PROPERTY INSIGHTS

Malaysia | Quarter 4, 2015

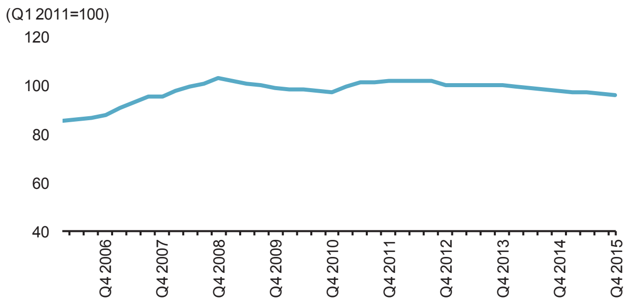
Investment activities remained resilient

Market Overview

The Malaysian economy slowed further to a two-year low of 4.5% y-o-y in Q4 with overall growth for the year at 5%. Consumer confidence worsened as the sentiment index hit an all-time low of 63.8 points by year end, as reflected by in weaker growth in private consumption. The labour market largely remained unchanged, with unemployment rate registering at 3.2%. The Overnight Policy Rate (OPR) was maintained at 3.25% in Q4. Investment in real estate was active in Q4 2015 driven mainly by domestic REITS, and there was an overall increase in sale volume of 37% in 2015 despite an uncertain business environment and the absence of foreign investors.

Figure 1

Prime Office Rental Index (Q1 2011=100)



Source : DTZ Research

The office market continued to be more competitive in the midst of a slowing economy and new completions. Owners of newer office buildings were offering more aggressive terms to gain market share. Although overall average capital value and rental rates are stable, downward pressure remains (Figure 1).

Despite weaker consumer sentiments that had negatively affect retail sales, the overall occupancy rate marginally down 1.0% y-o-y in Q4. The market is aggravated by more malls opening in Q4 including the country's second IKEA at Jalan Cochrane. Several proposed malls such as Empire City Damansara Mall and M3 Mall have delayed their openings to 2016 in response to weaker leasing pre-commitments.

The residential market was lackluster in 2015, with volume affected by tighter credit and weak market sentiment. Throughout 2015, residential price saw a marginal drop between 1.5% and 3.2% in first three quarters while rents fluctuated between -9% and 3.8%. Irrespective, high-end condominium market registered a marginal increase in Q4 of both price and rental values at 4.4% q-o-q and 3.1% q-o-q, respectively.

Economic Overview

Slower economic growth since Q1 2015

The Malaysian economy continued to grow at a slower pace in Q4 2015, registering low growth rate of 4.5% y-o-y and an overall expansion of 5% in 2015 (Figure 2). GDP growth recorded in 2015 was the lowest in the past two years. On a q-o-q seasonally-adjusted basis, the economy grew by 1.5% in Q4, lower than the 1.8% achieved in the corresponding period in 2014. This was due to the lower growth in aggregate domestic demand.

Private domestic demand grew by 4.9% y-o-y in Q4 (Q3 2015: 4.4%). The higher growth in private consumption was due to year end festivities. The labour market largely remained unchanged, with unemployment rate registering at 3.2%. Private investment continued to grow due to capital spending in the manufacturing and services sectors. Demand from the public sector increased by 2.1% y-o-y in Q4 (Q3 2015: 2.8%), due to the turnaround in public investment.

On the supply side, the construction sector led the growth in Q4 with a y-o-y expansion of 7.4%, followed by the Services and Manufacturing sectors which both grew by 5.0% y-o-y. The Agriculture expanded at a slower pace of 1.3%, with mining declining by 1.4% due to the sharp downturn in oil price.

Headline Inflation increases

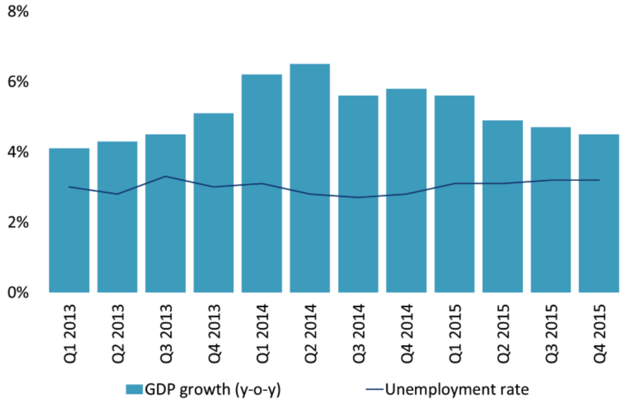
The Consumer Price Index (CPI) rose by 2.7% y-o-y in Q4 (Q3 2015: 2.6%). This was mainly due to the higher inflation in food and non-alcoholic beverages. Inflation is expected to moderate due to weaker crude oil prices.

BNM maintained Overnight Policy Rate (OPR) at 3.25%

Bank Negara Malaysia maintained the OPR at 3.25%, given the heightened downside risk and slowing private consumption. Moving forward, several analysts believe that BNM is unlikely to increase OPR in 2016.

Figure 2

GDP growth and unemployment rate



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

Ringgit strengthened in Q4

The Ringgit was among the worst-performing currencies in 2015, with a double-digit drop of 22.8% against the greenback. This was attributed to a number of factors which included low crude oil prices, the expected increase in US interest rate, and weakened investors' sentiment.

However, the Ringgit rebounded partially, partly driven by the improvement in investors' sentiments following the sale of Edra Global Energy Berhad by 1Malaysia Development Berhad (1MDB) to China General Nuclear Power Corp.

In Q4, the Ringgit appreciated against the US dollar by 3.5%. Apart from the US dollar, the Ringgit also appreciated against the pound sterling (5.6%), euro (6.3%), Japanese yen (3.9%) and Singapore dollar (2.7%). However, it depreciated against the Australian dollar by 0.5%.

Residential

A Slowing market, as buyers take a cautious stand

Generally, 2015 is a year where both buyers and developers were cautious given the implementation of GST in Q2, the tightening of credit facilities by financial institutions, the cooling measures imposed, weakening currency, etc.

908 high-end condominium units completed in Q4

In Q4 2015, 908 high-end condominium units were completed. This is unlike the previous quarter, when there were no new completions. The new completions in Q4 were all located outside of the city centre, which consists of Scenaria @ North Kiara (468 units) and Concerto North Kiara (440 units).

Of the 7,939 units that were initially expected to complete in 2015, only 3,722 units (or 47%) from 11 high-end residential projects were completed.

High-end condominium market relatively stable, registered increase in both price and rental

Throughout 2015, house price sae a marginal drop of between 1.5% and 3.2% in the first 3 quarters, whilst rental value has fluctuated between -9% and 3.8%. In Q4 prices went up by 4.4% from the preceding quarter Q3. The average price of high-end condominiums in Kuala Lumpur was stable in the quarter, despite tightened credit facilities that resulted in a slow-down in transaction volumes. The average capital value increased marginally by 4.4% q-o-q to RM755 per sq ft in Q4 (Figure 3), whilst average rental increased to RM3.33 per sq ft per month in Q4, a slight increase of 3.1% q-o-q.

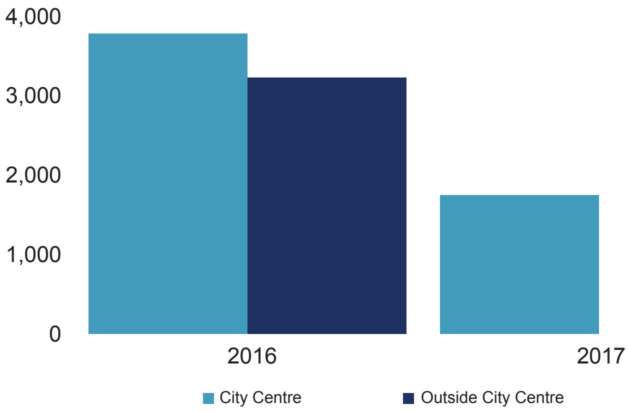
2016 likely to be more challenging with many uncertainties

Sales and new launches continued to slow, especially for luxury properties. This is largely due to the increasingly saturated market amid a difficult marketing environment.

With economists predicting the two years ahead to be a challenging period for most businesses, market sentiments are expected to weaken further. The softening of the market is expected to be compounded by the downside risks from the external

Figure 3

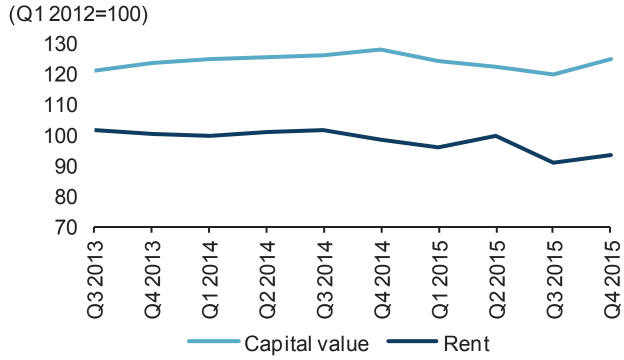
Future supply of high-end condominiums in Kuala Lumpur



Source : DTZ Research

Figure 4

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



Source : DTZ Research

environment and lasting effects from the various cooling measures imposed. Moreover, the weakening of the Malaysian Ringgit is anticipated to further reduce consumers' purchasing power.

Notwithstanding the above, there is a significant supply of about 7,028 units in 2016, of which about half (54% or 3,786 units) are located in the city centre (Figure 4).

Projects sited in the city centre and close to infrastructure developments such as the new MRT line and extension of LRT line are more likely to benefit from stronger demand. Additionally, the values of these projects will be more resilient against external market forces due to their prime locations.

To mitigate the slowdown, developers are strategizing to target the middle income home buyers in 2016.

Retail

Weakened consumer confidence in Q3

In Q3 2015, Consumer Sentiments Index sank to a new low of 70.2 points, compared to 71.1 points in Q2 2015. This was mainly attributed to subdued consumer spending and delayed shopping plans amid lowered consumer confidence.

According to the Retail Group Malaysia (RGM), the projected retail sales growth rate in 2015 was lowered for the fifth time within a year, from 3.1% to 2.0%. It also cut its retail sales growth forecast for Q4 2015 to 3.8% from an earlier forecast of 6%.

Retailers have experienced a major drop in sales with some registering a more than 40% decline over the festive periods in the second half of the year 2015, according to Malaysian Employers' Federation (MEF). The decline was due to the combined impact from the implementation of the GST in April and the Ringgit's depreciation against the US dollar.

Computer and Multimedia Association Malaysia (Pikom) also reported that the GST and weaker Malaysian Ringgit led to a 30% drop in ICT sales. Nonetheless, the ICT retail market is expected to recover in the second half of 2016.

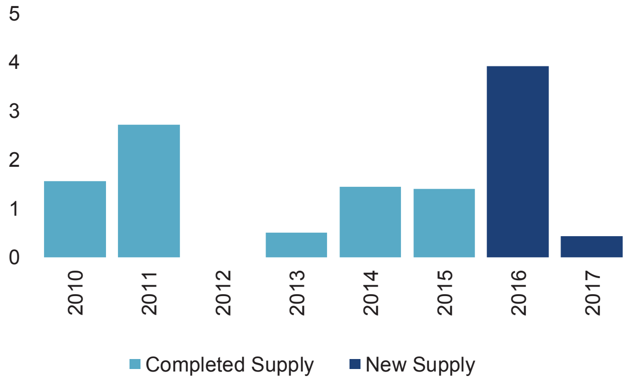
Influx of mall space despite softer retail market

Driven by domestic demand, the retail sector was resilient with occupancy rate rising marginally to 90.4% in Q4 2015, marginally down 1.0% year-on-year (y-o-y). The marginal increase was largely supported by the increase in occupancy levels at Sunway Putra Mall and the opening of IKEA Cheras. IKEA Cheras was the exciting entry in Q4. It was the second IKEA store in Malaysia after IKEA Mutiara Damansara opened in 2003. IKEA also plans to open their third and fourth stores in Johor (2017) and Penang (2018).

In Q4, 2015, retail stock in Kuala Lumpur stands at 25.82 million sq ft with the completion of IKEA Cheras, with NLA of 450,000 sq ft. In Q4, two malls opened in the suburban areas, namely Evolve Concept Mall @ Pacific Place and Star Avenue Lifestyle Mall.

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

Some malls that were expected to open in Q4 had postponed their openings to 2016. Empire City Damansara Mall for example, delayed its opening to 2016. The delay was attributed to requests by some international brands for additional time to source from their suppliers. Similarly, M3 Mall also postponed its opening to 2016.

Pressure on retail outlets

Due to the relatively large impending supply, existing secondary malls are expected to face challenges in maintaining their occupancy levels and rental values. Approximately 4.3 million sq. ft and 12.2

million sq. ft of retail spaces are projected to complete in the city and suburban areas, respectively (Figure 5). Malls that are expected to be completed in next three years include Empire City Mall, MyTown, The Two, KSL City Mall 2 and Tropicana Gardens (Table 1).

The retail sector is anticipated to become increasingly competitive in 2016, as numerous new mixed-use developments have incorporated retails centres as key components with similar concepts.

Acquisition of The Intermark Mall by Pavilion REIT

Pavilion REIT proposed to acquire The Intermark Mall, which forms part of the Intermark mixed-used development for RM160 million. The acquisition comprises a six-storey retail building together with 367 parking bays, which are located at the intersection of Jalan Ampang and Jalan Tun Razak. The retail building has net lettable area of 225,014 sq ft and is currently 74% occupied.

Office

Total stock in Klang Valley reached 76.5m sq ft

The total stock of office space in Klang Valley reached 76.5 million sq ft in 2015. About 4.2m sq ft of new supply was added to the existing stock, which is higher than the 2.9 m sq ft in 2014. 2016 will also see a similar level of new office supply with construction of project still unabated, thus potentially delaying any prospect of an early recovery.

The stock of office space is expected to go up further and peaked in 2017, exerting further pressure on office rents (Figure 6). Notwithstanding, developers may postpone the date of completion to spread out supply. This is evidenced in Q4 2015 when no new supply came on board.

Challenging occupancy dampen rental rate

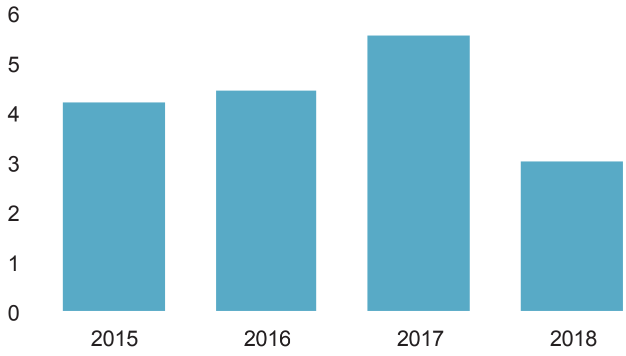
Due to the slowing economy and greater uncertainty, landlords are offering more flexible terms to retain and attract tenants. Leases at some of the new buildings such as Naza Tower and Ilham Tower were secured at rental rates lower than expected, i.e. from RM6.50 psf per month. This helped to support the demand and net absorption in 2H 2015, where vacancy rate remained stable at about 20% in Q4 (Figure 7).

In light of subdued demand and economic uncertainties, primary rental rate saw a marginal decline in Q4 to RM6.12 psf (Figure 8). Separately, secondary rental rate stagnated in Q4 at RM4.25psf.

Despite the weaker rental market, capital value for office space in Q4 remained stable. This is because most owners were not in a hurry to sell, as they have

Figure 6

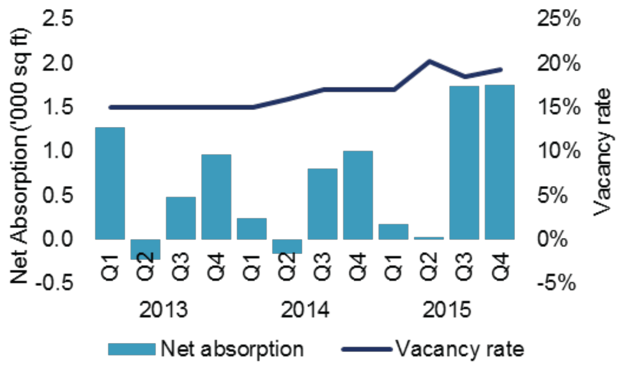
Office development pipeline, sq ft (million)



Source : DTZ Research

Figure 7

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



Source : DTZ Research

the financial ability to hold their assets. Menara Shell at Jalan Tun Sambanthan was sold at RM1,129 psf which was marginally higher than two previous offices sold at KL Sentral in the earlier part of the year, i.e. Menara CIMB and Nu Tower 1 at RM1,061 psf, and 1,090 psf respectively. While a recent entitlement of a 186,667 sq ft office at Damansara town Centre done at a lower price at RM825 psf, it was a related party transaction involving Malton Bhd.

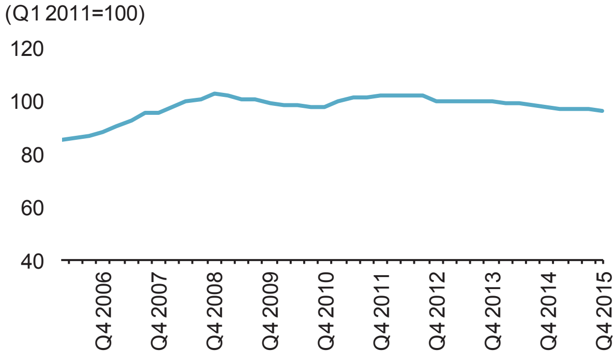
Reliance may shift towards MNCs

In 2016, it is anticipated that the demand of office space will be supported by MNCs as the depreciation of the Malaysian Ringgit make it cheaper to locate there. According to A.T. Kearney's Global Services Location Index, Malaysia places third in terms of its level of attractiveness for investment. InvestKL, the government agency task to promote inward investment to the Kuala Lumpur is also targeting at least 16 MNCs for 2016 to set up regional offices here.

As concerns over the political economy tide over, the office market is expected to recover.

Figure 8

Prime rental index (Q1 2011 = 100)



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