# PROPERTY INSIGHTS

Kuala Lumpur | Quarter 3, 2016

## Investment sales increased despite subdued economic climate

### Market Overview

- Malaysia's economy expanded by 4.1% y-o-y in H1 2016, compared to 5.3% in the same period last year. This was due to slower growth in the private sector demand and a contraction in net exports. To support Malaysia's economic growth amid a slower global economy, Bank Negara Malaysia (BNM) reduced the Overnight Policy Rate (OPR) by 25 basis points to 3.00%.
- Investment sales grew to RM1.2b in Q3 2016 from RM414.35m in Q2
- The largest investment deal was the acquisition of Renaissance Hotel Kuala Lumpur for RM765m.
- Office average occupancy rate maintained at 79.4%, while average office rents in central areas stayed at RM6.03 per sq ft q-o-q.
- Retail sales increased by 7.5% y-o-y in Q2 2016.
- Although prices for high end condominiums improved marginally, rents have declined by 4.0% q-o-q to RM3.07 per sq ft.

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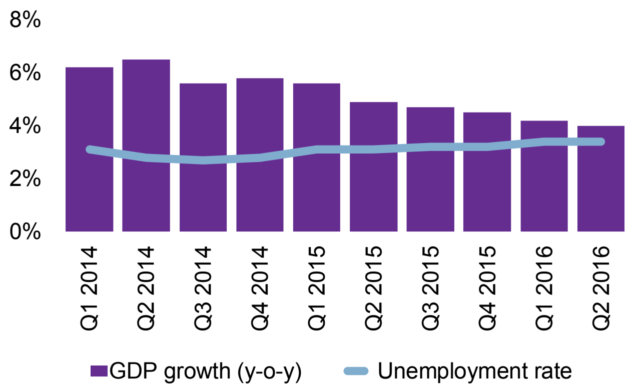
## The Economy

**Key Highlights in Q3**

- The Malaysian economy expanded at a slower pace of 4.1% y-o-y in H1 2016 (H1 2015: 5.3% y-o-y).
- Bank Negara Malaysia (BNM) reduced the Overnight Policy Rate (OPR) from 3.25% to 3.00% to support economic growth amid weaker global sentiments.
- Consumer Price Index (CPI) grew by 2.7% y-o-y in H1 2016, higher than the 1.4% increase in H1 2015.
- Consumer Sentiment Index rose to 78.5 in Q2 from 72.9 in Q1 2016.
- Between 30 June and 14 September 2016, the Malaysian Ringgit depreciated against the US Dollar by 2.7% to RM4.13 to USD1.

Figure 1

**Malaysia GDP growth and unemployment**




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

**Market Commentary**

Malaysia's economy grew at a measured pace, as it registered moderated growth in the first half of 2016 (Figure 1). This was due to the slower growth in private sector demand and a contraction in net exports.

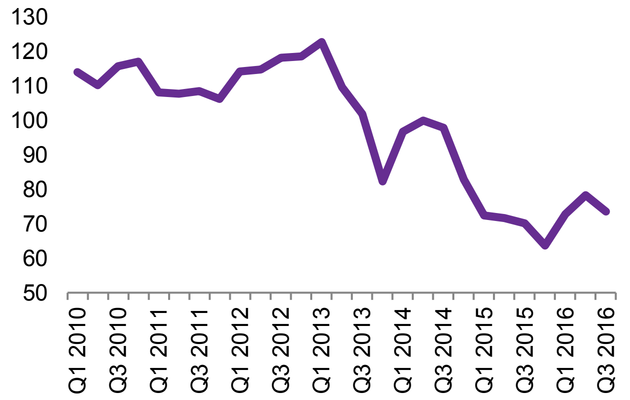
The decline in net exports led to concerns on the possibility of a current account deficit. The fall in net exports was largely due to the fall in prices for liquefied natural gas. Coupled with the increase in imports of capital goods, which was driven by demand from ongoing construction projects, the current account will be under pressure to narrow further. With the Malaysian Government running a fiscal deficit, there is risk of twin deficits occurring

> If Malaysia were to have "twin deficits", it will negatively impact on its credit ratings and currency value.

On the supply side, the construction sector led the growth in H1 with a y-o-y expansion of 8.4%, followed by the services and manufacturing sectors, which grew by 5.4% y-o-y and 4.3% y-o-y respectively. The mining sector expanded at a marginal pace of 1.4%

Figure 2

**Consumer Sentiments Index**




Source : Malaysian Institute of Economic Research, NTL Research

y-o-y, while the agriculture sector declined by 6.0% y-o-y due to the fall in palm oil production, after El Nino cut yields in H1 2016.

Separately, the Consumer Sentiments Index (CSI) remains below its threshold level of 100 despite improving by 5.6 points q-o-q (Figure 2). Sales of big-ticket items continued to be slow, as evidenced by slower sales of residential properties and passenger vehicles, which declined by 15% y-o-y in H1 2016.

**Outlook**

With energy and commodity prices remaining subdued, BNM lowered its inflation forecast for 2016 from 2.5% - 3.5% to 2.0% - 3.0%. To encourage growth and consumption, BNM further reduced its OPR from 3.25% to 3.00%.

# Residential

**Key Highlights in Q3**

- Five residential projects with a total of 1,095 high-end condominium units were completed in Q3, of which two developments are in the city centre.
- Some 6,088 units of high-end condominiums are expected to come on board in Q4 2016, with 44% of the upcoming supply coming from the city centre (Figure 3).
- Prices for high-end condominiums marginally improved by 0.3% q-o-q to RM742 per sq ft (Figure 4).
- Nonetheless, rents for high-end condominiums eased by 4.0% q-o-q at RM3.07 per sq ft per month.

**Market Commentary**

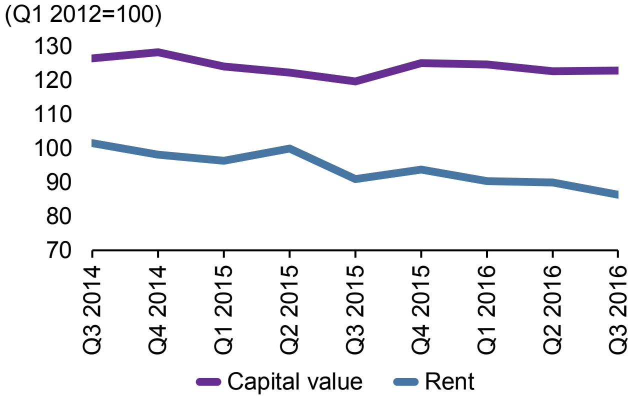
While the lowering of the Overnight Policy Rate (OPR) reduces the cost of borrowing for home buyers, buying sentiments remained subdued due to slower economy. This further exerted downward pressure on residential sales volume and capital values. The National Property Information Centre (NAPIC). that The volume and value of transactions in Q1 2016 recorded a y-o-y decrease of about 14.4% and 17.9%.

Notwithstanding, the prices for high-end condominiums at choice locations were resilient amid the slower economy (Figure 4). Buyers, who are mainly locals, are attracted to high-end developments that are close to MRT stations. There is also strong demand for smaller condominium units in city centre. Although the unit price was high, the quantum of the smaller units is affordable to middle income who seek properties to invest.

Additionally, to encourage sales, developers are also more flexible. These included offering housing loan assistance packages, rebates and discounts, gifts and prizes, and absorbing legal fees.

Figure 3

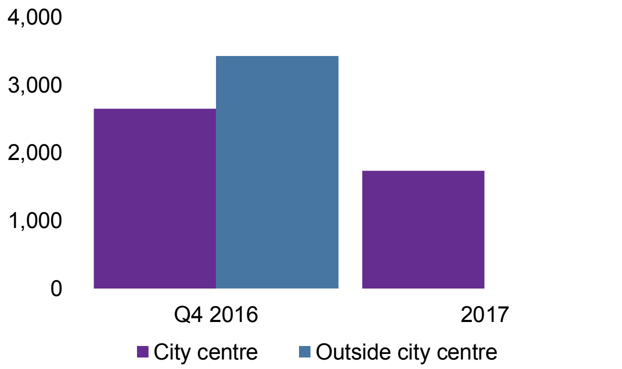
**Rental and price indices of high-end condominiums in Kuala Lumpur**




Source: NTL Research

Figure 4

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




Source: NTL Research

By allowing eligible developers to be moneylenders, it is expected to increase home sales as it gives more flexibility to buyers in financing their home purchases.

While prices maintained q-o-q for high-end condominiums, rents continue to trend downwards the slower economy and more completions.

**Outlook**

As the economy continues to show signs of slowing, the residential market is expected to remain subdued till end 2017 and likely to bottom out in 2018. Notwithstanding, the demand for smaller homes at affordable quantum in city centre will remain strong.

We also anticipate homes for the mass market to pick up, if eligible developers can provide loan facilities of up to 100% to property buyers. Under the scheme, developers can apply for a moneylenders' license under the Moneylenders Act, which will be issued by the Ministry of Urban Well-being, Housing and Local Government Ministry. Developers with the license will be able to give out loans to buyers at 18% without collateral and 12% with collaterals. For the developers, the end-financing will also serve as another profit centre.

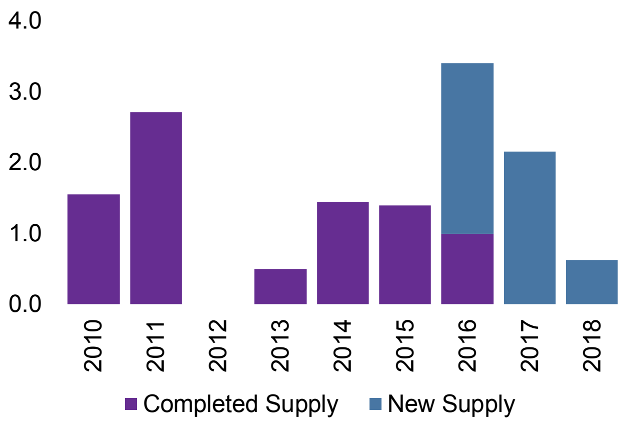
# Retail

**Key Highlights in Q3**

- Retail sales increased by 7.5% y-o-y in Q2 2016, which was a rebound compared to Q2 2015. Retail sales fell by 11.9% in Q2 2015 after the announcement of the GST.
- For Q3 and Q4 2016, the Retail Group Malaysia (RGM) forecasted 5.9% and 5.5% y-o-y growth in sales respectively.
- There is no new mall completions in Q3 2016. Total retail stock in Kuala Lumpur remained at 27.47m sq ft, while retail stock outside Kuala Lumpur amounted to 29.49m sq ft.
- Occupancy rate of retail malls in Kuala Lumpur stayed firm at 90.0%.
- Malls have to keep up with changing retail trends in order to attract more people.

Figure 5

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




Source: NTL Research

The retail sector remained challenging and the upcoming malls in the pipeline will worsen the situation.

**Market Commentary**

Despite consumer sentiments crawling up by 5.6 points to 78.5 points in Q2 2016, It remained below the threshold level of optimism. Overleveraged, Malaysians in the bottom 40 and middle 40 household income segments showed concerns over rising costs of living and remained cautious in spending.

According to RGM, the positive growth in Q2 2016 was attributed by the Hari Raya festival in early July as well as a post GST rebound. The department store category performed the best at 21.1% growth, according to the retailers' association. The annual sales growth forecast for 2016 was maintained at 3.5%.

There were no completion registered in Kuala Lumpur in Q3 2016, although about more than 2m sq ft of NLA is expected to come on board in Q4 (Figure 5). This includes Sunway Velocity and the extension of Pavilion KL (10-storey retail podium with NLA of 250,000 sq ft).

The challenging retail landscape also led to the sale of malls. For instance, SStwo Mall in Petaling Jaya, which shuttered down, was put up for sale by ASIAN Retail Mall Fund II (ARMF). Other retail malls in the market included Empire Shopping Gallery in Subang Jaya and Evolve Concept Mall in Ara Damansara.

According to Malaysia Shopping Malls Association (PPKM), the retail market was exhibiting signs of stress such as higher retail space per capita, delays in mall openings, closures of malls and the number of malls put up for sale. In response, the local authorities in Kuala Lumpur and Selangor were urged to impose a two-year freeze on new applications to build new shopping malls.

To draw shoppers to the malls, retailers capitalize on the popularity of the augmented reality game Pokemon Go by placing lure modules in designated areas in the malls. Sunway, Publika, Suria KLCC and KK Supermart reported higher footfall at the malls through the Pokemon Go events. Notwithstanding, the popularity of Pokemon Go is waning.

**Outlook**

With more malls completing in 2016 and 2017 (Table 1), we anticipate landlords and retailers to face greater competition. Furthermore, the retail market is also losing market share to e-commerce.

Table 1

**Selected upcoming retail malls in Klang Valley**

| Name of development | Est Area (NLA, sq ft) | Location | Est year of completion |
|---|---|---|---|
| Sunway Velocity | 1,000,000 | Cheras | 2016 |
| MyTown | 1,100,000 | Cheras | 2017 |
| KSL City Mall 2 | 2,200,000 | Klang | 2017 |
| Tropicana Gardens Mall | 1,000,000 | Kota Damansara | 2018 |
| Central Plaza @ i-City | 1,000,000 | Shah Alam | 2018 |

Source: NTL Research

# Office

**Key Highlights in Q3**

- The Vertical (Tower B) is the sole completion in Q3. This brings total office stock in Kuala Lumpur to 78.9m sq ft.
- Average office rents in central areas stayed at RM6.03 per sq ft per month (Figure 6).
- Occupancy rate for Kuala Lumpur office maintained at 79.4% q-o-q (Figure 7).
- Capital value and average yield for office space were RM933 per sq ft and 6.25% respectively in Q3.

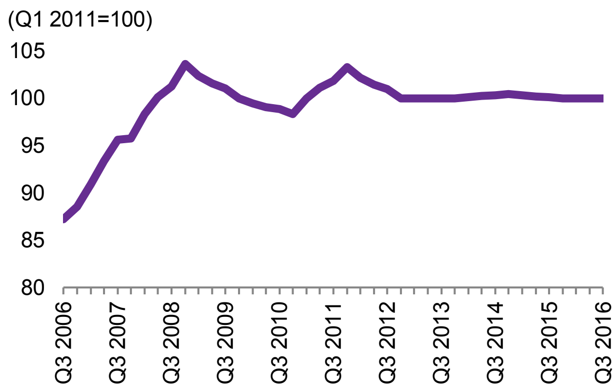
**Market Commentary**

The Kuala Lumpur office market largely remained the same state as in Q2, as the market seems to be at an equilibrium state. The Vertical's Tower B (NLA: 750,000 sq ft) at Bangsar South is the sole completion in Q3. Both towers of The Vertical will offer a total of 1.5m sq ft of office space. Tower B, however, is expected to be put for sale on an en bloc basis.

With the economy slowing, and the office market likely to be more competitive, developers were slowing their construction schedule. Bangsar Trade

Figure 6

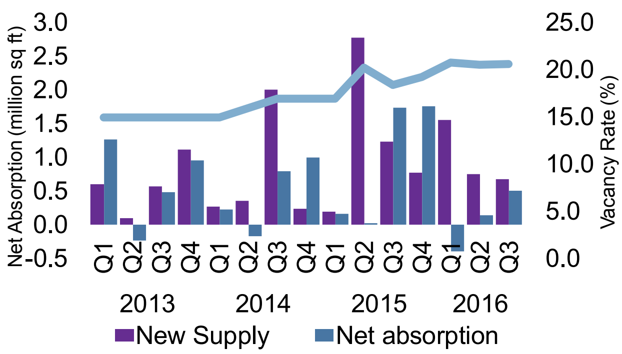
**Prime rental indices – Kuala Lumpur**




Source: NTL Research

Figure 7

**Office net absorption, sq ft (million)**




Source: NTL Research

Center, for example, delayed its completion and cancelled the construction for one of its originally-planned three buildings for the time being.

While the developers or owners can consider converting their office buildings to other uses to avoid a compression in yields, there is little room to maneuver under current market conditions. On top of the issue of oversupply in the other real estate sectors, the KL City Hall (DBKL) has also stopped approving of new hotel licenses in Q1 and there were calls to freeze retail developments in Klang Valley in Q3.

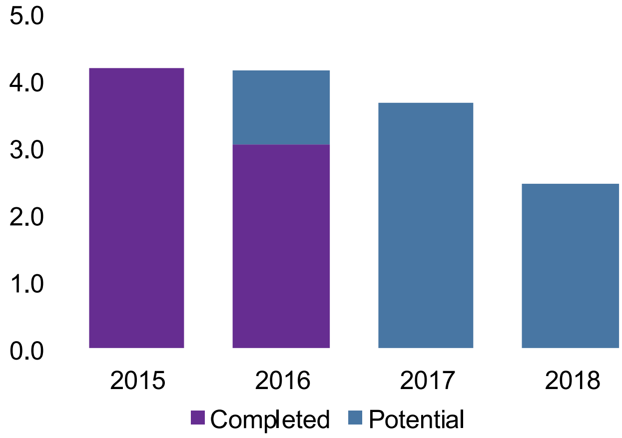
One of the last conversions of use was the former Menara ING, now known as Holiday Inn Express. It was partially converted, with at least 4 floors still operating as office space (NLA: 47,500 sq ft). The other conversion was the former Wisma MBSB at Leboh Ampang. However, the conversion is happening at a slow pace.

**Outlook**

Whilst the sector has been downgraded by analysts and rating agencies, rents are unlikely to decline further. New completions are likely to be introduced slowly to maintain the rents. The health of the office sector relies significantly on stronger growth in the services sector, and a recovery in the Oil and Gas segment that remains subdued.

Figure 8

**Future pipeline supply, sq ft (million)**




Source: NTL Research

As the office market becomes more competitive with the upcoming completions (Figure 8), landlords become more flexible to attract tenants.

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