Tenants’ Acceptance Level of Current Tenancy Terms for Selected Office Buildings in Kuala Lumpur, Malaysia

Yasmin Mohd Adnan¹, Tey Hue See²

¹ (Center for Studies of Urban & Regional Studies (SURE), University of Malaya, Kuala Lumpur
² Department of Estate Management, University of Malaya, Kuala Lumpur)

Abstract: This paper explores the common lease/tenancy agreement terms of purpose built office buildings in Malaysia and the acceptance level of lease/tenancy agreement terms of the space occupied. It attempts to identify main variation of lease terms and its arrangement for office buildings practiced in Malaysia and other countries. In addition, the acceptance level of lease terms between local and international tenant organisations at these selected office buildings is examined. From survey findings gathered from the tenants’ organisations of two selected office buildings chosen in the study, it can generally be concluded that both international and local organisations in the study are of the view that the clauses in the current tenancy/lease agreements practiced in Malaysia do not pose any major problems to them.

Keywords: Acceptance; Office buildings; Tenancy agreements; Kuala Lumpur; Malaysia

1 Introduction

A leasehold estate is created when a landowner (the ‘landlord’ or ‘lessor’) grants a tenant (or known as ‘lessee’) the right to occupy the owner’s property for a specified period of time in exchange for some form of consideration which is called rent as proposed by Kyle (1995). It is usually created by a written document (the ‘lease’) which states that the property is ‘demised’ or ‘let’ to the tenant for a particular period and specifies the term and conditions of his occupation, especially the amount of rent he has to pay and how and when such rent has to be paid. This lease terminates at the end of this period and the right to possession reverts to the landlord (Lye, 1990).

The changing business practices and attitudes to space is that businesses require more flexibility, not only in terms of the physical characteristics of buildings but also in terms of leasing arrangements. The identification of core and peripheral activity has already helped to fuel the increasing provision of serviced offices. The length of the lease has different impact from the landlord and tenants’ perspective. Landlords typically like longer term leases and are more willing to make concessions for such leases. With a long lease, the landlord enjoys the financial security of a regular rental stream over a number of years. In addition, the landlord can avoid the hassle and expense of re-leasing the space. From the tenant’s point of view, a long term lease has both benefits and risks. The benefit would be that the premises are available at a predictable cost for the long term. The risk is that the company may outgrow the space, may need less space as its business contracts, or is locked into paying what turns out to be above-market rent if demand for rentals subsequently declines. The ideal lease length is one that matches the business needs of both the owner and the occupants. Unfortunately, these two interests do not usually coincide.

A study conducted earlier in Australia revealed the five most problematic lease terms in rank order. They are: lease length, break clauses, assignment and sub-letting, repairs and insurance, and rent review type. Upwards-only reviews are an important element of occupier concerns regarding review type, but the main occupier’s concerns regarding leases (Rowland, P, 1999). It has been highlighted in the same study that lease length is the major concern of all occupiers with a significant mismatch between business planning horizons and length of occupation. This was particularly highlighted as a problem to international occupiers. This group is also very concerned about other clauses which impact on the length of occupational liability and ease of exit from the premises such as break clauses.
2 Leasing and tenancy definitions in Malaysia

Land ownership in Peninsular Malaysia is governed by the National Land Code 1965 (NLC), in force since January 1966. (Salleh Buang, 2002). Section 340 signifies the essence of the Torrens system—a land registration method built on two fundamental principles. These are, firstly, the mandatory use of prescribed forms when entering into any land deal recognized under the Code, and secondly, the registration of the deal at the appropriate Land Office (Salleh Buang, 2002). Since the law is based on the Torrens System (where “the register is everything”) ownership is evidenced by having one’s name on the title. One of the routes to ownership is by “dealings,” which includes not only transfers, but also leases, charges, easements and liens, while “alienation” is the process by which state land is “disposed by way of alienation.” (Salleh Buang, 2002). In Malaysia, basically the word “lease” conveys the meaning of “to rent” which is to have the benefits of something in return for payment of a certain sum of money. Traditionally this relationship existed in the context of land and landed property. The owner of the property allows another to occupy it and in return the other person pays money in a lump sum in advance or periodically such as weekly, monthly, quarterly or yearly. The payment is referred to as rent. However, the word “tenancy” has been used for letting for short periods. When such a letting is for a longer period, it is called a lease. In the context of our National Land Code which only applies in Peninsular Malaysia, a tenancy is for a period of up to three years. Any longer than that, it becomes a lease. The terms ‘lease’ and ‘tenancy’ are often used interchangeably, as with the terms ‘landlord/lessor’ and ‘tenant/lessee’.

Under the National Land Code, all leases have to be registered for which the letting to be endorsed on the title deed and therefore in the Register of Titles. The registration is thus highly beneficial to the lessee because his interest in the title is effectively made known to third parties. Any person taking a subsequent charge does so subject to the existing lease. On the other hand, a tenancy is exempted from registration. Therefore if a third party is buying the land or creating a charge, such a person may not know about the tenancy that is not registered.

Leases and tenancies are traditionally classified into four main types, namely, fixed-term leases, periodic tenancies, tenancies at will and tenancies at sufferance. Of these, the tenancy at sufferance is not strictly a ‘tenancy’ in the true sense, for there is no relationship of tenure (Lye, 1990). Leases or tenancies may be created for a fixed period of time. As far as leases are concerned, the maximum period for which it may be granted is 99 years in respect of the whole of the land and 30 years in respect of part of the land (Teo, 1995).

3 Essential provisions of valid lease

The effects on rents of several lease covenants have been modelled in a wide variety of ways in recent years in other countries. Some approaches are of more practical application to lease negotiations than others. The essential provisions of a valid lease are as follows:

3.1 Lease lengths

The length of the lease has a significant impact on the rental rate. Landlords typically like longer-term leases and are more willing to make concessions for such leases. The lease period in Malaysia is usually 2 to 5 years with an option to renew. The landlord normally requires 3 to 6 months notice of tenants’ intention to exercise his option for the former and a 2 month’s for the latter (propertyetasia.com.my).

3.2 Options to renew or break leases

According to Del W. Williams (2002), an option to renew the lease amounts to an offer by the landlord to grant a new lease and is normally contained in the lease. The option usually provides for the new lease to be granted for a term equal to the ‘old’ lease but at an increased rent. If the option does not contain a formula and machinery for ascertaining the rent for the new term it may be unenforceable.

3.3 Rent review provision

Generally, landlords prefer frequent (upwards-only) market rent reviews unless a large surplus of space is imminent, in which case fixed increases are favoured. Often tenants argue for infrequent rent reviews.
tied to an index of affordability (consumer price inflation or as a percentage of the gross sales of the business).

An upward only rent review gives an option to the landlord to demand a rental increase unless market rents have declined since the start of the lease (or since the previous review). Since in Malaysia, the shorter period of leases is being adopted, rental will be renegotiated for review at the end of each term, at a mutually agreed rate between both parties based on market conditions (propertynetasia.com.my).

3.4 The liability for property responsibilities and expenses

The maintenance and management of properties may be carried out inadequately when there is insufficient incentive for the responsible party to operate the property in the way that the other party would like (and there are difficulties in specifying, monitoring or enforcing repair and management clauses). Benjamin et al. (1998) indicated that the tenant’s inclination to overuse and/or under maintain leased premises (which they refer to as an “incentive problem”) imposes a cost, initially on the landlord that would be expected to “cause the market for leased space to fail”. The tenant has no interest in preserving the residual value of the property and this neglect would not exist in owner-occupied properties. In Malaysia, the landlord is responsible for the upkeep of the common area whilst the tenant is responsible for the internal area of its tenanted area. Landlord is responsible for the insurance of the building, excluding fittings and fixtures installed by the tenant against damage by fire or such risks as the landlord deem fit. Tenant is to keep insured the internal premise including any fittings, furniture, chattels and properties of the tenant throughout the renovation and tenancy period at their own cost.

3.5 Leasing incentives

Leasing incentives are concessions given to tenants to entice them into signing new leases. In most instances, they can be priced by assessing their effects on the cash flow from the property (Bond, 1994, Jefferies, 1994).

According to Lye (1990), it is essential for a valid contract to contain the name of the parties, the property, the term and its commencement, rent and special covenants. Whilst considered as a contract, the tenancy agreement is governed by Part 15, Part 18 Chapter 7 and the Sixth Schedule of the National Land Code (Act 56) of 1965 (Gurjit Singh, 1996).

4 Comparison of lease structures

The types of leases and their lengths can be compared across markets and within markets. Table 1 shows the leasing guidelines as international comparisons of what are believed to be the usual bases and lengths of lease for substantial lettings of city office space as provided by Colliers International (2001). Many large businesses make international comparisons in deciding where to locate their regional or global offices.

Whilst no firm conclusions can be drawn from such international comparisons, they revealed some traits of leasing market that are broadly consistent with the expected link between lease length and the allocation of responsibilities for the property. Commercial leases tend to be shortest in Asian countries where landlords look after the properties, with partial or no recovery of operating expenses is common. In Western Europe, leases in many countries are longer (with statutory minima or renewal rights in some countries). Landlords manage and maintain their premises but, since the 1980s, service charges have become the norm in many countries.

The very long leases in England usually pass all responsibilities, including structural repairs and inherent defects, to the tenants. Many landlords of single tenanted properties leased for 15 to 25 years have shown little interest in their buildings, arguing that they do not receive the benefit of good management until the lease expires (Greenwood, 1982).
<table>
<thead>
<tr>
<th>Country and Area</th>
<th>How Long are Leases Generally</th>
<th>How is Rent Quoted?</th>
<th>Are Options to Renew or Extend the Lease Possible?</th>
<th>Major Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Not less than 3 years, no 5 – 10 years</td>
<td>Australian Dollars PSM per year</td>
<td>Yes, with rent review to market levels</td>
<td>Sydney Melbourne</td>
</tr>
<tr>
<td>Austria</td>
<td>Leasing periods are normally limited</td>
<td>Austrian Schillings/ Euros PSM per month</td>
<td>Options are rare, because original lease term is usually indefinite</td>
<td>Vienna</td>
</tr>
<tr>
<td>Canada</td>
<td>5 years in Class A buildings</td>
<td>Canadian Dollars PSF or PSM per year</td>
<td>Yes, with rent review to market levels and agreement of both parties</td>
<td>Toronto, Montreal, Vancouver</td>
</tr>
<tr>
<td>China</td>
<td>2 years, 3 years terms also common</td>
<td>US Dollars PSM per month or day</td>
<td>Yes, with rent review to market levels</td>
<td>Shanghai Beijing</td>
</tr>
<tr>
<td>France</td>
<td>9 years with break clauses at 3 and 6 years for the tenant only</td>
<td>French Francs/Euros PSM per year</td>
<td>Yes, with 6 months notice tenants may renew at market rents</td>
<td>Paris, Lyon Marseille</td>
</tr>
<tr>
<td>Germany</td>
<td>5 years average, 10 years if improvements made for tenant</td>
<td>Deutsche Marks/Euros PSM per month</td>
<td>Option generally granted in original contract, otherwise negotiations held</td>
<td>Frankfurt</td>
</tr>
<tr>
<td>Hong Kong, SAR of China</td>
<td>3 years average, 2 years in smaller spaces, 9 years in larger spaces</td>
<td>Hong Kong Dollars PSF per month</td>
<td>Yes, 2 – 3 years renewals are possible with rent review to market levels</td>
<td>Hong Kong</td>
</tr>
<tr>
<td>India</td>
<td>3 – 5 years, longer terms in large spaces</td>
<td>Rupees PSF per month</td>
<td>Yes, generally for period equal to original term, with rent review</td>
<td>New Delhi, Mumbai, Chennai</td>
</tr>
<tr>
<td>Indonesia</td>
<td>3 years average, although moving to 5 – 6 year term</td>
<td>US Dollars/ Rupees PSM per month</td>
<td>Yes, as agreed in initial contacts</td>
<td>Jakarta</td>
</tr>
<tr>
<td>Japan</td>
<td>2 years</td>
<td>Yen per Turbo</td>
<td>Yes, tenant has legal right to automatically renew, with “reasonable” rent review</td>
<td>Tokyo Osaka</td>
</tr>
<tr>
<td>Malaysia</td>
<td>3 years</td>
<td>Ringgit PSF per month</td>
<td>Yes, a 3 year extension under new Kuala Lumpur conditions is generally granted</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>3 – 5 years</td>
<td>Philippines Peso PSM per month</td>
<td>Yes, renewals are generally for 1 Manila year</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>3 years</td>
<td>Singapore Dollars PSF per month</td>
<td>Yes, generally for period equal to original item, with rent review</td>
<td></td>
</tr>
<tr>
<td>Taiwan, China</td>
<td>3 – 5 years</td>
<td>Taiwan Dollars per Ping Per month</td>
<td>Yes, generally for period equal to original item, with rent negotiation</td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>3 years</td>
<td>BAHT PSM per month</td>
<td>Yes, generally tenants may renew for 2 – 3 years, with rent review</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>15 – 25 years, although moving to shorter terms and PSF per month break clauses</td>
<td>Pounds Sterling</td>
<td>Yes, tenants generally have the right to renew at market rates</td>
<td>London, Birmingham Glasgow</td>
</tr>
<tr>
<td>United States</td>
<td>5 – 10 years, 15 years for larger users</td>
<td>US Dollars PSF Per Year or month</td>
<td>Yes, renewals are possible usually New York, Chicago with review to market levels/pre-a-Los Angeles greed rate</td>
<td></td>
</tr>
</tbody>
</table>
5 Research objectives

This research seeks to investigate the acceptance level of local and international tenants' organisations towards the current tenant agreement terms and arrangement in Malaysia. The proposed research objectives are as follows:

(i) To gather the overall opinion from the identified tenant organisations selected in the study of the general structure of leasing arrangement and the main terms & clauses in the tenancy/lease agreements.

(ii) To identify the acceptance level of current tenancy/lease terms from various categories of the international and local tenant organisations in the selected office buildings in the study.

6 Research methods

The information needed for this research was obtained from the following sources:

6.1 Literature review

The literature review provides the information on the practices and terms of the tenancy/lease structure in Malaysia and other countries. The reviews also provide useful guidelines in the formation of questions in the survey. The main objective of the survey is to gather feedback from tenant organisations of the acceptance towards the tenancy/lease terms practiced in Malaysia while interviews amongst the buildings managers, senior leasing executives, senior marketing executive and solicitor selected in the study provides information on the practices adopted in the office leasing structure in Malaysia.

6.2 Questionnaire survey and interviews

The survey questionnaires were distributed to two (2) office buildings tenant organisations located within Kuala Lumpur. The selection of the buildings was based on the percentage composition of tenants comprising local and international organisations. Building A has a tenant profile constituting of 67% of international organisations. It is an intelligent office tower with tenancy period limited to two (2) to three (3) years. On the other hand, Building B has 67% of local organisations as tenants. It is a 35-storey office tower block.

7 Findings of survey

A survey was conducted through circulated questionnaires which were sent to 100 individual occupiers respectively in Building A and Building B. A total of 60 responses were received from occupiers in both buildings, giving a response rate of just 30% each. Although this may appear to be a poor response rate, it needs to be considered in a wider context. The response rate of 30% is considered appropriate based on Ellhag & Boussabaine (1999).

The respondents of the survey are varied from different sectors such as insurance, business services, IT, telecommunication, finance, construction and development, trading, consultancy, research and development, industrial and others. According to the survey carried out, it was found that most of the organizations in the survey were in the trading sectors. It consisted of 20% of respondents from Building A and 13.3% of respondents from Building B. The distribution of sector of the organization is show as the Figure 1.

The respondents’ profile were firstly divided into four (4) main sectors namely international corporate occupiers, national corporate, local business and the public sector. However, there was no public sector organizations presented in the chosen buildings. For Building A, 67.6% of the tenants are from international corporate mainly from Switzerland, Japan, Korea, China and China’s Taiwan province. Only minority of tenants are from local business and national corporate. In contrast, the majority of the tenants of Building B are from local business organisations comprising of 67.6%. Figure 2 shows the distribution of the different profiles of type of organizations in both buildings.
8 Length of lease/tenancy of organisation

From the survey carried out, the current terms of the lease/tenancy of most respondents are less than 3 years. For Building A where the majority of the tenants are from international corporates, the current lease/tenancy terms of most of the tenants are less than 3 years comprising 60% of the total organisations. There are also tenants enjoying lease/tenancy terms ranging from 3 to 5 years. This category of tenants constitutes 36.7% from the total respondents of the survey carried out at Building A. Building B in which the majority of the tenants are from local business recorded 96.7% for lease/tenancy term less than 3 years. From the survey carried out, none of the tenants from both office building exceeded 5 years of lease/tenancy terms.
From the survey carried out at these two buildings, it can be drawn that the common lease/tenancy terms are less than 3 years. Figure 3 shows the lease/tenancy term of organizations in the two buildings in the study.

9 Leasing arrangement and the main terms & clauses in Malaysia

The various categories of tenant organizations were then asked on the acceptance level towards the leasing arrangement and the terms of the tenancy agreements. They were then asked to identify the problematic clauses and the ones which need improvement. The responses are as follows:

9.1 Acceptance to current Leasing system

A percentage of 70% the respondents agreed that the current leasing system is responsive to their organisation’s requirements and have no problem in negotiating appropriate leases. However, 28% of the respondents agreed that the system operates satisfactorily on the whole. A significant minority (2%) indicate the Malaysia leasing system is unsatisfactory and undermines the organisation’s ability to operate effectively.

9.2 Ideal lease/tenancy term

The respondents were also asked on the ideal lease/tenancy period. A majority of the respondents is of the opinion that the ideal lease/tenancy period for them is less than 3 years which comprises of 77%. Meanwhile, 23% of the total respondents indicated that the ideal lease/tenancy term is 3 to 5 years.

Figure 5 illustrates the views on the ideal lease/tenancy term among the respondents.

9.3 Problematic lease terms / clauses

The clauses within a lease/tenancy agreement which can cause problem are Lease Length, Break Clauses, Assignment and Sub-letting, Repairs and Insurance, Right to Renew, Rent Review, Termination Clause, Payment of Rental, Outgoings and Deposit, Alteration and Renovation Clause, Fitting Out Clause, Compliance to Law and In House Regulations, Use of Premise and Indemnity. However, Figure 6 summarises the range of varying views of the respondents towards these clauses.

Figure 6 shows that 80% of respondents felt that lease length creates no problem; the percentage fell to 47% for break clauses, 55% for assignment/sub-letting, 32% for repair and insurance and 62% for review type. Almost all of the lease terms/clauses create no major problems with the exception for the fitting out clause which constitutes 2% to 5% for insurance and repair and 2% for the ability to assign/sub-let which pose major problems to the respondents.

9.4 Improvement of lease terms/ clauses

After identifying the problematic clauses, the respondents were asked to indicate the clauses which need improvement. Most of the respondents indicated that the right to renew clause, review period, repairs and insurance need to be improved compared to the other lease/tenancy clauses. Up to 60% of the total respondents indicate that review period need to be im-
Figure 6 Problematic lease terms/clauses

55% of the total respondents indicate that repair and insurance needs improvement while 30% of total respondents indicate that the assignment clause needs to be improved. From the analysis, only a minority of the respondents are of the opinion that leases length, break clauses, right to renew, compliance to law and in house regulations need improvement. Only 15% of the total respondents suggest that lease length need to be improved. Similarly, 15% of the total respondents suggest that break clause also need to be improved. Among all the lease/tenancy terms, compliance to law and in house regulations receive least responses from the respondents. There are only 10% of the total respondents suggest that this lease/tenancy clauses need to be improved.

Figure 7 illustrates the breakdown of the respondents views on the required improvement of the lease terms and clauses.

9.5 Analysis of sub groups

Comparisons of the opinions on the tenancy/lease terms practiced in Malaysia are also made between the International corporate, the national corporate and local business categories of the tenants organisations in the buildings identified in the study. However, comparisons are only made on the identified most problematic clauses as well as the clauses that have been identified as those that need improvement. The clauses chosen are related to Repair & Insurance and Assignment. The respondents were asked on whether these clauses posed the following attributes: no problem, minor problem, major problem occasionally or major problem regularly. The respondents were also asked on the lease length clauses as to make a comparison of the acceptance level amongst the various categories of tenant organizations. In general, only three (3) types of organizations are identified as the main respondents in the study as there is no public sector organizations form any subgroup as tenants in the identified buildings.

Figure 8 shows that 38% of the international corporate and 38% of the local business category of tenant organisations are of the view that the current lease length pose no problem and only 11% of local business organization tenants is of the view that it constitutes a minor problem occasionally. The majority of the tenants indicated that the current period adopted posed no problem to them.
9.6 Acceptance to assignment clause

The current assignment clause limits tenants on the assignment of the term to another party.

About 23% of the international corporate and 25% of the local business as compared to 7% of the national corporate tenants indicated that the assignment clause posed no problem. A total of 17% of international corporate and local business tenant organizations are of the opinion that that assignment clause cause minor problems occasionally.

9.7 Acceptance to repairs and insurance clause

About 15% of international corporate think that there is no problem with this clause while 3% of national corporate respondents held this view. 22% of the international corporate think that this clause leads to minor problems occasionally compared to 5% of national corporate. A number of 5% of international corporate and 3% of national corporate think that this clause constitutes major problems occasionally. Only 3% of national corporate think that this clause leads to major problems regularly. Figure 10 depicts the acceptance level towards to repairs and insurance clause.
10 Findings & Conclusion

It is found that the international, national corporate and local business tenants in the office buildings chosen in the study are of the opinion that the Malaysia leasing system creates no problems to their tenancy agreement arrangement for their organization.

The problematic lease terms identified amongst the tenants in the study are assignment and repair and insurance clauses. The tenants however added that review period, right to renew, break clauses and length of the lease is the other clauses which need improvement. The solutions to the problems are largely predictable. More breaks and a relaxation of restrictions on a range of issues such as breaks, assignment, sub-letting, consents for improvements, etc. can be improved and looked upon. Even though majority of the respondent thinks that lease length does not bring any problems to their organization but a minority of them in their view think that lease length occasionally creates problems to their organisation. Most of the international corporate tenants found that length of lease in Malaysia is compatible with their business planning horizon.

Shorter leases may reduce the need for breaks, reduce the incidence of unwanted properties which may have to be held until lease expiry, reduce the number of reviews and reduce any length of time on which a set of upwards-only clauses have an effect.

The results of the survey suggest that there are concerns about the operation of the system and revolve around the length of commitment to occupy and the speed of reaction to business change. As lease length is not the main concern noticeable with the international occupiers, it does not raises the question of whether perceived inflexibility in the leasing market actually works against companies from overseas setting up in Malaysia. A further study on the identified clauses which need improvement may make the leasing system a dependable way of planning for the occupation in the office buildings in the future.

References