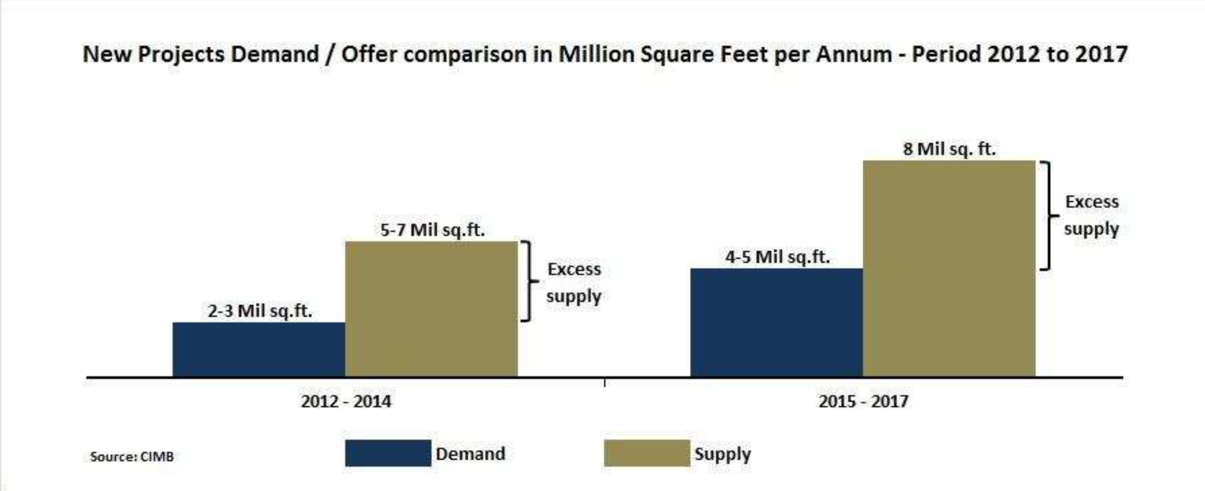
Office space: innovate, create and "recycle"

Last year in September CIMB published a "Strategic report" on office space titled "Overbuilding Risks" and one paragraph immediately caught my attention. It read: *"It has not been statistically proven that FDI in the real estate sector complements FDI in the manufacturing and services sectors in helping to boost the economic growth of the host country. As such, liberalizing and developing property policies to attract higher FDI flows, subsequently used to stimulate the economy, may not*



be the most effective tool. While the policies could act as catalysts for the nation's growth, they could also jeopardize growth should shocks or external factors hit." The ones that know me might be wondering if this was written by me as I always use exactly the same language and this is why it called my immediate attention. What is happening in Greater KL, Klang Valley and somehow Iskandar Malaysia is precisely this; there is a general willingness to bet on the "law of opposites" and pretend to generate economic growth using the "arrival point" as catalyzer. Following this principle we are finding ourselves in an oversupply of office space that, if not addressed properly, might generate a painful backfire within the next few years.

Here are some figures and statistics that should bring us to reconsider the direction taken and start proper corrective actions. As shows, the challenge that KL, Grater KL and Klang Valley are already

EXISTING SPACE AND OCCUPANCY RATES FOR OFFICE BUILDING AS AT DECEMBER 2013 - LOCAL AND REGIONAL COMPARISON				
STATE	EXISTING OFFICE SPACE AS AT DECEMBER 2013 FLOOR AREA (Sq.Ft.)	POPULATION AS AT 2012	OFFICE SPACE PER CAPITA	CURRENT OFFICE SPACE OCCUPANCY RATE
KUALA LUMPUR	82,595,645.68	1,768,680.00	46.70	78.20%
SELANGOR	33,088,551.52	5,826,240.00	5.68	73.30%
PULAU PENANG	11,480,377.48	1,664,640.00	6.90	75.90%
JOHOR	11,036,603.41	3,537,360.00	3.12	73.10%
PUTRAJAYA	21,425,101.63	97,340.00	220.11	54.30%
MALAYSIA	203,365,538.05	30,060,860.00	6.77	70.96%
SINGAPORE	79,222,304.00	5,165,866.00	15.34	90.80%
BANGKOK	87,854,675.00	8,243,832.00	10.66	89.47%
JAKARTA	65,668,769.00	10,860,334.00	6.05	94.30%
Source: NAPIC PMR 2013, Yearbook of statistics Singapore 2013, The Star archives, REI group archives				

facing is going to become tougher in the next three years as a number of project today under construction will be soon completed without a proper back-up from the demand side. The fact that the three regional capital cities are having a “per-capita” office space that is almost one fourth of Kualal Lumpur one, is something that should make us thinking about. A blatant and smart example to look at is what Jakarta’s regulatory and planning authorities have done in the last few years; construction moratoria for commercial buildings which resulted in a whopping 94% occupancy rate for the existing ones.

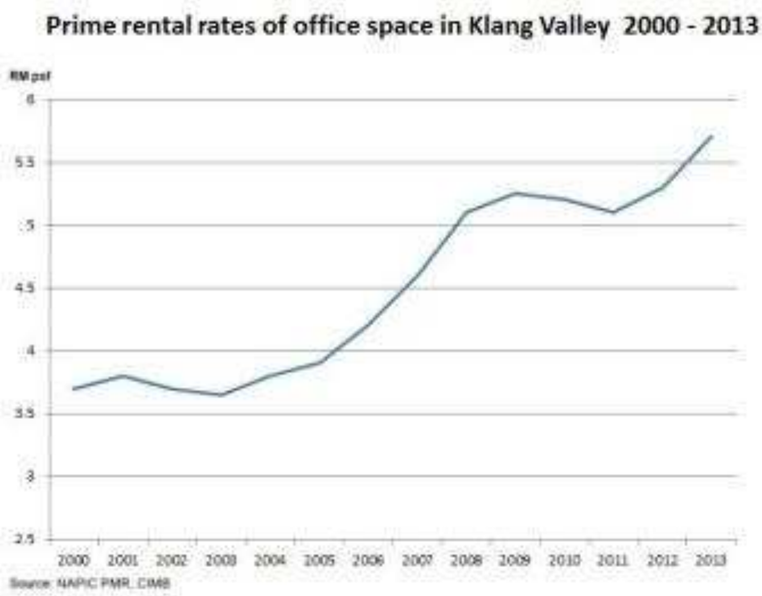
New and old buildings

Generally speaking MNCs invest in specific locations because of strong and stable economic drivers in the host countries such as: large market size, availability of skilled workers and sustainable macro-economic environment. Even though everybody agree that the Malaysian steady and sustainable economic growth propelled by stable economic fundamentals, proper Government planning through different plans (ETP, NKEA and so on), close monitoring of monetary authorities (BNM) and improved ranking for global competitiveness are generating enough appeal for MNCs to look at Malaysia as convenient location for their regional HQ with a consequent uptrend of FDI flow, we are still not as competitive and attractive as some of our regional neighbors competitors.

KLANG VALLEY GROWTH AREAS		
PROJECTS	LOCATION	SIZE (acres)
Bangsar South City	KUALA LUMPUR	59.30
Platinum Park KLCC	KUALA LUMPUR	9.14
Bukit Jelutong Commercial Centre	SELANGOR	179.89
KL Sentral	KUALA LUMPUR	71.66
Datum Jelatek	KUALA LUMPUR	5.93
MPHB's Golden Triangle Develp.	KUALA LUMPUR	n.a.
Damansara Avenue	SELANGOR	46.95
KL City Centre Redevelop. Kg Baru	KUALA LUMPUR	375.59
Bukit Bintang City Centre	KUALA LUMPUR	21.25
Bangsar/KL Eco City	KUALA LUMPUR	23.97
Pekeliling Tamansari Riverside Garden City	KUALA LUMPUR	54.36
TRX	KUALA LUMPUR	84.01
Merdeka Park City	KUALA LUMPUR	n.a.
City of Malaysia - Sg Besi	KUALA LUMPUR	400.30
Jln Cochrane-Jln Peel Development Cheras	KUALA LUMPUR	n.a.
KL Media City - Kerinchi/Pantai Dalam	KUALA LUMPUR	n.a.
Sungai Buloh Urban Development - RRIM	SELANGOR	3,385.27
Bukit Jalil Green City	KUALA LUMPUR	59.30
Bukit Jalil Link 2	KUALA LUMPUR	51.89
Kesas new Shopping Mall Sri Petaling	KUALA LUMPUR	49.17
Naza KL Metropolis	KUALA LUMPUR	7.41
PJ Sentral Garden	SELANGOR	11.86
TOTAL		4,897.27

Source: CIMB, REI Archives

If we look into the future supply, even though spanned over a 20 years period, the concern increase and it shows how it might be the right time to start looking into a more stringent regulation and planning of construction permits. **Table 3** lists the most important projects which are already under construction or expected to take off in the next few years and numbers are quite impressive.



At a first glance, with the picture given by the numbers above, we should expect rental rates and yields to fall. Well this is not happening, or at least not with such a bad rate as statistics were preparing us to, as the new office buildings are actually taken up consistently due to better location, better facilities, MSC status and so on. As average in Klang Valley (including Kuala Lumpur areas) office rental rates have been moving up from RM3.7 psf in year 2000 to RM5.7 psf in 2013. This fact is leaving investors, the ones with new office space tenanted, with a good and positive peace of mind. This trend will probably sustain for several more year, providing what has just been said above will happen soon. The future challenge will actually not be represented by the new Grade A, A Premium or "Investment Grade" office buildings as these will be occupied by PLCs and MNC which are looking at new office skyscrapers as representative of their image and status. The question is entirely on the destiny of the old buildings where the already quite low occupancy rates might be further falling to unsustainable levels. While expecting the stakeholders to define a proper regulatory framework for future buildings we are going to see more and more old office buildings moving towards a zero occupancy and dragging the respective owners to unwished financial troubles.

The way forward

In the last few years a new type of development has been successfully showing up in Malaysia. Two very positive examples of it are the Standard Chartered Tower and the Intermark "re-development" even though both resulted in the same type of product, office space. What I'm talking about here is the "re-development cum recycling" of old office or retail buildings into a new type of final result. Malaysia is developing a new level of Educational offer, there is a huge un-addressed demand of affordable houses, rural population migrates towards urbanized areas at a rate of 3% to 3.5% on a yearly basis, the Malaysian third age group (i.e. 60 years and above) is going to double its number before 2050 and by 2020 Malaysia should achieve the status of fully developed country which will bring along an higher number of expatriates. These are just few examples of future property/building demand generators which might be carrying the possible reply to a "building recycling" question. Schools, Hospitals, affordable houses, student hostels are few of the many different concept that Malaysian developers and building owners should be start looking at as solution to an office space glut that everybody is feeling but nobody want to talk about.

On the way towards Wawasan 2020 Malaysia has to step from an efficiency driven economic model to an innovation driven one. Becoming innovative and creative re-developers looks like a good possibility for profitable future business that will contribute to maintain the Malaysian Economy in a leading position in the region.

Sources: Napic Property market Report 2013, CIMB, Colliers reports, Knight Frank reports, Yearbook of Statistics Singapore 2013, REI Archives

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