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The economics of Putrajaya

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WHEN TALK OF a new federal government administrative centre surfaced in the late 80s, few took it seriously. Even fewer knew what the impact would be on the local property sector.

It was only after the government had decided on the site in 1992 - a 4,581 hectare parcel located in Prang Besar, off the KL-Seremban Highway - that many started to realise what a new federal government administrative centre would mean economically and socially.

Putrajaya, to be built at a cost of RM24 billion, is the biggest project to be undertaken in the country. When completed in the year 2010, it is expected to have 62 million sq feet of space for government offices, commercial and retail activities. Up to the end of 1996, Kuala Lumpur had 39 million sq feet of commercial space.

The inclusion of Cyberjaya, which is adjacent to Putrajaya, adds spice to the whole project as the two mega endeavours form the backbone of the Multimedia Super Corridor (MSC). Despite their huge size and heavy task, both projects have all the ingredients of coming out tops, especially Putrajaya. As for Cyberjaya, which is still in its infancy stage, the potential weighs heavily on the shoulders of its lead developer Cyberview Sdn Bhd. (See story on Cyberjaya).

Like a buoy staying well afloat in the sea even in strong wind conditions, the Putrajaya project stands out as one which has the ingredients to weather any turbulence that looms in the property sector, for instance, a slowdown.

There are many reasons why the Putrajaya project will be a success. Chief among them is the project, together with Cyberjaya, lies on the hottest property bed in the country. Also, Putrajaya has a ready-made market of occupants as it will house the federal government administrative centre. What it means is that most government offices will be located in Putrajaya and with this will come demand for office space and housing. The first of the government offices is expected to move in September next year. Within the next two years, the population is expected to be 70,000 and by the year 2005, when the big shift of most government offices is completed, Putrajaya will have about 200,000 people living and working there.

'Ultimately Putrajaya will have a population of about 360,000 when the project is fully completed. The surrounding areas will also be developed and it will easily be the focus of one million people,' says Putrajaya Corporation president Tan Sri Azizan Zainul Abidin in an interview with Malaysian Business.

With a sizeable population and a project which comes under the scrutiny of Prime Minister Datuk Seri Dr Mahathir Mohamad himself, everything points well for the developers. Putrajaya Holdings Sdn Bhd, with banker Tan Sri Rashid Hussain as its chairman, is the lead developer of the massive project. Putrajaya Holdings has roped in four listed companies and Peremba as joint-venture partners to develop the area. The four listed companies are SP Setia Bhd, Malaysian Resources Corporation Bhd, Hong Leong Properties Bhd and Malaysian Plantations Bhd. All the five joint-venture partners are involved in the development of infrastructure and residential units in Putrajaya.

Putrajaya Holdings chief executive officer Datuk Mohd Hashim Hassan says the company will sign joint-venture agreements with three more companies

to carry out only infrastructure work. On paper, all things look sweet and easy for the lead developer, the five core developers and their joint-venture companies.

But before these companies can enjoy the pot of gold, there are a few steep obstacles to cross to complete the mammoth task. Firstly, the five core developers must help ensure that each of the joint-venture vehicle fulfills the requirements for listing on the Kuala Lumpur Stock Exchange within the next three years. To facilitate the listing, each joint-venture company must come up with a profit guarantee.

More importantly, as in most development projects, most questions hinge around financing and the demand for the units. In this case, demand will not be a problem. About 35,000 of the 67,000 residential units to be built in Putrajaya will be taken up by the government to house its staff.

As for the government office space, a total of 32 million sq ft is planned for the whole project lasting until 2010. But initially 15 million sq feet will be built and this will be taken up by the various ministries and departments. It is learnt that the rest is to meet the future needs of the government. All ministries, except the International Trade and Industry Ministry and Works Ministry, will re-locate to the new administrative centre.

Another 30 million sq ft of commercial and retail space will be available over the years with the bulk to be built at the core area. But this amount also includes shoplots and supermarkets at the peripheral areas.

But the financing aspect may not be so simple. Unlike other property development projects, Putrajaya involves a massive RM24 billion. The government's funding is confined to RM2.6 billion. This means Putrajaya Holdings and its joint venture partners will have to cough out RM21.4 billion. Their task will not be made any easier as there is a strong possibility that the government will lease the buildings and residential units on a long-term basis instead of buying it outright.

Azizan says at the moment the government is looking at leasing the buildings and residential units from Putrajaya Holdings at reasonable rates for 30 years after which they will be handed to the government. 'The civil servants will probably occupy the residences on rentals. The important thing is that the government will not be burdened,' he says.

It is learnt that the government is keen to lease the buildings but a decision has not been finalised if all or part of the 32,000 residential units will be leased. The long-term lease, notes an analyst, will qualify the joint venture companies for listing under the infrastructure project company (IPC) category on the KLSE as it is similar to a concession period and provides a constant and guaranteed long-term source of income.

While most analysts agree leasing will be a source of long-term income, the question arises if this might strain the short-term cash flow of the development companies concerned. Putrajaya Holdings, being the lead party in the development of the project, has to come out with the bulk of the funding, estimated at RM6 billion. This is based on its 30 per cent equity stake in each of the five joint venture companies. But Putrajaya Holdings has strong shareholders in the form of Petronas (40 per cent), Khazanah Nasional Bhd (40 per cent) and Kumpulan Wang Amanah (20 per cent).

Hashim says to ease the financial strain, Putrajaya Holdings has formulated a strategy that will maximise inflows. Besides listing the joint venture companies, Putrajaya Holdings is also looking at raising funds by the issue of bonds. 'We will also generate cash through sale of land to the joint venture partners, develop the commercial and private residential units with them and also undertake other viable business activities,' says Hashim. (See story on Putrajaya Holdings.)

Putrajaya Holdings, being the land owner with strong shareholders, perhaps has an easier task in financing its share of the project. But what about the five core developers and their joint venture companies? This issue is most pertinent as during a media briefing recently, Putrajaya Holdings stated it would take about six years for them to break even given the vast amount of infrastructure work that needs to be done at the initial stages.

Although an official of one of the companies involved says that they (the companies) will be paid for all infrastructure work outside their respective precincts, details are still hazy.

An analyst estimates that each joint venture partner has to contend with development work to the tune of RM2.5 billion to RM3 billion which would require about RM400-RM500 million in working capital. 'This does not include the land and infrastructure costs that the joint venture partner has to pay,' he says.

At the initial stages, the cost borne by the five companies will be basically confined to land cost. It is learnt that the land cost for the joint venture developers in Putrajaya is between RM9 and RM12 per square feet (psf) while another RM2.50 psf is added as infrastructure cost, including the cost of constructing roads, drains and sewerage systems. Several analysts, when contacted, felt that being established and experienced developers, it is unlikely that any of the joint venture companies will have trouble with working capital as long as they can maintain their cash flow well.

For instance MRCB, says Audrey Ho of Mohaiyani Securities, has de-gearred itself well in recent times and should not have any problem with working capital of that amount.

Kamunting Construction Sdn Bhd executive director Wie Hock Kiong, in a faxed reply, politely declines to comment on the matter of leasing.

Kamunting Construction is the joint venture vehicle between Malaysian Plantations and Putrajaya Holdings to undertake the development. 'We are unable to answer as we believe Putrajaya is still in the process of discussion with the government regarding this matter. We have yet to be informed on the mode of payment between Putrajaya and us,' he says.

Similar questions posed to SP Setia, MRCB and Hong Leong Properties were not answered. Tan Fu-mei, an analyst with Inter-Pacific Capital, says it all boils down to the terms of the leasing agreement, when the companies lock in the leasing and whether the rates are adjustable for inflation over the 30-year period. 'For certain, the leasing agreement provides assurance that the companies' properties will be taken up. In our opinion, the risks in property development in Putrajaya are much less compared to other places as it is the administrative centre. Moreover, the companies concerned will earn the goodwill of the government which is an intangible asset and may prove to be valuable in the longer run,' she says.

Hashim disagrees that by leasing, the companies will face cash flow problems. This is because the government will only take up about 52 per cent of the residential units and office space that is being built. 'The joint venture companies can sell the remaining 48 per cent to realise their investments in the short-term. Then there is also the commercial and retail space which can be sold,' he says.

It is learnt that the price of the units in Putrajaya cannot be fixed according to the whims and fancies of the companies as it is a national project. Profits, although important, is not exactly a key priority here. While in some development projects, the developers can expect profit margins of up to 40 per cent, the margins are expected to be less in the Putrajaya project given its low risk element. Moreover, Putrajaya Holdings wants to see that the national project is accessible to all sectors of the

society with minimum speculation.

Hashim says Putrajaya Holdings will peg the price of the land and house with the joint venture partner to ensure there is minimum speculation. 'We do not want speculation because our objective is to provide housing for people from all walks of life right from the low to high income group. To make Putrajaya a success within a short time, this speculation will have to be controlled. If there is going to be any speculation, it can only take place in the 32,000 residential units that are open to the public,' he adds with a smile.

SP Setia, which is already constructing the Prime Minister's office and residence, and Hong Leong Properties are the first two companies which will start building residential units in Putrajaya. By end of 1998, a total of 3,000 residential units are supposed to be completed and these two companies will build the bulk of the houses. In fact, SP Setia had said in an analysts' briefing that it will launch 1,300 units this month. Terence Wong of Peregrine Research says although the margins may be less and cash inflow coming over a longer period due to the leasing, the companies can enjoy the economies of scale as they will be building in large quantities. 'Moreover the developers will know in absolute terms their returns. If the project is not viable, I am sure they will not undertake it,' he says.

Although there is a strong possibility that the returns may be over a long term, the spillover effects are tremendous. Numerous companies involved in construction, landscaping and development are expected to benefit from the project. Even in the early stages of the first phase, which is phase 1A, more than 25 companies have been awarded packages and many more will get to enjoy the benefits.

Azizan says the Putrajaya project will provide the basis for sustaining the property sector and the construction industry for many years to come. 'Rather than banking on speculative development, this is for the nation and is less risky,' he says.

Hashim agrees. He says it is unlikely Putrajaya will suffer from any effects in case there is a slowdown in the property sector. 'In fact people are saying with only 32,000 units for sale to the public, we are not building enough!'