# PROPERTY INSIGHTS

Malaysia | Quarter 1, 2016

## Market softens as sentiments falter

## Market Overview

A slowdown in global economy led to a decline in approved investments in Malaysia by 21.0% in 2015. GDP growth for 2016 was revised downward to 4.0% - 4.5%, from 4.0% - 5.0%. While the Overnight Policy Rate (OPR) was maintained at 3.25%, BNM decreased the Statutory Reserve Requirement (SRR) Ratio by 50 basis points to ensure adequate liquidity in the financial system.

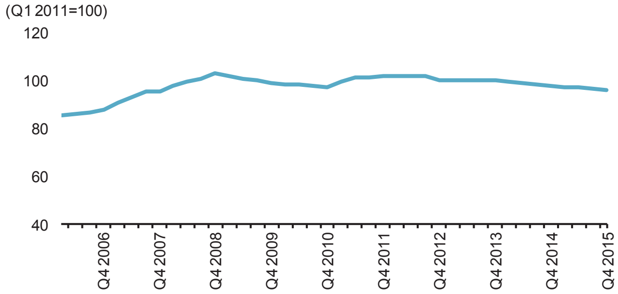
Notwithstanding, Ringgit strengthened in Q1 as sentiments improved following the increase in oil prices and the announcement of the revised budget. Overall the economic prospect is stable.

Average rental rates, capital value and yields for office remained unchanged from Q4 2015 (Figure 1). Total office stock in Kuala Lumpur rose by 1.5 million sq ft in Q1 2016 to 77.5 million sq ft, and the new completions marginally lowered the overall average occupancy rate.

Malaysia's Consumer Sentiments Index has been declining since Q3 2014, dropping to a six-year low of 63.8 points in Q4 2015. The weaker sentiments were largely due to concerns over rising prices. Notwithstanding, growth in retail sales is forecasted to be about 4.0% for 2016.

Figure 1

**Prime Office Rental Index (Q1 2011=100)**




Source : DTZ Research

The residential market in Q1 2016 saw an increase in the number of units (2,171 units) completed compared with Q4 2015 (908 units). This led to a fall in rentals for high-end condominiums (Figure 1). Capital values for high end condominium continue to soften as sales and new launches tapered in Q1 2016. Stricter bank lending attributed to the weaker demand.

## Economic Overview

**Malaysia recorded 5.0% GDP growth in 2015**

The Malaysian economy expanded by 5.0% y-o-y in Q4 2015, which was less than -6.0% in Q4 2014 (Figure 2). Despite a 2.1% expansion in demand from the public sector, private domestic demand saw slower growth (2015: 6.1%, 2014: 7.9%) and net exports contracted by 3.7%.

On the supply side, the construction sector was the main economic driver in 2015, with an annual growth of 8.2%, followed by the services sector which expanded by 5.1%.

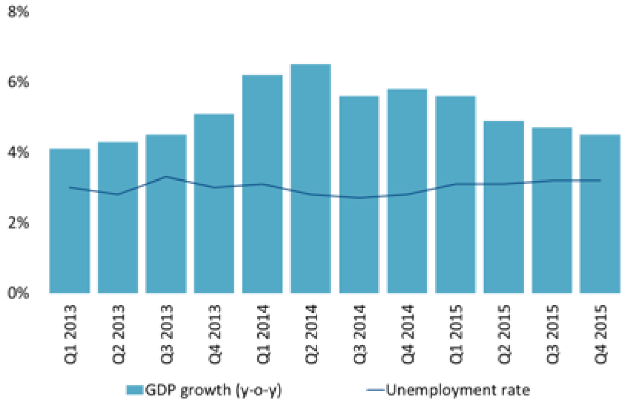
**Approved investments declined by 21% in 2015**

Malaysia attracted RM186.7 billion worth of investments in 2015, 21.0% lower than the RM235.9 billion recorded in 2014. Domestic investors continued to dominate in 2015 with RM150.6 billion of capital outlay, whereas foreign investors committed RM36.1 billion. The services sector remained the leading contributor with 58.0% share of total investments, followed by manufacturing sector (40.0%) and the primary sector (2.0%).

The decline in approved investments can be attributed to the global economic headwinds and political uncertainty in Malaysia. Investments in the services sector fell by 28.0% due to a drop in value of real estate projects, whereas the primary sector contracted by 74.0% due to the sharp downturn in oil and commodity prices. Nevertheless, the manufacturing sector continued to attract investments, which increased by 4.0% in 2015. Companies were attracted to Malaysia because of its increased connectivity through Asian Economic Community (AEC) and China's "One Belt, One Road" initiative. Malaysia was also ranked 24th out of 144 economies in the WEF Global Competitiveness Ranking 2015/2016 for infrastructure. The bulk of the investments came from petroleum products, natural gases, E&E, transport equipment and non-metallic mineral products as the costs of living and operation are lower.

Figure 2

**GDP growth and unemployment rate**




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

**GDP growth for 2016 revised**

The Government has revised its budget amid the decline in oil prices. The revised budget is now based on oil price projection of US$30 to US$35 per barrel, as compared with US$48 which the initial budget was based on. The target for fiscal deficit, however, remains unchanged at 3.1% of GDP. This has attracted positive comments from the rating agencies. GDP growth for 2016 is now projected at 4.0% - 4.5%, as opposed to the earlier projected 4.0% - 5.0%.

In its bid to boost private consumption, the Government has announced that employees' contribution to the Employees Provident Fund (EPF) will be reduced by 3.0% from March 2016 to December 2017. This is expected to increase private sector expenditure by RM8 billion.

**Inflation is set to moderate**

Headline inflation averaged 2.1% in 2015. For the year 2016, inflation is expected to moderate as low energy and commodity prices will mitigate the impact of adjustments in administered prices and the weaker Ringgit.

**BNM decreased SRR by 0.5%**

Bank Negara Malaysia (BNM) has decreased the Statutory Reserve Requirement (SRR) Ratio from 4.0% to 3.5%, with the objective of ensuring adequate liquidity in the financial system. Analysts expect that this measure will inject at least RM6 billion to the system.

**Ringgit appreciated against the US Dollar by 4.7%**

The Ringgit strengthened in Q1, as sentiments improved given the revised budget and the appreciation in oil prices. Between 1 January and 14 March 2016, the Ringgit appreciated against the US dollar by 4.7%. Apart from the US dollar, the Ringgit also appreciated against the Pound Sterling (7.5%), Euro (2.7%), Australian Dollar (1.0%) and Singapore Dollar (1.8%). However, it depreciated against the Japanese Yen by -0.8%.

# Residential

**Significant new completion in Q1 2016**

The number of completions in Q1 2016 reached 1,053, surpassing that in Q4 2015. Nevertheless, it was fewer than in the same period last year. Some of these completed developments included Platinum Victory Face Project (733 units) on Jalan Sultan Ismail and KL Trillion (320 units) on Jalan Tun Razak. They were launched at about RM1,000 per sq ft and RM1,350 per sq ft respectively. An additional 6,708 condominium units are slated to complete from Q2 to Q4 2016 (Figure 3). The pending completions for the rest of 2016 will place some downward pressure on capital and rental values, especially in the city centre.

Amongst the major developments expected to be completed in 2016 are The Sentral Residences (722 units: KL Sentral) and The Ritz-Carlton Residences (300 units: Jalan Sultan Ismail).

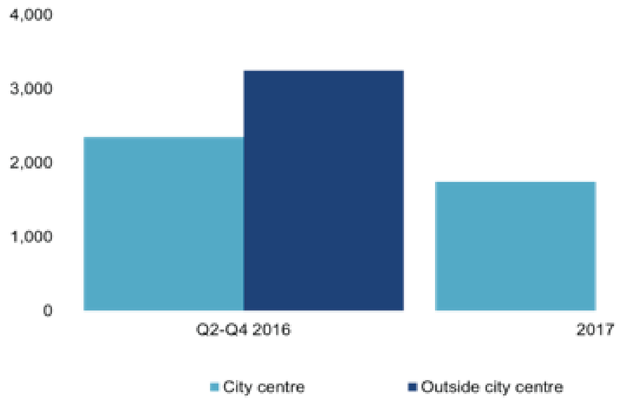
**High-end condominium market registered drop in both rental and capital values**

Average rents of high-end condominiums in Kuala Lumpur eased by 3.5% to RM3.21 per sq ft per month in Q1 2016 from RM3.33 per sq ft per month in Q4 2016 (Figure 4). New completions and retrenchment, especially in the Oil and Gas sector, contributed to the decline in rents.

In contrast, prices are stickier, as average prices decreased marginally by 0.3% in Q1 2016 q-o-q to RM753 per sq ft from RM755 per sq ft in Q4 2015.

Figure 3

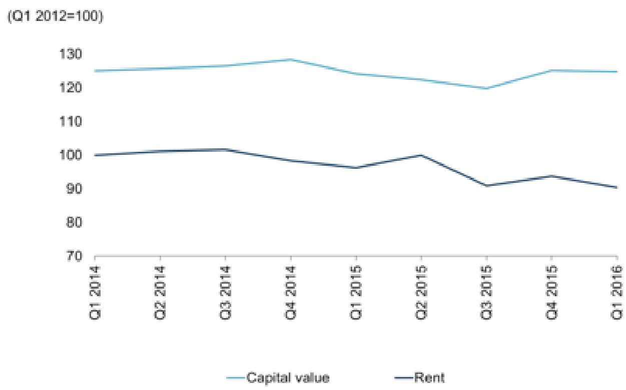
**Future supply of high-end condominiums in Kuala Lumpur**




Source : DTZ Research

Figure 4

**Rental and price indices of high-end condominiums in Kuala Lumpur**




Source : DTZ Research

In Q1, one notable newly launched project was 8 Kia Peng Residences in Jalan Changkat Kia Peng. It is developed by I-Bhd group, the master developer for the 72 acre i-City 'Ultrapolis' development in Shah Alam. The 50 storey luxury residential tower will house 442 units with built up area of between 718 sq ft. and 7,824 sq ft. The selling price starts from RM2,300 per sq ft.

The other notable new launch was the high-rise residential project in Mont Kiara. The proposed development is jointly developed by Agile Real Estate Development and PJD Group. The Agile Mont Kiara is offering 813 units via its 11 towers (8-44 storeys tall). The floor area for each unit ranged between 1,162 sq. ft. and 5,037 sq ft. The average unit price during the launch was about RM950 per sq ft.

More developers are offering rebates to offload unsold stock that have been accumulating from past launches. This is especially so for nearly-completed projects. Additionally, developers are phasing out their launches. Even though the Chinese New Year offered an opportunity to offer auspicious cash ang pows promotions, there are not many units launched.

**Market remains uncertain amid slower macro-economy**

Sales and new launches continued to be slower, although reasonably priced projects at choice locations continue to attract demand. Buyers were more cautious amid the slower macro-economy. Stricter bank lending further dampen demand for residential properties.

## Retail

**Weakening consumer confidence**

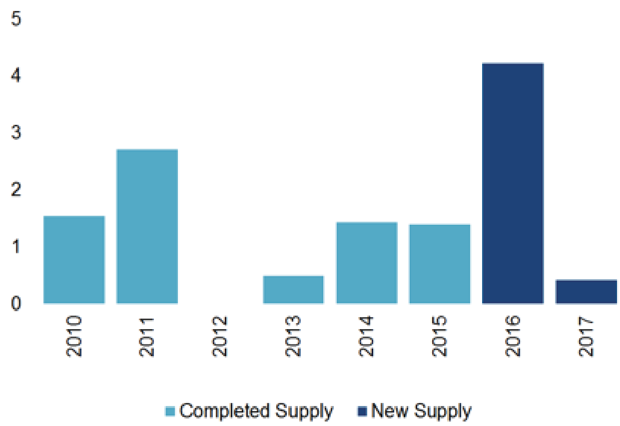
In Q4 2015, Consumer Sentiments Index continued to slip to a record low of 63.8 points from 70.2 points in Q3 2015. Malaysians remained cautious in spending, as their sentiments were clouded by subdued economic and employment outlook and concerns regarding cost of living.

According to Retail Group Malaysia (RGM) in December 2015, Malaysia's retail industry had yet to recover from the imposition of Goods & Services Tax (GST). Problems with the retail sector were compounded by the unexpected and significant weakening of the Ringgit.

The growth rate for overall sales from January to September 2015 was recorded at only 1.0% compared with 4.8% in 2014 for the same period. RGM projected the retail sales growth rate in 2016 to be 4.0%, which will bring sales to RM100.6 billion. Retail sales over the Chinese New Year in Q1 was, however, reportedly disappointing and the announced retrenchment, although moderate in numbers, by Petronas casted a pall on sentiment. Some 38,500 workers were retrenched in 2015.

Figure 5

**Retail new supply (NLA) in Kuala Lumpur, sq ft (million)**




Source : DTZ Research

Table 1

**Selected upcoming retail malls in Klang Valley**

| Name of development | Est Area (NLA, sq ft) | Est year of completion |
|---|---|---|
| Empire City | 1,500,000 | 2016 |
| MyTown | 1,100,000 | 2016 |
| The Two | 1,350,000 | 2017 |
| KSL City Mall 2 | 2,200,000 | 2017 |
| Tropicana Gardens Mall | 1,000,000 | 2018 |

Source : DTZ Research

### More malls despite softer retail sector

The opening of Da:mén USJ and AEON Shah Alam added 400,000 sq ft and 650,000 sq ft of NLA respectively. The opening of the malls brings the retail stock outside Kuala Lumpur to 30.59 million sq ft. Retail stock in Kuala Lumpur stood at 25.82 million sq ft with the opening of the 300,000 sq ft M3 Mall in Setapak (Figure 5). In 2016, more malls are expected to open despite the softer retail sector. This includes Empire City, which will add 1.5 m sq ft of NLA (Table 1).

In Q1 2016, the occupancy rate for retail malls in Kuala Lumpur dropped to 89.9% from 90.4% in Q4 2015, reflecting the challenging retail landscape. Squeezed between higher operating costs and lower revenue, more retailers are expected to close marginal outlets. To retain and attract retailers, landlords are offering rebates, and longer leases for the newer malls. Rental growth is anticipated to moderate for existing malls and more leasing incentives are expected to be offered for the forthcoming malls.

### More outlet centres to be opened

Outlet centres, which offer many luxury brands and designer stores, are getting more popular in Malaysia. The existing outlet centres include Mitsui Outlet Park KLIA Sepang, Johor Premium Outlet and Freeport A'Famosa Outlet. The success of these outlet centres is closely linked to the growth of tourism. The government is ramping up its efforts to revive the Chinese tourist market by providing visa free entry to support the hotel and retail industry.

Pipeline projects such as Kuala Lumpur International Outlets (KLIO) in Putrajaya, Genting Premium Outlet (GPO) in Genting Highlands, and Design Village Penang in Batu Kawan, Penang are expected to become new retail attractions in Malaysia.

## Office

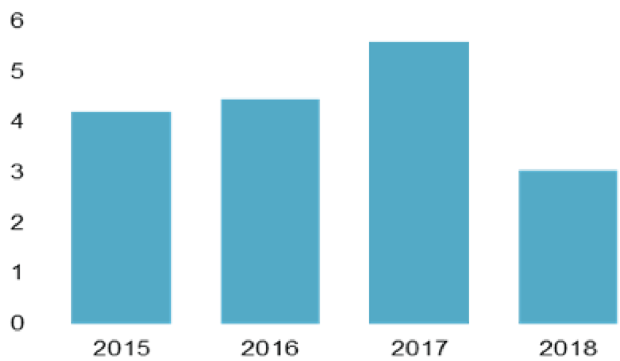
### 1.5m sq ft of NLA was completed in Q1 2016

Total office stock in Kuala Lumpur is approximately 77.5 million sq ft as at Q1 2016 (Figure 6). About 1.5 million sq ft of the office supply was completed in Q1, after the completion of three office developments, namely KL Trillion, Damansara City, and Menara Bangkok Bank. There will be about 3 million sq ft more of office space slated to complete in the remaining 2016.

There was a termination in Q1, with Menara Tun Razak (NLA: 343,000 sq ft) at Jalan Raja Laut completing its demolition works in January 2016. The building will make way for two adjacent Grade A office towers, which are expected to be 42-storey and 18-storey high respectively and have a combined GFA of 2.1 million sq ft.

Figure 6

**Office development pipeline, sq ft (million)**




Source : DTZ Research

## Marginal drop in occupancy despite new completions of new buildings

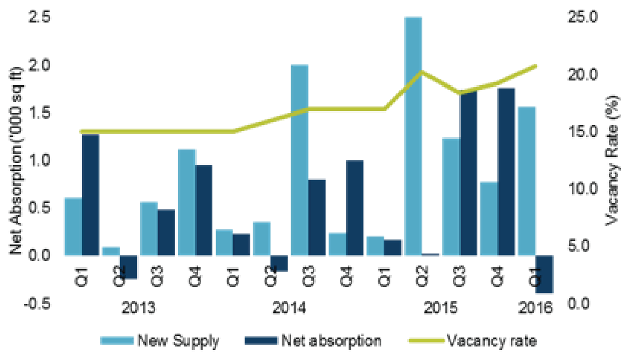
The average occupancy rate in Q1 2016 eased marginally to 79.2% in Q1 2016 from 80.7% in Q4 2015 (Figure 7). The completions of office buildings outstripped the growth in demand, which exerted some downward pressure on the occupancy rate. The new completions, including the aforementioned three buildings, dampen the overall occupancy rate as they are new to the market. They have yet to secure strong commitments from tenants. Nevertheless, several office buildings in Kuala Lumpur recorded healthier occupancy. Additionally, consolidation in the oil and gas industry led some firms to relocate from Singapore to Kuala Lumpur to manage costs, especially given the slump in value of the Ringgit in 2015. Moreover, some companies cited the advantage of being closer to customers in Malaysia's offshore oil and gas sector. Businesses that have relocated to Kuala Lumpur include McDermott, Technip and Subsea 7. Nevertheless, the increase in demand from the cross-border relocation of companies cannot offset the giving up of space from other oil companies, such as Exxon Mobil, that saw retrenchment.

Overall office capital value maintained at RM933 per sq ft in Q1 2016. The sole notable office transaction in Q1 2016 was the disposal of Dijaya Plaza (NLA: 156,488 sq ft). It was transacted at RM895 per sq ft with rental rates staying at RM6.12 per sq ft as per Q4 2015 (Figure 8), the average yield remained stable at 6.25%.

In Q1 2016, Merdeka PNB181 was officially launched. The mixed-use development will be the tallest building in Malaysia when completed in 2024, and will have 82 floors of office. The building will be mainly occupied by the PNB Group. With another major brownfield project, Bukit Bintang City Centre, launched in Q1, the city fringe will have the capacity to be a new business hub.

Figure 7

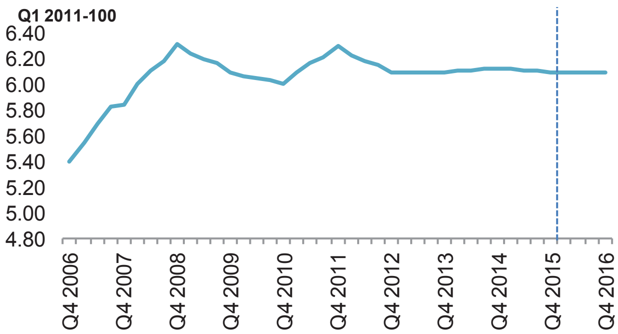
**Office net absorption, sq ft (million) and vacancy rate**




Source : DTZ Research

Figure 8

**Prime rental index (Q1 2011 = 100)**




Source : DTZ Research

Nevertheless, due to slower growth, the unabated new supply continues to be a concern in the market and rental and occupancy rate are expected to ease.

## Reliance may shift towards MNCs

Sentiments on the Malaysian economy are set to strengthen in 2016 in light of the recovering oil price and Ringgit. Foreign investors, who previously adopt a wait-and-see approach, are likely to enter the market. With more foreign entities setting up their offices in Kuala Lumpur, the impact of the new completions will lessen.

Looking forward, office rental growth is forecasted to moderate throughout the rest of 2016, and tenants will have more affordable options.

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