THE EDGE

Shophouses in Jalan Bukit Bintang ... one of the megaprojects in the pipeline is the Bukit Bintang City Centre

Expect correction but market won't crash, say experts

BY **WONG MEI KAY**

A CIMB Research report last month stating that Malaysia's office construction boom — coupled with the flurry of government megaprojects such as the Tun Razak Exchange (TRX), Menara Warisan Merdeka and Bandar Malaysia — could lead to a Dubai-style property crash has sent shock waves through the industry.

The bursting of Dubai's property bubble circa 2009-2010 caused prices to plunge more than 50%, pushing the city close to a debt default. According to a recent report by Reuters, the market is recovering strongly this year, with apartment prices up about 20% from a year earlier, forcing the government to double the real estate transaction fee to fight speculation.

Asked about the report, the general consensus among industry observers is that "while the office market is certainly rather overcrowded and there is a need for landlords to brace themselves for some corrections in the future, we are definitely not on the path towards a crash".

However, most of the respondents polled by *City & Country* voiced concerns about the recent announcements of various megaprojects.

What the report said

According to the report, the office space glut is real and the overhang in commercial space in the Klang Valley deteriorated further in 2012 due to oversupply, holding back rental rates.

"Occupancy of office space in the Klang Valley fell for the fifth straight year in 2012 as the strong demand growth of 4.8 million sq ft was overwhelmed by the new supply of 7.8 million sq ft. Overall occupancy in the Klang Valley receded 1.2 percentage points to 79.8%," says CIMB.

The report estimates that around 17 million sq ft of gross office floor area will come on stream between 2015 and 2017, and adds that even if demand doubles, it won't absorb the influx.

CIMB Research says Dubai has an advantage over Kuala Lumpur because of the demand for office space from Fortune 500 companies already located there and strong tenancy levels of around 97% to 99%, compared with Kuala Lumpur's levels of around 80%.

According to the research house, the government is offering special incentives to the developers of TRX and to potential occupants to encourage relocation there when it is finished. This will widen the disparity between KL hot spots and other areas that are not privy to these incentives.

It also voiced concerns that local property developers are at risk of being crowded out if the government dishes out more incentives for property development and foreigners start to enter the local property scene in a big way.

"Our conclusion is that without the solid backing of fundamental demand, the overbuilding of commercial real estate could result in painful long-term issues, such as a magnified oversupply of office space, depressed rentals and yields, wastage of strategic land resources and knock-on effects on the financial sector as borrowers default on their loans and the industry's NPL (non-performing loan) ratio rises.

"Should the project be part-funded by government-guaranteed bonds and fail, the losses would hit the government's balance sheet and exert further pressure on overall public debt. A slowdown of these projects will help to lessen the impact on the country's current account balance," the report concludes.

Megaprojects: In the news

Last July, Prime Minister Najib Razak launched TRX as Kuala Lumpur's new financial district. The development has an indicative gross development value (GDV) of RM26 billion and is expected to attract over 250 global companies. It sits on a 70-acre parcel between Jalan Tun Razak, Jalan Sultan Ismail and the Putrajaya elevated highway.

LEE LAY KIN/THE EDGE

"The office market is healthy. Demand is still strong now." — Previn

In April, 1Malaysia Development Bhd (1MDB) awarded a contract worth RM169.26 million to WCT Bhd for earthworks and substructure works at TRX. The first phase of TRX is scheduled for completion in 2017.

In the same month, KLCC (Holdings) Sdn Bhd and Qatari Diar Asia Pacific Ltd announced that they will jointly develop the fourth phase of the KLCC master plan under a joint-venture company named Cititower Sdn Bhd. The project is a mixed-use commercial development with an estimated GDV of more than RM5 billion. The four-acre development will have a floor area of more than 3.8 million sq ft and will house a luxury hotel, a 64-storey office tower, a six-storey retail podium and a basement car park. The development is expected to be completed by end-2017 too.

It was also in April when 1MDB appointed a global team in partnership with local planners to develop Bandar Malaysia in Sungai Besi. This will be led by master planner Broadway Malyan and supported by design and engineering teams from Arup and Sinclair Knight Merz, in collaboration with local planner Arah Rancang Malaysia.

Last month, Najib announced an additional RM4.2 billion worth of opportunities for bumiputera companies to participate in four megaprojects — Menara Warisan Merdeka, Bukit Bintang City Centre (BBCC) (the former Pudu Jail), development of the Rubber Research Institute (RRI) land in Sungai Buloh and the Malaysia External Trade Development Corporation (Matrade) Exhibition Centre.

Of the four projects, some are already being implemented — such as the Matrade Exhibition Centre — while Menara Warisan Merdeka is still in the preliminary stage with the timeline being determined.

The 13.1-acre Matrade Exhibition Centre, launched in October 2011, is part of the RM15 billion KL Metropolis by Naza TTDI Sdn Bhd, which will span 75.5

CONTINUES ON PAGE 11

'Major projects take a long time to complete'

FROM PAGE 6

acres. The overall development is expected to be completed by 2025. The first phase will include residential and office towers and a regional retail centre slated for completion in 2015 and the Matrade Centre, to be completed the following year.

For the BBCC project, it is in the request-for-proposal stage, while the development of the RRI land is expected to start soon.

Recently, UDA Holdings Bhd reported that it is negotiating with several parties, including the Employees Provident Fund, Kumpulan Wang Persaraan, Permodalan Nasional Bhd and Malaysian Resources Corp Bhd, to jointly redevelop the 34-year-old Bukit Bintang Plaza. The development project is expected to cost between RM700 million and RM800 million. UDA is also behind the redevelopment of the iconic Pudu Jail, which will make way for seven blocks of buildings for commercial and residential use, including office towers, a hotel and a shopping complex. The estimated GDV of BBCC is RM6 billion to RM6.5 billion.

The 2,000-acre RRI land, purchased last year by EPF subsidiary Kwasa Land Sdn Bhd, is currently awaiting approval from the Selangor government. The site will make way for a township similar to Cyberjaya or Iskandar Malaysia.

Plans to build a 100-storey Menara Warisan Merdeka (later revised to 118 storeys) was announced during the Budget 2011 speech. It will be built by Permodalan Nasional Bhd, with a budget of RM5 billion.

What the developers say

An industry source, who is a private developer and the owner of a office building in the Kuala Lumpur central business district, says he understands that the government has already started taking steps to ensure that most of the space in TRX will be filled up upon completion.

Several government agencies and government-linked companies (GLCs) received "orders" to move their offices to TRX about 1½ years ago, says the source.

"It doesn't make sense for the government to compete with the private sector. Instead, it should be trying to support us," he says, adding that the market is already competitive now.

He opines that such mammoth projects are counterproductive to the growth of the office market and that funds could have been channelled towards something else.

There is an office building in the Golden Triangle that is only about 40% occupied now, he points out.

With that said, however, he does not believe that there is an impending crash in the market.

Another developer says the talk of an impending oversupply had started three to four years ago. In spite of that, his new office towers have been doing well in recent years with 100% occupancy.

"The key is to build great products in good locations," he says. However, he does not plan to acquire any substantial landbank until more details about the megaprojects are officially released. "I fear the government's [megaproject] supply."

Refurbish to stay relevant

According to CBRE's Greater Kuala Lumpur MarketView 2013, the Kuala Lumpur office market (Golden Triangle and central business district) showed encouraging signs of life during the second quarter (2Q) with vacancy rates decreasing to 12.7% from 13.2% in 1Q, on the back of some notable leasing activity. An example would be an oil and gas firm leasing over 200,000 sq ft in Integra Tower.

However, the overall Greater Kuala Lumpur vacancy rate was 15%, up from 14.4% in the previous quarter. Although the vacancy rate in the suburban areas increased, those in outer Klang Valley showed improvement from 19.4% in 1Q to 17.8% in 2Q.

Overall, there was no change in the average gross asking and passing rents for selected grade A office space in the city, at RM8.10 and RM7.10 psf respectively, says Nabeel Hussain, associate director in CBRE's research and consultancy arm, during his presentation of the 2Q2013 report.

Meanwhile, Previn Singhe, group CEO and founder of Zerin Properties Sdn Bhd, rubbished claims of a potential crash.

"The office market is healthy. Demand is still strong now," says Previn. Although he is generally optimistic about the market, he does foresee a correction. But in the worst case scenario, it will be "nothing more than 10%", which does not equate to a crash, he adds.

New green buildings in prime locations will fare well, he says, adding that at the end of the day, location is still the key in this industry.

While government megaprojects such as the TRX will definitely cause supply to increase, these are major projects that will take a long time to complete, says Previn. So the increase in supply will be gradual, he explains, drawing comparison with previous successful megaprojects such as KLCC and Mid Valley.

According to Previn, with an incoming supply of about 10% per annum in the Klang Valley, owners of older office buildings may have to brace for a drop in occupancy and, maybe, rental rates.

"We foresee a drop of between 3% and 4% for older office space, especially if it has been around for more than 20 years," says Previn, adding that building owners have to consider upgrading their facilities and security features to remain relevant.

He believes building owners in the Klang Valley must analyse the market and try to find a gap to fill. It is also crucial to upgrade the three Ls — lift, lobby and lavatory.

There is also the option of converting the buildings into serviced residences.

'It's a tenants market now'

Knight Frank Malaysia managing director Sarkunan Subramaniam believes that while the office market will face some tough years ahead, calling it a "Dubai-like crash" is an exaggeration and is vastly sensationalised.

ABDUL GHANI ISMAIL/THE EDGE

"Maintaining good rapport with the tenants is important towards the continuous success of a building" — Sarkunan

"With the impending high supply of space in the city centre and city fringes, it is inevitable that there will be mounting pressure on occupancy and rental rates as the gap between supply and demand widens," says Sarkunan, in presenting *The Edge*/Knight Frank Kuala Lumpur Office Monitor for 2Q2013 recently.

In the same report, he cautions developers that continue to announce new projects with a large amount of office space to monitor the market closely, review their proposals from time to time, and engage in pre-leasing activities before starting the construction.

With regards to the CIMB Research report, Sarkunan says he has his concerns about 1MDB's bond-funded projects such as the TRX. The fund is payable within a short period of time, which is about five years. However, a project of such scale — such as Cyberjaya — will take about 15 to 20 years to complete. Secondly, the TRX is just going to add a lot more supply to the market, he adds.

"It's a tenants market now," he says, adding that some building owners are offering deals such as rent-free periods of up to six months.

He believes that landlords should change their attitudes and that there is an urgent need for the building managements to form a relationship with their tenants to understand the latter's needs and interests and hopefully address them.

According to Sarkunan, many landlords fall out of touch with their tenants after awhile and only follow up when it is time to renew the lease. Maintaining good rapport with the tenants is important towards the continuous success of a building in the long term, he points out.

First impressions matter. Buildings with add-on services such as concierge services and higher security will fare better, says Sarkunan.

He believes that there is still an opportunity in the market. "Only 8% of the incoming increase in supply are green and MSC-status buildings," he points out, adding that existing building owners can upgrade or refurbish their buildings to suit the needs of multinational companies (MNCs), which are seeking such office spaces.

"Give the end users what they want," he says.

On another note, Sarkunan advices tenants to take advantage of the available offers and try to leverage for better rental rates.

Both consultants believe that the concerted efforts of InvestKL will help cushion the high supply coming into the market in the next few years.

InvestKL is a government initiative that aims to attract MNCs to set up their regional hubs in Kuala Lumpur. To date, it has brought in 17 MNCs in collaboration with partners such as the Malaysian Investment Development Authority and Multimedia Development Corp. InvestKL is currently in talks with five MNCs from the US, Europe and Japan. It aims to secure another 10 MNCs this year. E

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Overall Greater Kuala Lumpur vacancy rate was 15% in 2Q, up from 14.4% in the previous quarter