisions, coupled with the reopening of large areas of the economy and international borders.

NEW SUPPLY

As of Q3/2022, Greater KL has over 139 million sq ft of office space, a 1.7% YoY growth from Q3/2021. Most of Greater KL's office space is in WP Kuala Lumpur, amounting to 67% (93.5 million sq ft) of the total. By the end of 2022, cumulative office space is projected to reach 141 million sq ft.

Overall, five new office building completions were recorded in the first nine months of 2022, led by 1.41 million sq ft from three new buildings within KL City – The Stride Strata Office @ BBCC, Menara Affin @ TRX and Pavilion Embassy Corporate Suites. Meanwhile, two new completions with a total area of 0.51 million sq ft were observed in Outer KL/ Selangor, i.e. Menara KWSP @ Kwasa Damansara and Corporate Suite @19, Sunway Resort Hotel Annexe.

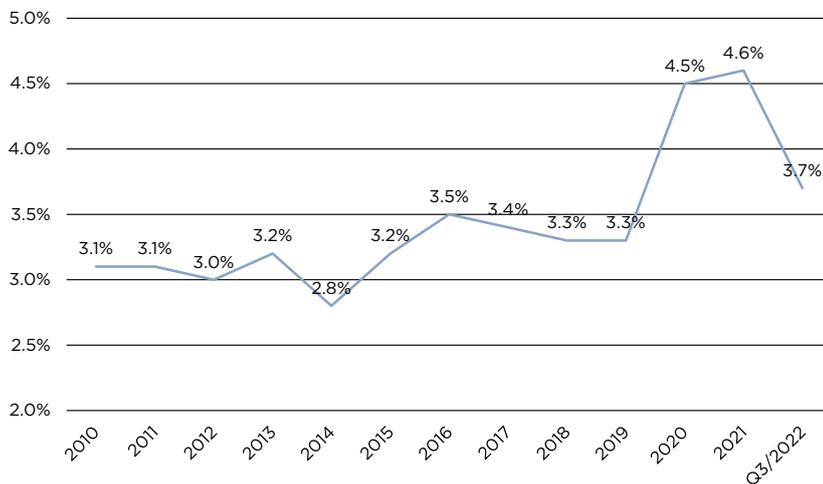
Current projections call for as much as nine million sq ft in Greater KL by 2024, equal to another 3.6% growth from existing supply in Q3/2022; 81% (7.3 million sq ft) of this new space is located in WP Kuala Lumpur.

VACANCY RATE

Vacancy rates of Grade A office space in WP Kuala Lumpur stood at 26.4% in Q3/2022, with an overall rate of 26.9% in Greater KL, a slight decrease of -1.1% from a year ago (27.2% in Q3/2021). Notable tenant movements during the review period included the relocation of KWSP (also known as EPF or Employee's Provident Fund) from its older downtown KL HQ to the purpose-built, newly completed, 0.48 million sq ft Menara KWSP in Kwasa Damansara.

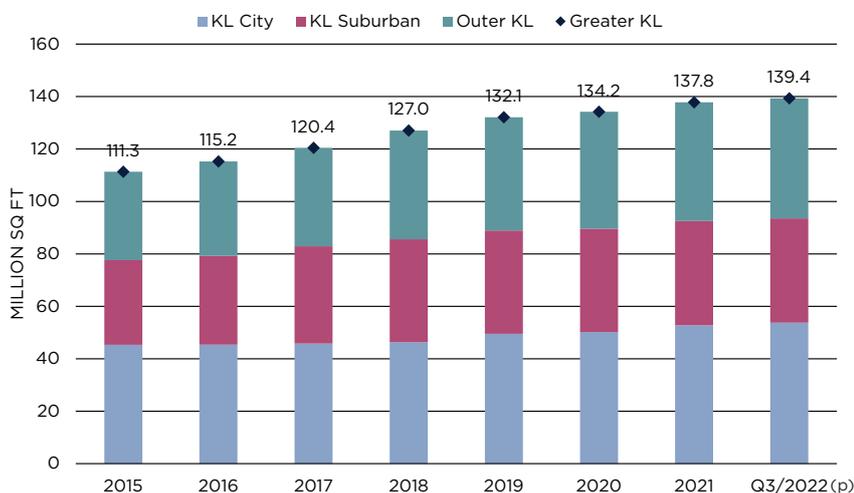
Overall, Grade A vacant space available for lease in Greater KL amounted to 15.5 million sq ft in Q3/2022. Of the newly-completed buildings, Menara KWSP @ Kwasa Damansara and Menara Affin @ TRX in Greater KL both registered over 70% occupancy. As leasing income continues to pick up, vacancy rates are expected to moderate further in the near term.

GRAPH 1: Malaysia Unemployment Rate, 2010 to Q3/2022



Source Department of Statistics Malaysia (DOSM)

GRAPH 2: Office Stock by Region in Greater KL, 2015 to Q3/2022



Source Savills Research
*(p) preliminaries

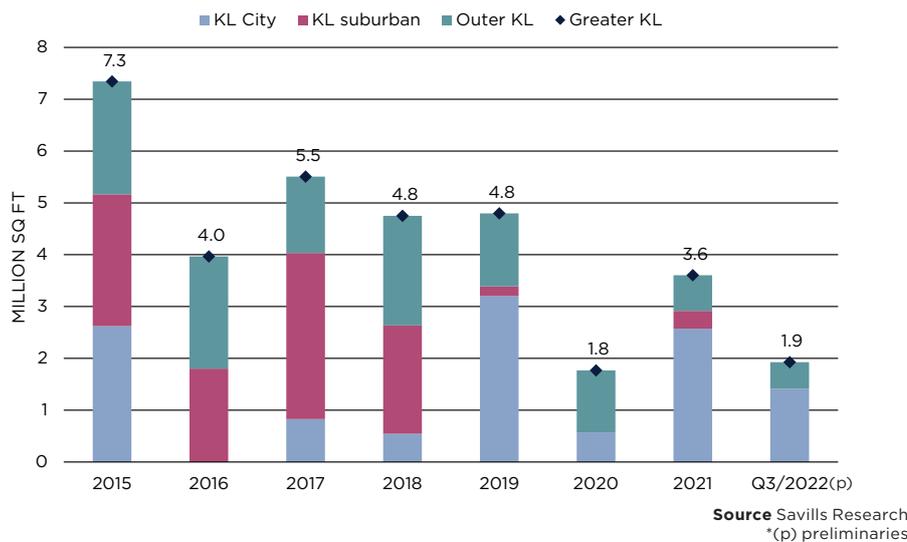
RENTAL RATES

Although WP Kuala Lumpur’s prime office gross asking rents have remained relatively stable at around RM8.40 per sq ft since 2015, rental incentives offered to tenants have increased substantially over the past three years.

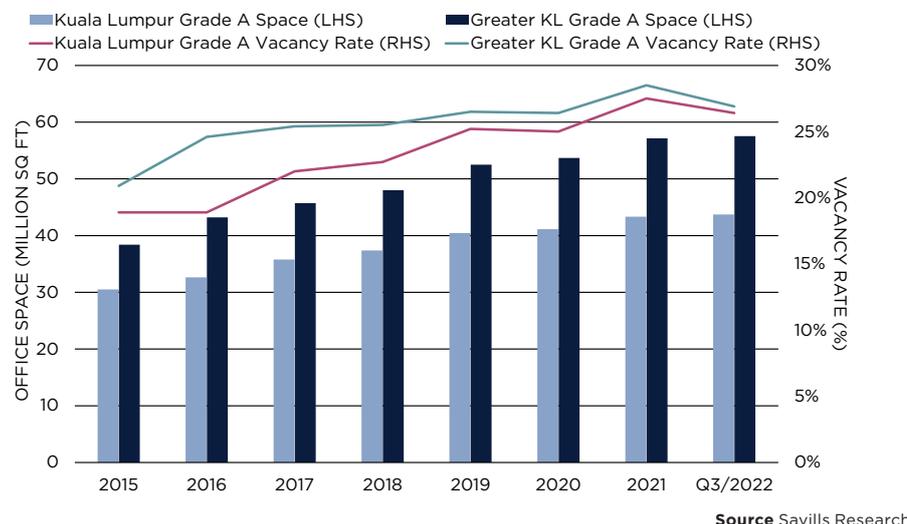
For all grades of office space, the gross asking rental in WP Kuala Lumpur was recorded at RM5.90 per sq ft in Q3/2022, equivalent to a slight YoY increase of 1.8% in Q3/2022. The sustained growth in supply over the past few years, coupled with weaker demand, especially from the oil and gas sector, has led to a situation where tenants are able to demand very attractive incentives from landlords in the event they relocate. Landlords are therefore faced with the challenges of maintaining their income streams as they are forced to offer competitive rental rates with generous rental

It will take some time to overcome the structural imbalances in the Greater KL office market, and tenants will continue to enjoy favourable leasing conditions in the interim. We expect to continue to see a flight-to-quality, with the success or failure of the newly-installed Prime Minister and his government one of the key factors impacting the prospects for the office sector in the near term.

GRAPH 3: New Office Supply by Region in Greater KL, 2015 to Q3/2022



GRAPH 4: Grade A Office Supply and Vacancy in Greater KL & Kuala Lumpur, 2015 to Q3/2022



waivers and rent-free periods, all as inflation continues to be a concern and the costs of doing business are increasing at the same time.

CAPITAL VALUES & INVESTMENT

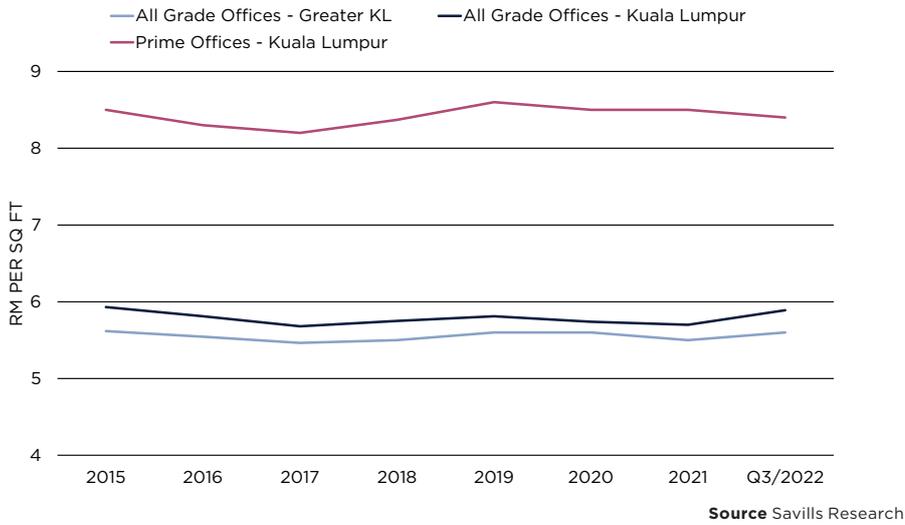
In terms of the office investment market, we saw a number of smaller transactions take place during the first nine months of 2022. Seven en-bloc offices with a total combined Net Lettable Area (NLA) of 0.87 million sq ft were transacted for a total combined value of RM571 million during this period.

The highest transaction in value terms was recorded in Q2/2022, with the disposal of Quill 9 to Neo Platinum Berhad, which is an SPV which seeks to securitise real estate, at RM200 million (RM715 per sq ft). Other notable transactions include the acquisition of Bangunan KWSP Kuala Lumpur for RM62 million by TIME DotCom Berhad’s wholly owned subsidiary, AIMS Data Centre Sdn Bhd, to expand their operational facilities by repurposing the building into a data centre. Additionally, Q2/2022 also saw the disposal of Bangunan AHP in TTDI by Amanahraya Trustees Berhad for RM86 million.

MARKET OUTLOOK

We have seen an increase in office leasing activity during the first nine months of the year, albeit in the form of very tenant-friendly deals in most cases. With a new Prime Minister named during the last week of November 2022, and a Cabinet line-up expected to be unveiled soon, it is hoped that this will lead to an improvement in economic conditions and investor sentiment, which over time is expected to lead to greater demand for office space from local Malaysian and foreign companies.

GRAPH 5: Average Office Asking Rents in Greater KL, 2015 to Q3/2022



As of 9M 2022, most corporate occupiers are either back in the office or have moved into hybrid or flexible working arrangements where employees are spending a greater portion of their time in the office than during the pandemic-affected years of 2020 and 2021; furthermore, with research from Savills and others appearing to confirm that instituting flexible working arrangements does not necessarily lead to proportional reductions in the demand for office space, prospects for the office market are much more positive than they were 12 or 24 months ago.

That being said, it is evident it will take some time to overcome the structural imbalances in the Greater KL office market, and tenants will continue to enjoy favorable leasing conditions in the interim. We expect to continue to see a flight-to-quality, with the success or failure of the newly-installed PM and his government one of the key factors which will impact the prospects for the sector in the near term.



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