PROPERTY INSIGHTS

Malaysia | Quarter 2, 2015

Higher consumer prices impact retail sales

Market Overview

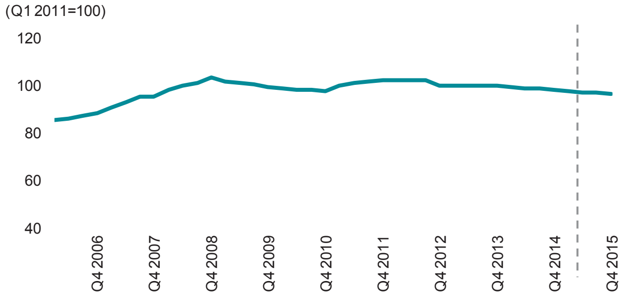
The Malaysian economy expanded by 5.6% y-o-y in Q1 while the unemployment rate increased from 2.8% in Q4 2014 to 3.1% in Q1. Bond selloffs, low oil prices, and concerns on 1MDB (a sovereign investment firm) have resulted in further depreciation of the Ringgit, which recorded a year-to-date drop of 8% against the US dollar. Under the 11th Malaysian Plan, the Government is targeting annual GDP growth of 5% to 6% for the year 2016 – 2020.

Investment activities were strong across the various sectors, with volume increasing 28% from the previous quarter. Prices are still holding at fairly aggressive yield rates as REITs and trusts remain active buyers.

Market sentiment was dragged down by concerns of potential oversupply in the midst of weakening economic conditions. Nevertheless, capital values and rental rates remained stable over the quarter. Looking to the future, the office market in KL is expected to remain cautious in light of significant pipeline supply (Figure 1).

Figure 1

Prime Office Rental Index (Q1 2011=100)



Source : MTI

The impact of the good and services tax (GST) implemented on 1 April 2015 on the retail market was as anticipated. Consumer confidence has continued to weaken as prices increase, thus cautious customer spending translated into moderate sales performance.

Market sentiment in the residential market continued to be weak, which was reflected in the slower sales in Q2.

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Trends & Updates

Economic Overview

Malaysian economy grew by 5.6% in Q1 2015

The Malaysian economy expanded by 5.6% year-on-year (y-o-y) in Q1 2015 (Q4 2014: 5.7%) (Figure 2). Seasonally adjusted growth quarter-on-quarter (q-o-q), however, declined as the economy expanded by 1.2% in Q1, lower than the 1.8% achieved in Q4 2014. This was largely due to the contraction in net exports, which offset the stronger growth in domestic demand.

Demand from the private sector, which was driven by stronger growth in both consumption and investment, increased by 9.6% y-o-y in Q1 (Q4 2014: 8.3%). The increase in Government spending also contributed to stronger demand from the public sector, with a y-o-y growth of 2.5% in Q1 compared to the 0.6% in Q4 2014. The labour market remained largely unchanged in Q1, with unemployment rate at 3.1%.

All sectors continued to register positive growth in Q1, with the exception of the agriculture sector. The construction sector was the main driver of the economy in Q1, with a y-o-y growth of 9.7%, followed closely by the mining sector which expanded by 9.6% y-o-y.

Inflation declined further in Q2

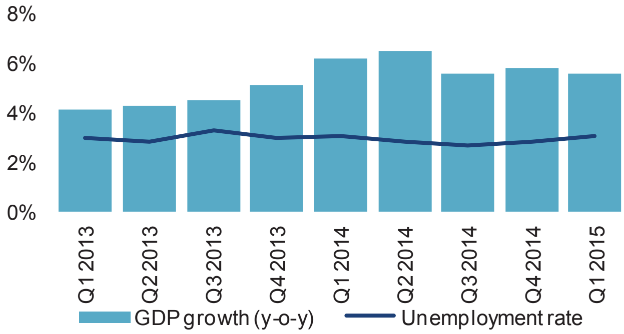
The Consumer Price Index (CPI) rose by 0.7% y-o-y in Q1 2015, significantly lower than the 2.8% increase recorded in the previous quarter. This was largely due to the downward revision of fuel prices that caused the cost of transport items to fall by 7.6% y-o-y in Q1. With the introduction of GST in Q2, it is likely that the CPI will continue an upward trend.

Consumer Sentiment Index continues to head south

The Consumer Sentiment Index (CSI) declined in Q1 2015 for the third consecutive quarter. The index decreased from 83 in Q4 2014 to 72.6 in Q1 2015, the lowest level in six years.

Figure 2

GDP growth and unemployment rate



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

Ringgit depreciated against the US Dollar in Q2

The Ringgit continued to depreciate against the US dollar in Q2. The depreciation was attributed to a number of factors which included sell-off activities in the bond market, the expected increase in US interest rates and low oil prices. The fall of the Ringgit also reflected a weakening of investor confidence due to the controversy surrounding 1Malaysia Development Berhad (1MDB), a sovereign investment firm.

In Q2, the Ringgit depreciated by 1.9% against the US dollar, after a drop of 6.0% in Q1. In addition to the US dollar, the Ringgit also depreciated against the pound sterling (-8.4%), euro (-5.5%), Australian dollar (-2.6%), Singapore dollar (-4.1%) and Japanese yen (-0.1%).

Malaysia targets 5%-6% annual GDP growth for the year 2016 – 2020

The Government has unveiled its 11th Malaysian Plan, as part of the vision to transform Malaysia into a developed nation by 2020. Besides targeting an annual GDP growth of 5% to 6%, the government is expecting the unemployment rate to sit at 2.8% in 2020, with inflation around 2.5% to 3%. The 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

Steady new supply during the quarter

A steady new supply of 1,437 high-end condominium units were recorded in Q2, an increase of approximately 4% from the 1,377 units completed in Q1. These new completions were all located outside of the city centre, such as Arcoris Residences @ Arcoris Mon't Kiara, Verdana North Kiara and G Residences. There were no completed projects within the city centre.

Some 5,125 units of high-end condominiums are expected to enter the market by the year end, with about 50% of new supply to be located within city centre (Figure 3).

High-end condominium market relatively stable with a slight drop in capital value

The average price and rental rate of high-end condominiums in Kuala Lumpur were both relatively stable in Q2. Average prices declined marginally by 1.6% q-o-q to RM738 per sq ft in Q2. On the other hand, average rents inched up from RM3.42 per sq ft per month in Q1 to RM3.55 per sq ft per month in Q2 (Figure 4).

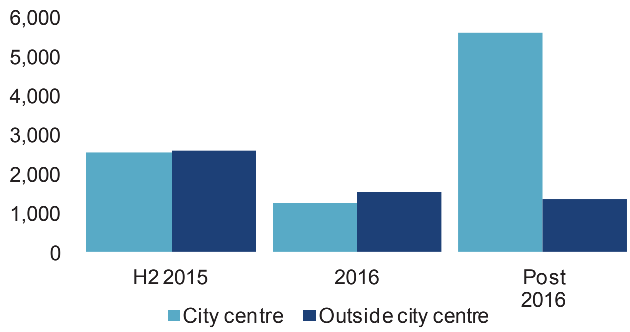
Demand for larger units are expected to be slower than demand for smaller ones (with a built-up size of less than 1,000 sf) due to budget constraints. However, a larger supply of small units in the pipeline is expected to moderate demand for smaller units.

Residential market remained tepid

Sales and new launches continued to be slow, especially for luxury properties. Housing demand is likely to be project specific. A case in point was Residensi Sefina at Mont' Kiara, which attracted strong interest. This project was developed by UEM Sunrise Bhd, offering 245 high-end condominium apartments. Most units have a built-up area between 1,300 sf to 1,700 sf with a starting price of RM830 psf (or at RM1.1 mil) and above.

Figure 3

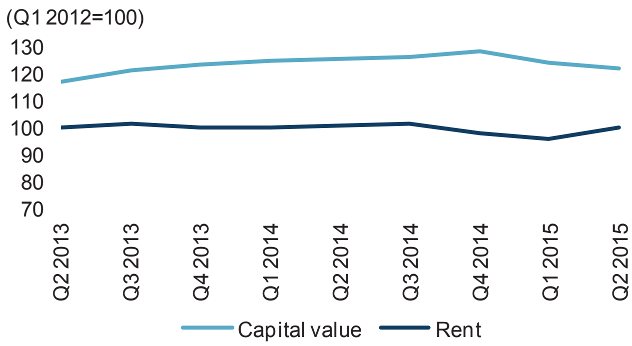
Future supply of high-end condominiums in Kuala Lumpur



Source : DTZ Research

Figure 4

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



Source : DTZ Research

Retail

Declining consumer confidence

The impact of the good and services tax (GST) implemented on 1 April 2015 on retail market has been as anticipated. Predominantly, retailers have experienced a slowdown in retail sales as consumers remain cautious to spending.

Consumer confidence continued to weaken, with the consumer sentiment index (CSI) declining below the 100-point threshold. The CSI has now reached its lowest level in six years. The index plunged 10.4 points quarter-on-quarter to 72.6 in Q1 2015 after falling 15 points to 83 points in Q4 2014. Consumers are tightening their spending as they are concerned over their financial and employment outlook.

The cautious mood translated into moderate sales performance, which dropped from 3.8% in Q1 to 3.5% in Q2. According to Retail Group Malaysia, for the six-month period after the implementation of GST, retail sales would likely slow down as consumers adopt a wait-and-see attitude on the increase of the goods prices before adapting to the new tax scheme. Sales are expected to pick up in the third and fourth quarter by 4.8% and 6.9% respectively. For the whole year of 2015 retail sales are expected to grow by 4.9%, lower than the 5.5% growth projected earlier.

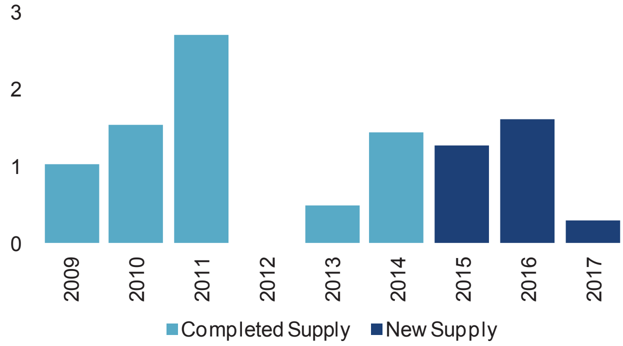
Buoyant occupancy

There was a marginal decline of three percentage-points in the occupancy rate to 90%. The retail sector remained resilient even though domestic demand continued to be the key driver.

The refurbished Sunway Putra Mall (formerly known as Putra Mall) added 620,000 sq ft to stock, increasing retail stock in Kuala Lumpur to 25.1 million sq ft (Figure 5) in Q2. The mall forms part of Sunway Putra Place that includes the Legend Hotel and an office tower, acquired by Sunway REIT from Metroplex Holdings Sdn Bhd about four years ago.

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
Sunway Velocity	1,000,000	2015
Glomac Damansara	350,000	2015
AEON Shah Alam	500,000	2016
The Starling	380,000	2016
The Two @ Rawang	1,350,000	2017

Source : DTZ Research

More malls despite softer retail scene

Despite the softer retail scene, more malls entered the market in Q2 (Figure 5). Atria Shoping Centre, a major mall in Petaling Jaya during the 1980s, made a re-entry as Atria Shopping Gallery. Atria Shopping Centre was unable to compete with the newer shopping complexes and lost its attraction in 2000s. In 2007, OSK Property Holdings acquired the mall from Lien Hoe Corporation and have subsequently redeveloped the complex.

Another exciting entry Q2 was the opening of the first phase of Mitsui Outlet Park KLIA, located about 6km from Kuala Lumpur International Airport (KLIA) in Sepang. It was developed by a joint venture between Malaysia Airports Holdings Bhd (MAHB) and Japan's Mitsui Fudosan Co.

It is the second outlet mall in Malaysia after Johor Premium Outlet was opened in 2011. The Mitsui Outlet Park is the first Mitsui branch in Southeast Asia and upon full completion in 2021 will be Mitsui's largest outlet mall, at approximately 470,000 sq ft.

The retail industry continues to be attractive to some developers with more large shopping malls being planned (Table 2). Tropicana Corporation revealed its 1 million sq ft shopping mall as part of an integrated development comprising a shopping mall, a hotel, residences and offices at Tropicana Gardens in Kota Damansara. In Bukit Jalil, Ho Hup Construction Co Bhd and Malton Bhd will be bulding 2 million sq ft mall dubbed as Pavilion 2 (Table 1). Overall, the retail scene is entering a more competitive and more subdued period in the coming years.

Office

No shortage of office space anytime soon

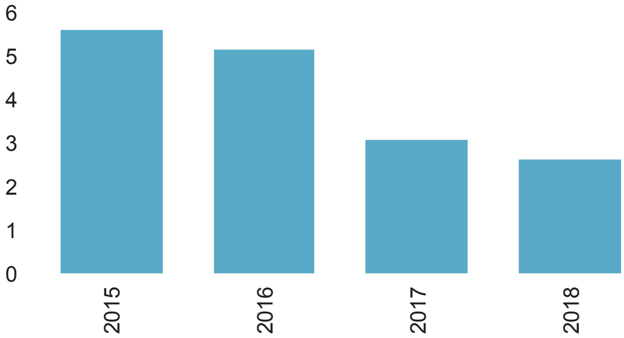
The completion of Naza Tower @ Platinum Park, Q Sentral, and Summer Suites added about 2.8 million sq ft of office space to the Kuala Lumpur market in Q2. The majority of the newly completed supply emanated from the completion of Q Sentral, which delivered 1.4-million sq ft of strata space. Q Sentral offers units ranging from 108 sq ft up to 40,880 sq ft, and has reported to be almost sold out. Naza Tower and Q Sentral are both dual-compliant (Green Building and MSC status) office buildings, reflecting the growing trend of higher specification buildings to meet tenants' preferences. Office stock in Kuala Lumpur now stands at 75.3 million sq ft in Q2, a 3.8% increase q-o-q.

Another 2.6 million sq ft of supply is in the pipeline over the rest of the year. The 58-storey Ilham Baru (IB) Tower at Jalan Binjai is expected to be completed in the next quarter, which will provide more than 500,000 sq ft of office space. Other developments such as KL Trillion at Jalan Tun Razak, and two of the six towers at The Vertical, Bangsar South will start to complete from Q4 2015.

It is projected that some 5 million sq ft of office space is expected to come on board in 2016 (Figure 6), which includes The Vertical (Bangsar South) and KL Eco City at Jalan Kerinchi.

Figure 6

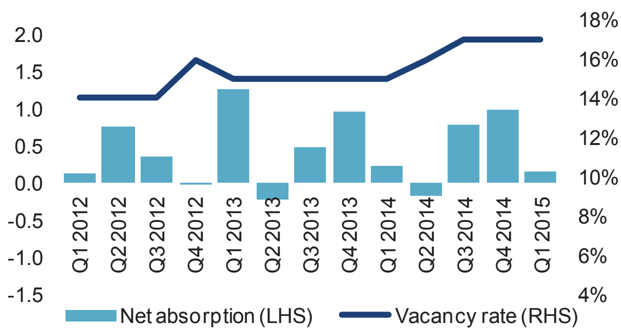
Offic e development pipeline, sq ft (million)



Source : DTZ Research

Figure 7

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



Source : DTZ Research

Market sees maintaining capital value and rental rates

Capital values for office space stayed flat at RM 942 psf. Similarly rental rates remained the same as the previous quarter at RM 6.40 psf per month (Figure 8). This is unlike previous quarters, where an average of 0.44% q-o-q appreciation has been recorded.

The looming potential oversupply of office space will add downward pressure to rents and capital values. Notwithstanding, the refurbishment of older buildings, which include Menara Citibank and Menara JCorp, help to support rent and occupancy and the demand stemming from tenants relocating to new buildings help to offset some of the pressure.

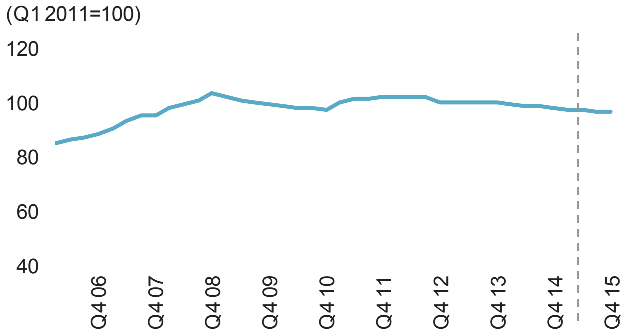
Resilient market amidst a challenging economy and weak sentiment

Despite the decline of the Ringgit against the US Dollar to a ten-year low in Q2, the office market is expected to remain healthy. A weaker ringgit may even increase the interest of international investors to local properties. Indeed this reason was cited by Singapore's Royal Group as one of their main reasons for acquiring the DoubleTree by Hilton.

The corporate office scene is going through rejuvenation as new office towers continually supply the market while numbers of the old ones are being refurbished or converted, such as the aforementioned Menara Citibank and Menara JCorp, while Menara ING is in the process of being converted into a hotel.

Figure 8

Prime rental index (Q1 2011 = 100)



Source : URA, DTZ Research

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