

**KL can expect 11.7 million sq ft of incoming office supply over the next three years**



## Fringes of KL fare better

**W**HILE the general consensus is that rental rates, particularly for Grade B and C offices in Kuala Lumpur, are dropping, there are areas that are bucking the trend.

In fact, Grade A offices on the fringes of Kuala Lumpur's central business district (CBD) appear to be performing better than their CBD counterparts.

"We have observed consistently strong demand, rental rates and occupancy for Plaza Mont Kiara, Solaris Mont Kiara, 1MK and Publika and even in our extended coverage zones of TTDI and Mutiara Damansara.

"There is also limited supply of such office spaces until new projects such as The MET Corporate Towers is completed," says Steven Wei, project marketing director of Property Hub Sdn Bhd.

"Rental rates are not dropping everywhere or even uniformly as it also depends on building occupancy and demand. Mont Kiara offices typically enjoy 80-90% occupancy at any one time with relatively stable rental rates due to the high demand (despite the age of some buildings) and unit scarcity," he says.

The emergence of Arcoris and Kiara 163 will bring in more supply to Mont Kiara but are filling up nicely, he adds.

JLL Malaysia director of research and consultancy Veena Loh says the average occupancy rates in the KL fringe rose by 2% from the last quarter to 84.6% in the first quarter ended March 31, 2019 with the leading areas being TTDI, Mont Kiara, Dutamas and Kerinchi.

"There is an increase in rental rates at KL Sentral (up 4% to RM7.03 psf), TTDI/Dutamas/Mont Kiara (up 1.3% to RM5.37 psf) and Mid Valley City (up 0.8% to RM6.10 psf)," she says.

In the case of KL fringe and decentralised areas (DC), rental markets have performed well in the past 12 months, she adds.

"We have divided Greater Kuala Lumpur into three submarkets: Kuala Lumpur City (KLC), Kuala Lumpur fringe and DC.

"While rents have remained flattish qoq, there has been improvement in 1Q19 compared to last year. Yoy, the average asking rents in Greater Kuala Lumpur have increased slightly by 0.8%. While the rents in KLC have remained flattish during this period, asking rents in KL fringe and DC have increased by 2.4% and 0.9%, respectively," says Loh.

KL fringe has been popular among broker price options, shared services, technology and flexible office, keeping its occupancy rate the highest at 89.1%, she says.

"The DC submarket is emerging and benefitting driven by new supply of Grade A buildings and demand spillover from KL fringe.

"In KLC, we foresee the rents to continue to be under downward pressure in the medium term due to large incoming supply in the pipeline, which is expected to increase the vacancy rate. However, rents in popular areas in KL fringe and DC are expected to rise steadily due to higher demand compared to KLC. Offices in KL fringe and DC are generally seeing an increase in rental rates," she adds.



**The existing stock of Prime A+ and Grade A office space is estimated at 35.7 million sq ft as of 1Q 2019, says Teh**



**Older buildings should be refurbished and repositioned to meet current and future occupier needs, says Wei**



**MNCs are taking up Grade A office space on the fringes of KL rather than in the CBD**

businesses. Some of them had also undergone M&As (mergers and acquisitions) and reduced their workforce.

"Demand from the O&G sector, which is the major industry in the city centre, has been soft for quite some time now. The finance sector had undergone automation along with technological advancement, hence it requires a smaller workforce and office space.

"In addition, many newer buildings are more space efficient, for example, column-less layout [and more] nett usable area. Thus, when companies relocate from older to newer buildings, they tend to take less space for the same number of workers.

"This has also contributed to less office space allocation per worker. There are also increasing

corporate leasing in co-working spaces, which have disrupted the traditional office leasing.

"Corporations now have the option to lease smaller office spaces for shorter terms in co-working centres. Co-working spaces may have taken away a portion of tenants from traditional office space," says Loh.

Furthermore, more landlords are also looking to partner with co-working or serviced office providers to attract new occupiers as they offer flexibility in terms of tenancy arrangement and sizes of occupied space, Knight Frank's Teh says.

"These arrangements appeal to the growing millennial workforce such as start-up companies, expatriates and young professionals," he says.

The main reason is that many buildings are old or there is sig-

nificant supply in the market, notes Property Hub's Wei.

"However, rising demand from multinational companies for good Grade A office buildings like the Tun Razak Exchange (TRX) has also had a good effect on the market and such buildings have been successfully attracting tenants as prospects improve for the market.

"For example, a big coup for TRX was having Prudential moving in as its first anchor tenant, with HSBC and Affin Bank deciding to move their headquarters there as well," he says.

### Price drops detected

Nevertheless, rental rates have seen a drop in recent times.

"It may not necessarily be the biggest drop but rental rates in Pantai-Bangsar dipped 1% to RM5.81 psf (per sq ft) while Shah

Alam declined slightly to RM3.42 psf. The average occupancy rate in the KL CBD (central business district) dipped 1.5% to 77% quarter-on-quarter with new supply looming in the form of TRX and Menara Bangkok Bank.

"These drops may not be that significant but they do indicate that traditionally strong and in-demand areas are also affected," says Wei.

There may be lots of available offices in the KL CBD with the correspondingly highest drops in rental rates due to the volume and expanse, he adds.

Teh also acknowledges the drop in rents even in new CBD Grade A offices.

According to Knight Frank, new CBD Grade A office rates fell to RM6.72 psf, a 1.6% decrease from 4Q 2018.

On the other hand, new CBD

Prime A+ offices saw an increase of 0.06% to RM12.01 psf and old CBD Grade A offices marginally crept up 0.02% to RM5.47 psf in the corresponding period.

The situation is not dire as some doomsayers predict. There is light at the end of the tunnel.

"[But] our real estate market needs to elevate itself in terms of expectations and standards; our Grade A offices are world class, so MNCs will shift towards these asset classes.

"The challenge is to convince the up-and-comers to uplift their game and image by taking up the new supply of prime offices. Additionally, over 100 MNCs are moving their operations into Malaysia by 2020 through the efforts of InvestKL, so offices with the right appeal will definitely be in demand, either in the CBD or prime fringe," says Wei. **FocusM**

- **Office** rental rates in KL city have been under downward pressure due to mismatch in demand and supply
- **Large** incoming supply expected to increase vacancy in Grade B and C offices
- **Grade A** offices still seeing positive growth with demand in the fringes gaining traction

Owners of Grade B and Grade C offices will need to up their game if they want to remain competitive in the persistently tough market.

The situation is further exacerbated with more Grade A offices entering the already over-supplied market, offering competitive rates with state-of-the-art trimmings.

“With office supply remaining elevated, especially in the Kuala Lumpur city centre, office rental rates are expected to continue to come under pressure in the short- to mid-term, with a total of circa 11.7 million sq ft (more than 70%) of incoming supply expected to come on stream in the near term from 2Q 2019 to 2021.”

“Currently, the existing stock of Prime A+ and Grade A office space is estimated at 35.7 million sq ft as of 1Q 2019,” says international property consultancy Knight Frank Malaysia corporate services executive director Teh Young Khean.

Landlords of dated buildings, mainly in Kuala Lumpur, will have to explore opportunities to repurpose their assets to improve recurring income and investment



by Joseph Wong

returns, he tells *FocusM*.

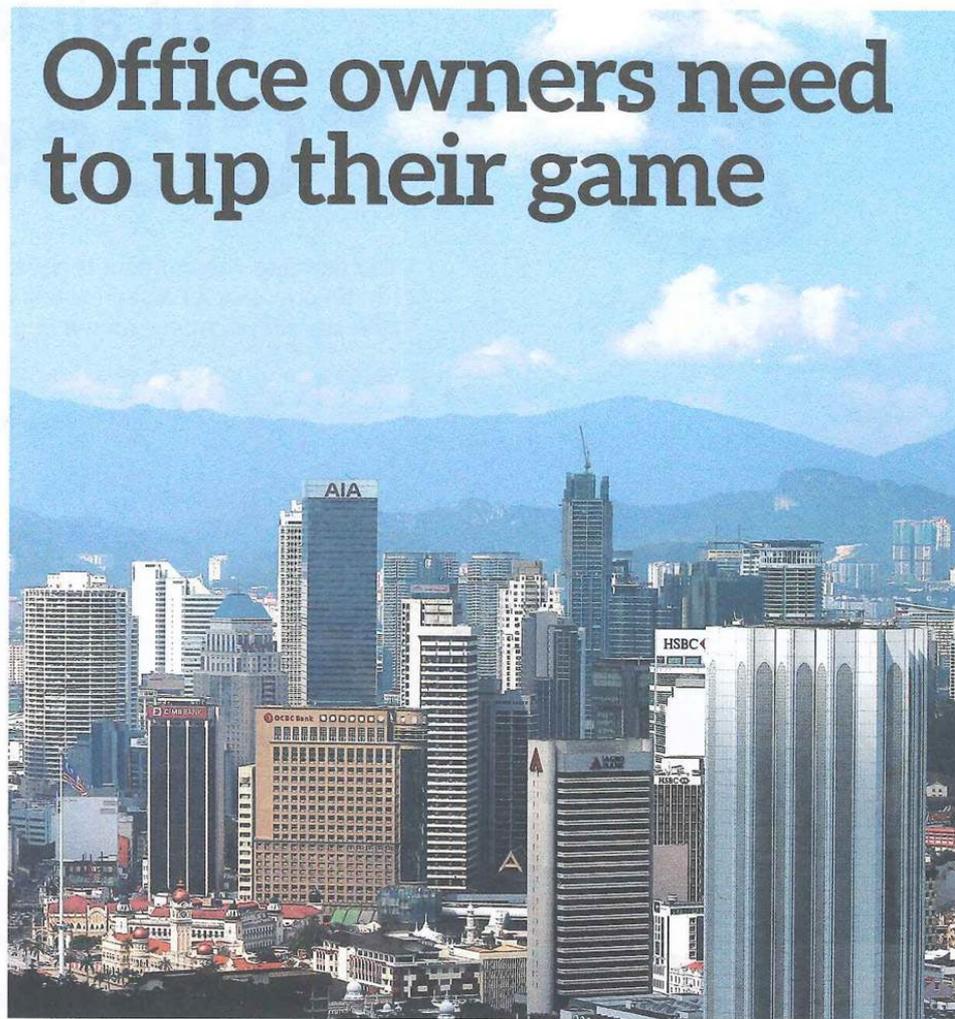
Generally, there are three classes of offices – Grade A, Grade B and Grade C. Grade A refers to the highest-quality office space on the market. These are usually newly constructed and have been outfitted with top-of-the-line fixtures, amenities and technological systems.

Grade B office space comprises properties that have been previously occupied and are not quite to the level of quality expected of a grade A office. Grade B office space is generally considered average but perfectly usable.

The lowest grade of office space is Grade C where properties are located in the least desirable areas of cities and are usually in need of major repairs or renovation. These are usually older buildings.

### Refurbishing and repurposing

“Older buildings should be refurbished and repositioned to meet



# Office owners need to up their game

current and future occupier needs. They also can add or upgrade outdated facilities to improve their market competitiveness to secure better rental rates and occupancy levels,” says Steven Wei, project marketing director of Property Hub Sdn Bhd.

“We will say that the market leaders in buildings tend to build what the market needs, not wants. Take The MET Corporate Towers for example. Triterra Group could have built a full Grade-A corporate office tower in Mont Kiara but this is not what the market needs in this area.

“It was only after a thorough study of market needs and the right location, concept and price that The MET Corporate Towers came about as the office of the future, with its unique third

spaces and concept that caters for a diverse business community from SMEs to MNCs,” Wei says.

The evolution of office spaces also affects the composition and trend of office supply, he adds.

“The venerable shop office is still very relevant today because such buildings account for 70% of the commercial market even as tenants upgrade to newer office buildings.

“Many savvy owners have caught on that they remain relevant in how they are used and with the right upgrades, still offer a cost-effective option for the small office market and the new trend for shop-retail spaces. It took decades for this to occur and similarly, offices also need time to evolve,” he points out.

To reduce the rental rate slide, landlords must ensure they continue to properly maintain their buildings and invest in refurbishing when necessary in order to retain and attract new tenants, says real estate and investment management firm JLL Malaysia director of research and consultancy Veena Loh.

“This will also give landlords the upper hand in rental negotiations with their prospects and tenants,” she explains.

### Downward pressure

“Rents in KL City have been under downward pressure due to demand and supply mismatch that pushes the vacancy rates higher. While the asking rents have remained resilient, the transacted rents are likely to be recorded at lower rates.

“Landlords in the city centre



Landlords in the city centre are generally offering higher discount rates to remain competitive, says Loh

are generally offering higher discount rates, longer rent-free period, or other incentives to remain competitive,” says Loh.

JLL’s Real Estate Intelligence Service (REIS) database shows that the average asking rents across Greater Kuala Lumpur have dropped by only 0.1% year-on-year, she says.

“It may be possible that landlords of stratified office blocks and less prime offices have dropped their rents, especially if they need to service their bank loans,” she says.

This is compounded by international firms that have ceased their operations in Malaysia, particularly when the oil and gas (O&G) industry underwent a downturn.

“The challenging market environment has affected expansion and hiring among many



MNCs like Deloitte appear to have a preference for the KL fringe rather than the CBD

## Average rental rates (Selangor)

| LOCALITY  | 4Q2018<br>(RM PER SQ FT / MONTH) | 1Q2019<br>(RM PER SQ FT / MONTH) |
|---|----------------------------------|----------------------------------|
| <b>Petaling Jaya</b>  | <b>4.43</b>                      | <b>4.50</b>                      |
| ■ Petaling Jaya Commercial District                                       | 4.24                             | 4.30                             |
| ■ Bandar Utama / Mutiara Damansara / Damansara Perdana / Damansara Uptown | 4.82                             | 4.90                             |
| ■ Ara Damansara / Tropicana / Kelana Jaya                                 | 4.12                             | 4.16                             |
| <b>Subang Jaya</b>  | <b>4.17</b>                      | <b>4.37</b>                      |
| ■ Subang Jaya Commercial District   | 3.68                             | 3.83                             |
| ■ Puchong   | 3.70                             | 3.76                             |
| ■ Bandar Sunway   | 4.88                             | 5.22                             |
| <b>Shah Alam</b>  | <b>3.48</b>                      | <b>3.41</b>                      |
| <b>Cyberjaya</b>  | <b>4.11</b>                      | <b>4.11</b>                      |
| <b>Overall</b>  | <b>4.23</b>                      | <b>4.29</b>                      |

Source: Knight Frank Research