PROPERTY INSIGHTS

Malaysia | Quarter 1, 2015

Cautious Sentiment Aggravates Uncertainties

Market Overview

The Malaysian economy grew by 5.8% year-on-year (y-o-y) in Q4. For calendar year 2014, Malaysia achieved GDP growth of 6%. The unemployment rate remained below 3% in Q4. A revised budget has been announced amid low oil prices. The strong US dollar and concerns on the prospect of the Malaysian economy have resulted in the Ringgit being depreciated.

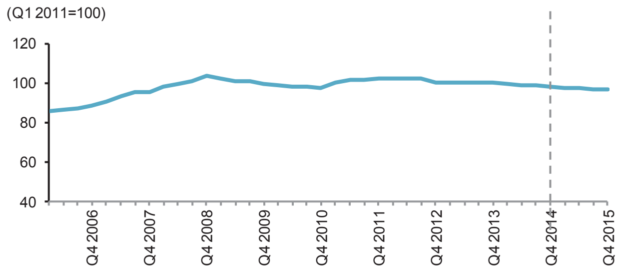
Capital values of purpose-built offices saw a marginal increase of 6%. However rental rates are likely to stay stagnant as the market awaits the incoming supply of roughly 2.7 million sq ft in the next quarter (Figure 1).

Retail sales are expected to grow at a slower rate as consumers accustom themselves to the introduction of GST, effective 1 April 2015. Despite the challenges ahead, more shopping malls will be developed as planned.

In Q1 2015, the high-end condominium market in Kuala Lumpur was relatively stable, although it registered a slight drop in both rental and capital values. Whilst average rents eased 2% from RM3.49 per sq ft per month in Q4 2014 to RM3.42 per sq ft per month in Q1 2015, the overall average price decreased by 3.2% to RM749 per sq ft from RM774 per sq ft.

Figure 1

Prime Office Rental Index (Q1 2011=100)



Source : MTI

Trends & Updates

Economic Overview

Malaysian economy expanded by 6% in 2014

The Malaysian economy expanded by 5.8% y-o-y in Q4 2014, higher than the 5.6% in Q3 2014 (Figure 2). This was mainly attributed to the stronger demand from the private sector, which increased by 8.5% y-o-y in Q4 (Q3 2014: 6.8%). Public expenditure grew by 0.6% y-o-y in Q4 due to low Government spending. On a full year basis, the Malaysian economy registered growth of 6% in 2014, significantly stronger than initially expected.

The unemployment rate remained below 3% for the third consecutive quarter.

With exception of the agriculture sector, all other sectors continued to register positive growth in Q4. The mining sector became the leading driver in Q4, with y-o-y growth of 9.6%. This was followed by the construction sector, which registered y-o-y growth of 8% in Q4.

Inflation declined

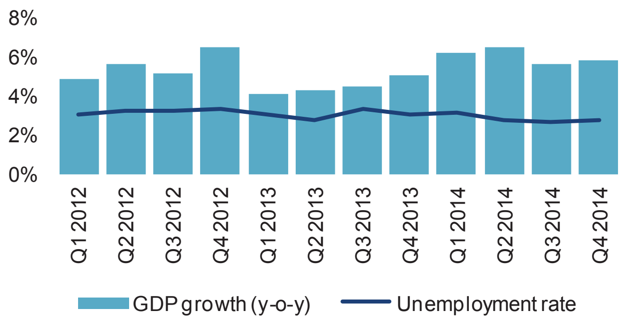
The Consumer Price Index (CPI) continued to decline, from 3.0% in Q3 to 2.8% in Q4. This was mainly contributed by the lower prices of fresh meat and seafood which resulted in lower inflation in the food and non-alcoholic beverages category, from 3.2% in Q3 to 2.7% in Q4. This is likely to change in Q1 2015 as price pressure due to the introduction of the GST in 1 April 2015 and currency depreciation take effect.

Consumer Sentiment Index declined further

The Consumer Sentiment Index (CSI) headed south in Q4. The index decreased by 15 points to 83, from 98 in Q3 2014

Figure 2

Prime Office Rental Index (Q1 2011=100)



Source: Bank Negara Malaysia, Department of Statistics Malaysia, DTZ Research

Ringgit depreciated against the US Dollar in Q1

The Ringgit continued to be under pressure in Q1. This was driven by a number of factors, namely the strengthening of the US dollar, and on-going concerns on the impact of the low oil prices on the Malaysian economy.

Overall, the ringgit depreciated by 6.4% against the US dollar. Besides the US dollar, the Ringgit also depreciated against the euro (-2.3%), pound sterling (-2.2%) and Australian dollar (-0.1%). However, it appreciated against the Japanese yen by 2.3%.

Budget revised amid low oil prices

The Government has revised its budget amid the sharp fall in oil prices. The revised budget is now based on an oil price projection of US$55 per barrel, as compared to US$100 which the initial budget was based on. Accordingly, the target for fiscal deficit has been adjusted upwards to 3.2% from 3.0%. GDP growth for 2015 is now projected at 4.5% - 5.5%, as opposed to 5% - 6%.

Residential

Significant new supply in Q1

The 1,377 condominium units completed in Q1 was more than 10 times that for the same period last year. Some of these projects included The Horizon Residences (335 units) in Jalan Tun Razak and Laman Ceylon (230 units) in Jalan Ceylon.

An additional 6,562 condominium units are expected to enter the market in the remaining quarters, with some 7,939 units expected to be completed by end-2015 (Figure 3). The higher new supply will definitely put some pressure on rental values, especially in the city centre.

Amongst the major developments expected to be completed this year are Banyan Tree Residences (441 units: Jalan Conlay) and M City Residential Suites (1,118 units: Jalan Ampang).

High-end condominium market registered drop in both rental and capital values

Average rents of high-end condominiums in Kuala Lumpur eased 2% to RM3.42 per sq ft per month, down from RM3.49 per sq ft per month in the previous quarter (Figure 4).

Overall average prices decreased by 3.2% in Q1 15 q-o-q to RM749 per sq ft from RM774 per sq ft in Q4 14, as cooling measures took effect.

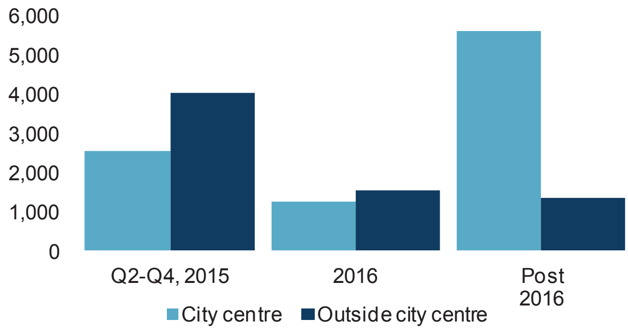
The quarter saw the launch of Tropicana The Residences, on Jalan Ampang which is part of the proposed integrated W Hotel. The project offers 353 exclusive, luxury apartments spread across 55-storeys sitting atop the 24-storey W Hotel. The standard apartments vary from one to three bedrooms, with built-up areas of 710 sq ft to 1,604 sq ft., at average prices of RM2,500 per sq ft.

2015, a year of caution

There is likely to be more caution in the market as a slower economy and higher completion rate are likely to affect investment sentiment. Developers will need to rethink strategies to attract demand, and will be turning to more affordable housing, if their land banks are suitable.

Figure 3

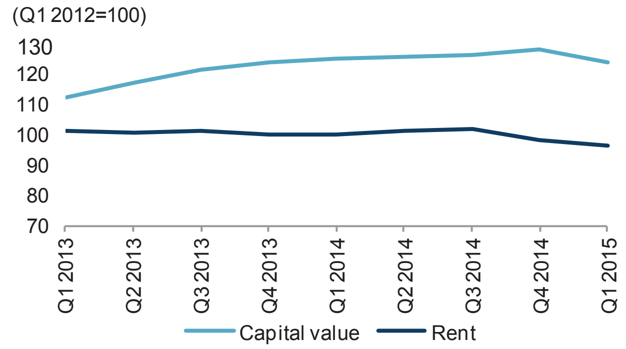
Future supply of high-end condominiums in Kuala Lumpur



Source : DTZ Research

Figure 4

Resale non-landed residential price indices



Source : DTZ Research

Retail

Lower retail sales growth with new GST

The implementation of goods and services tax (GST) effective on 1 April 2015, poses the greatest challenge to the retail industry in the next two quarters. Retail sales are expected to grow at a slower rate as consumers are expected to adopt a 'wait and see' approach that will further weaken sales growth. Consumer confidence is down, as reflected by the waning Consumer Sentiment Index, which slid below the 100-point threshold q-o-q to 83 points in Q1, amidst concerns over uncertainties of incomes, finances and increasing prices of goods.

Retail sales performance in Q4 2014 registered the lowest growth of 0.8% since 2009 despite the school holiday, year-end sale and festive season as consumers remained prudent in spending. Sales growth in Q1 2015 is anticipated to be higher due to the Chinese New Year festival, bonuses and the rush to spend before GST which raised growth to an estimated 3.8%. Retail sales are likely to slow down immediately after introduction of GST, as many consumers have already spent on big-ticket items in advance of its implementation. Retail sales growth in Q2 is expected to expand to 3.5% and increase to 4.8% in Q4 when retail spending is expected to begin to return to normal. Retail sales activity is expected to recover towards the end of the year, with a growth of 6.9%. For the entire 2015, Retail Group Malaysia (RGM) has revised downward its projected retail growth to 4.9% from 5.5%.

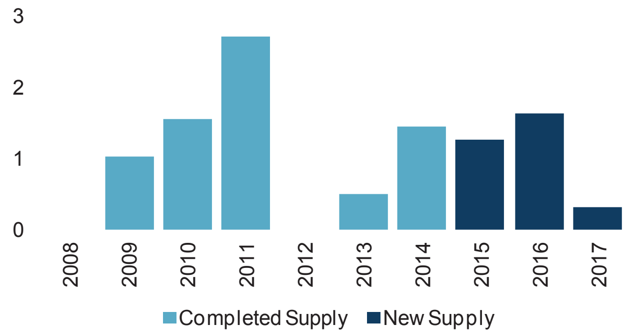
Domestic demand sustained retail activities

Driven by domestic demand, the retail sector remained resilient despite a marginal decline in occupancy by 1.0 percentage-point to 90.3%

Retail stock in Kuala Lumpur stands at 24.45 million sq ft with the entry of Jakel Mall of 330,000 sq ft and the refurbishment of CapSquare after its acquisition from Bandar Raya Developments Berhad (BRDB) in 2012. Some 1.27 million sq ft of retail space is expected to complete in 2015 (Figure 5). Some of the major malls that are expected to enter the market in the next three years are shown in Table 1.

Figure 5

Retail development pipeline including projects on awarded GLS sites, sq ft (million)



Source : DTZ Research

Table 1

Upcoming major retail projects

Name of development	Est Area (NLA, sq ft)	Est year of completion
Sunway Putra Place	620,000	2015
Sunway Velocity	1,000,000	2015
Atria Shopping Mall	450,000	2015
AEON Shah Alam	500,000	2016
The Two @ Rawang	1,350,000	2017

Source : DTZ Research

Mall developments to continue

GST and weaker consumer confidence are not a deterrent to the development of new malls. UDA Holdings Bhd, together with Eco World Development Group Bhd and the Employees Provident Fund Board (EPF), have inked a deal to jointly participate in the development of Bukit Bintang City Centre (BBCC) or the former Pudu Jail site that comprises strata offices, office towers, a hotel and serviced residences and a lifestyle mall of about 1.2 million sq ft. Japan's Mitsui Fudosan (Asia) Pte Ltd is reported to have an interest in the development and operation of the mall. UDA Holdings Bhd is also re-developing Bukit Bintang Plaza (BB Plaza) and will turn it into a 60-storey luxury condominium with three-level mall below through a joint venture with Tradewinds International Sdn Bhd.

The much awaited Tun Razak Exchange (TRX) project revealed that 1MDB Real Estate, the master developer of TRX and Australia's Lend Lease have sealed their partnership to develop the TRX lifestyle quarter with a potential Gross Development Value (GDV) of over RM8bn upon completion. The project will have a new shopping mall, residential towers and a hotel tower connected to a multi-layer central park and the TRX MRT Station.

In Cheras, Jakel Development Sdn Bhd, a textile merchant turned developer, will re-develop the Cheras Velodrome into an integrated mixed-use development tentatively to be called Dupion Island comprising a large scale shopping mall and residential units. Confidence in the retail market led to CMMT acquiring the four-storey Tropicana City Mall and 12-storey Tropicana City Office Tower for RM540m. The acquisition will further strengthen CMMT's position as a sizeable and diversified shopping mall real estate investment trust in Malaysia.

Meanwhile, certain malls are undergoing rebranding and repositioning to face the challenges. The owner of the SSTwo Mall, AsiaMalls Sdn Bhd, under its entity Pramerica AsiaRetail, is planning to rebrand the mall and scale down its size as it has not been trading well since its completion.

Office

Market braces for supply influx

The impending office supply influx has been of concern to the market since last year. While only one office was completed in Q1, Menara Centara with 200,000 sq ft of nett lettable area, looming supply in Q2 is expected to inject close to 3 million sq ft of office space, with Naza Tower, Q Sentral, and Summer Suites. Some 6 million sq ft of completions in total is expected in 2015. (Figure 6)

The minimal increase in supply (200,000 sq ft) was offset by the overall take-up of 208,000 sq ft, resulting in a marginal change in vacancy rate (Figure 7). Total office supply now stands at 72.5 million sq ft, while total occupied space is estimated at around 60.2 million sq ft.0

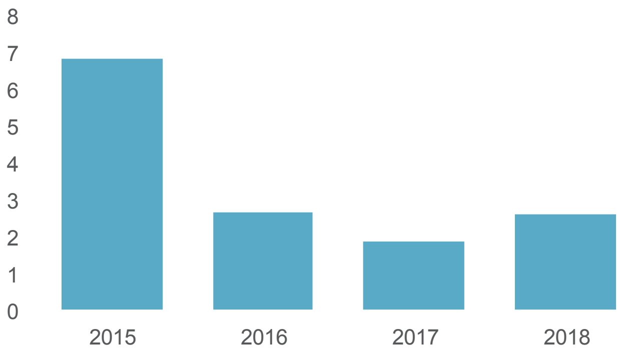
Capital values increased despite weaker rental rates

Capital values increased by about 6% in Q1, despite weak sentiment and easing rents. (Figure 8) As a result, with weaker rents, yield continues to be under pressure.

Two other transactions of office buildings were recorded in Q1 i.e., Quill 10 in Section 13, Petaling Jaya, transacted at RM27.3 million, and Plaza Pekeliling in Jalan Tun Razak, transacted at RM28.28 million. The latter is planned to be converted into a SOHO development.

Figure 6

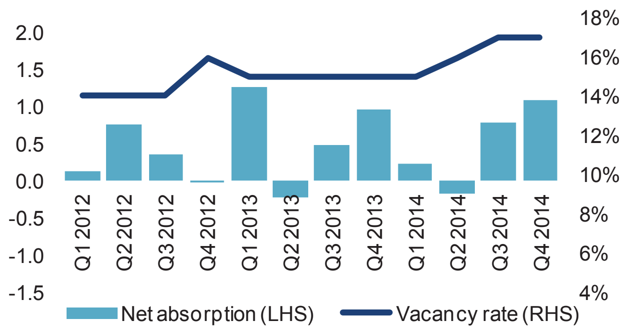
Office development pipeline, sq ft (million)



Source : DTZ Research

Figure 7

Office net absorption, sq ft (million) and vacancy rate



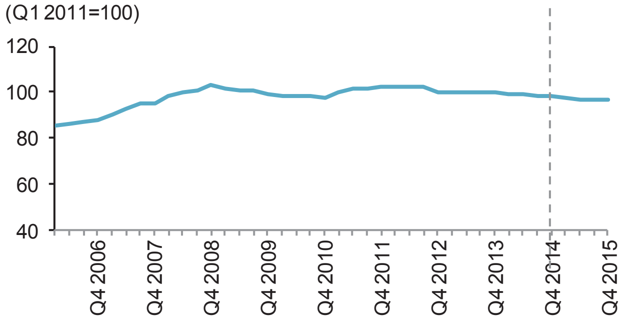
Source : DTZ Research

Impact of weak oil prices

The weak oil and gas sector, which has traditionally driven office demand, is expected to have significant impact on the market in the short to medium term. Lower planned opex and capex from Petronas, the national oil corporation, will have a wider impact on the office market, especially around KLCC. It is still uncertain how long weak oil prices will persist, and diversifying to other higher value service sectors remains challenging despite strong efforts by the Government.

Figure 8

Prime office rental index (Q1 2011 = 100)



Source : URA, DTZ Research

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