PROPERTY INSIGHTS

Kuala Lumpur | Quarter 4, 2016

Residential price show resilience due to lack of selling pressure

Market Overview

- After five consecutive quarters of decline, Malaysia's economy rebounded with y-o-y growth of 4.3% in Q3, compared to 4.0% y-o-y registered in Q2 2016. This was driven mainly by a turnaround in net exports. Unemployment rate edged up to 3.5% in Q3 due to slowing hiring activities.
- The proposed injection of a portfolio of six retail properties into KIP REIT worth RM580m is the highlight for Q4 2016.
- Office average occupancy rate improved to 82.4%, while average office rents in central areas stayed at RM6.03 per sq ft q-o-q.
- Retail sales increased by 1.9% y-o-y in Q4 2016, slightly better than 1.6% growth a year ago.
- Rents for high end condominiums marginally improved by 1.9% q-o-q to RM3.13 per sq ft, but declined by -6% y-o-y, while the prices remain stable at RM742 per sq ft with decline of -1.7% y-o-y.

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Trends & Updates

The Economy

Key Highlights in Q4

- The Malaysian economy grew by 4.3% y-o-y in Q3 (Q2 2016: 4.0% y-o-y).
- Unemployment rate increased slightly to 3.5% in Q3, from 3.4% in Q2 2016.
- Consumer Price Index (CPI) increased by 1.3% y-o-y in Q3, lower than the 1.9% y-o-y growth in Q2 2016.
- Consumer Sentiment Index declined to 73.6 in Q3 from 78.5 in Q2 2016.
- Ringgit slipped to RM4.48 per US dollar, its lowest level since the Asian Financial Crisis in 1998.

Market Commentary

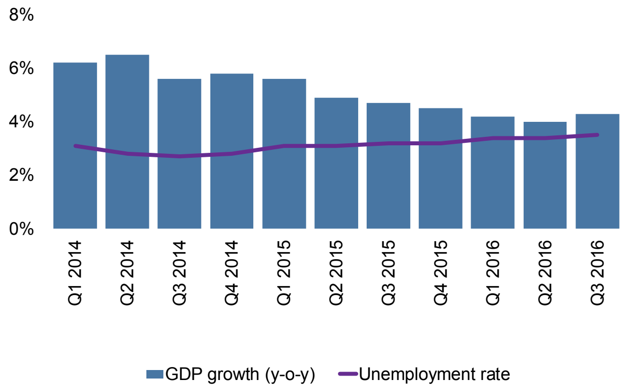
Malaysia' economy expanded at a faster pace in Q3 after five quarters of decelerating growth (Figure 1). The faster economic growth was largely due to growth in domestic demand. Sectors that expanded in Q3 included services (6.1%), manufacturing (4.2%), mining (3.6%), and construction (7.9%). However, the agriculture sector contracted by 5.9% y-o-y due to the lagged impact of El Nino. Net exports also increased by 5.9% (Q2:-7.0%), but that improvement was due to a fall in imports.

Private sector expenditure rose by 6% y-o-y, supported by growth in private consumption (6.4%) and private investment by 4.7%. In comparison, public sector expenditure edged up slightly by 0.3% with 3.1% increase in public consumption offset by a 3.8 percent contraction in public sector investment. The GDP growth for Malaysia is projected to be at 4.2% in 2016.

Despite the uncertain external environment and weaker economic conditions, the labor market remained largely stable. Consumer sentiments were 4.8% y-o-y higher. (Figure 2).

Figure 1

Malaysia GDP growth and unemployment

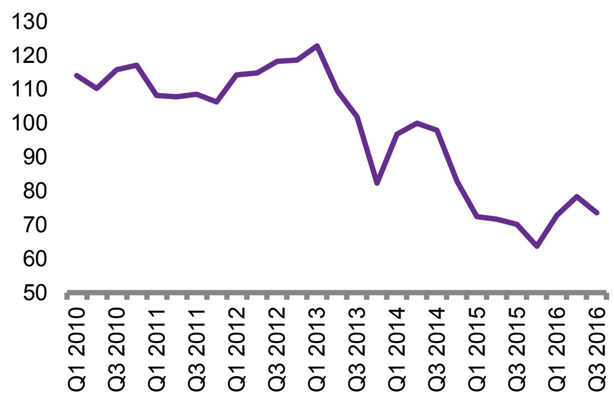


Source :Bank Negara Malaysia, Department of Statistics Malaysia, NTL Research

The domestic economy will be the main driver of growth in 2016, as the infrastructure projects will generate employment and significant multiplier effects to the economy.
The upward trending commodity will add further support to the growth of economy.

Figure 2

Consumer Sentiments Index



Source : Malaysian Institute of Economic Research, NTL Research

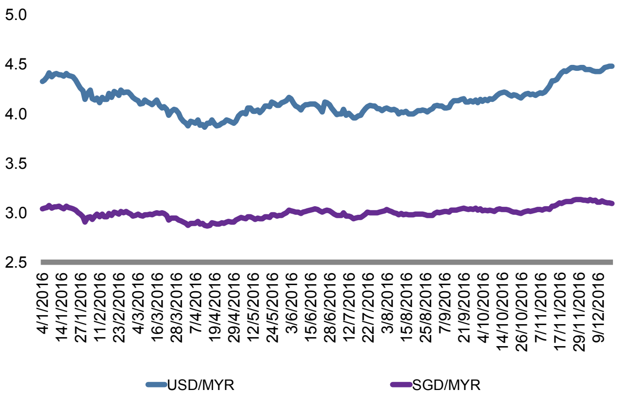
The Ringgit slipped to its lowest level since 1998 after US Federal Reserve raised its interest rate by 0.25% (Figure 3). Bank Negara Malaysia introduced several measures in bid to stabilise the Ringgit, which included banning non-deliverable forward contracts on the currency and requiring exporters to convert 80% of foreign earnings into the Ringgit.

Outlook

Looking ahead, the Ringgit is likely to see further depreciation amid volatile external environment. This will add pressure on business as it is unlikely transfer the cost to consumers. Private sector demand will remain as the key driver of the Malaysian economy in 2017, The World Bank projected that GDP growth for the year 2017 will be marginally higher at 4.3% although various external uncertainties could pose risk to this recovery.

Figure 3

Malaysian Ringgit Exchange Rate



Source: Bank Negara Malaysian, NTL Research

Residential

Key Highlights in Q4

- In the final quarter 2016, only two residential projects with a total of 475 high-end condominium units were completed.
- Of the 7,761 units that were initially expected to complete in 2016, only 3,064 units (or 37%) from 10 high-end residential projects were completed. Some 8,135 units of high-end condominiums are expected to come on board throughout 2017, with 60% of the upcoming supply coming from the city centre (Figure 4).
- Prices for high-end condominiums remain stable at RM742 per sq ft with -1.7% y-o-y growth (Figure 5).
- Nonetheless, rents for high-end condominiums recorded a slim improvement of 1.9% q-o-q at RM 3.13 per sq ft per month, against -6.0% y-o-y.

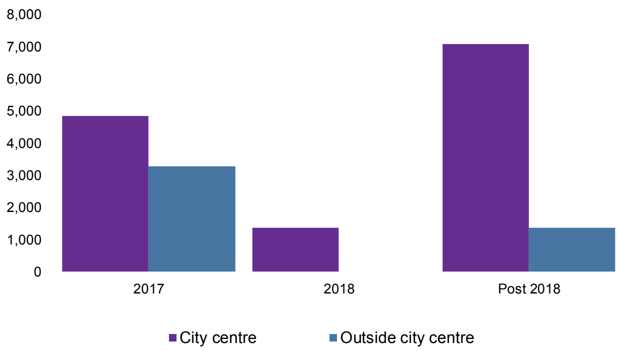
Market Commentary

Buyers and developers were cautious in 2016, given the uncertain market, tightening of credit facilities by financial institutions, the cooling measures imposed, and the weakening currency.

Most of the sales in 2016 emanated from the primary residential market, driven by affordable homes under initiative of the Federal Government. As outlined in

Figure 4

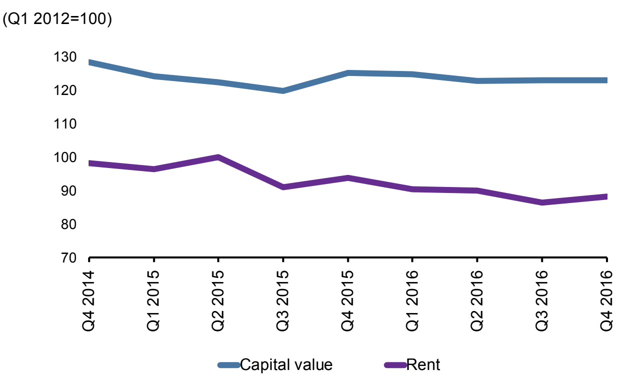
Future supply of high-end condominiums in Kuala Lumpur



Source: NTL Research

Figure 5

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



Source: NTL Research

the Budget 2016, some RM200 million were allocated under the First House Deposit Financing Scheme, which was established by the Ministry of Urban Well-being, Housing and Local Government, and about RM1.6 billion spent to build 175,000 units of PRIMA homes throughout the country. These allocated budgets were well-received and helped increase homeownership rate, especially for the lower middle and middle income earners.

Prices and rents continued to trend downwards with the slower economy. Prices for high-end condominiums that are sited in the city centre and close to infrastructure developments, such as the new MRT line and extension of LRT line, are more resilient.

> The allocated budgets on affordable homes were well-received as it helped the middle income earners to afford housing.

Outlook

Given the uncertain economy, the market is expected to remain subdued till end 2017 and likely to bottom out in 2018. There are 8,135 units of high-end condominiums expected to come on board in Kuala Lumpur throughout 2017. The KL's residential property market will be more challenging due to oversupply, coupled with other factors – the falling Ringgit, political uncertainty, and the property market's cooling measures.

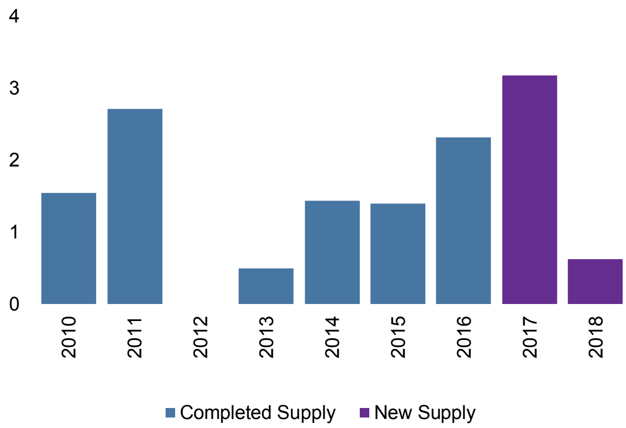
Retail

Key Highlights in Q4

- Retail sales increased by 1.9% y-o-y in Q4 2016, slightly better than 1.6% growth a year ago.
- For Q4 2016, the Retail Group Malaysia (RGM) estimated 5.5% y-o-y growth and expected a rebound in the department store cum supermarket operators.
- With the completion of Pavilion Elite (the extension of Pavilion Mall), Sunway Velocity Mall and DC Mall at Damansara Heights, total retail stock in Kuala Lumpur increased to 28.79m sq ft while the retail stock of Outside Kuala Lumpur maintained at 29.94m sq ft (Figure 6)
- Occupancy rate of retail malls in Kuala Lumpur stayed at the same level of 90.0%.
- Heightening interest from Japanese retailers seen from the opening of the world's largest Isetan The Japan Store, the first Family Mart outlet in Malaysia and the world's third premium superstore Aeon Max Value Prime.

Figure 6

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



Source: NTL Research

Market Commentary

Consumer sentiments were higher in Q3 2016 than a year ago, but it has started to ease, declining by 6.2% q-o-q. According to Retail Group Malaysia (RGM), the third quarter saw below expectation retail sales growth of 1.9% y-o-y and it was expected to rebound and grow by 5.5% in the fourth quarter. Weak performance in the previous quarters and expecting consumers continue to hold back their spending, RGM has revised the retail sales growth for 2016 from 3.5% to 3% with a total retail sales value of RM99.1 billion. The challenging retail market is expected to continue and for 2017, a 5% growth is forecasted.

This quarter saw two major malls, Pavilion Elite (250,000 sq ft NLA) and Sunway Velocity Mall (880,000 sq ft NLA) opened in November and December respectively to capture some of the end of year sales. While, another mall, MyTown Shopping Centre has delayed its opening to February 2017 from November 2016.

More interest from Japanese retailers in the market as Japan-based Isetan Mitsukoshi Holdings Ltd has opened its world's largest Isetan The Japan Store at Lot 10 that has NLA of 118,400 sq ft. It is the second store after Paris. Another retailer, the well-known Family Mart store opened its first outlet in Malaysia at Wisma Lim Foo Yong, Kuala Lumpur. About 300 Family Mart stores are being planned throughout Malaysia in 5 years. Under Aeon, the first Aeon premium superstore in Malaysia known as Aeon Max Value Prime was opened recently. Located at Sunway Velocity Mall, it is Aeon's third premium superstore in the world after Japan and Hong Kong.

Besides the upcoming new supply in 2017 (Figure 6), there will be significant supply of retail space slated to complete in 2021. BBCC mall with more than 1 million sq ft NLA will start its construction works in January 2017 and it is expected to complete in 2021.

Retail sector remained dampened by weak consumer sentiments and retail sales.

Table 1

Selected upcoming retail malls in Klang Valley

Name of development	Est area (NLA, sq ft)	Location	Est year of completion
MyTown	1,100,000	Kuala Lumpur	2017
KSL City Mall 2	2,200,000	Selangor	2017
Tropicana Gardens Mall	1,000,000	Selangor	2018
Central Plaza@i-City	1,000,000	Selangor	2018
IOI City Mall (Phase 2)	1,000,000	Selangor	2018

Source: NTL Research

Other malls in the pipeline include Paragon@KL Northgate mall and Mitsui Outlet Park. Paragon@KL Northgate mall is in a mixed-used development located along Jalan Kuching, and it is aimed to be the largest mall in Northern Klang Valley with 1.6 million sq ft NLA. Mitsui Outlet Park also aims to become Southeast Asia's biggest outlet mall by 2021 upon completion of Phase 3.

Outlook

The retail market is likely to remain subdued due to the uncertain economy and the upcoming supply of more than 5 million sq ft in 2017 and 2018. The retailing scene will be more competitive (Table 1).

Office

Key Highlights in Q4

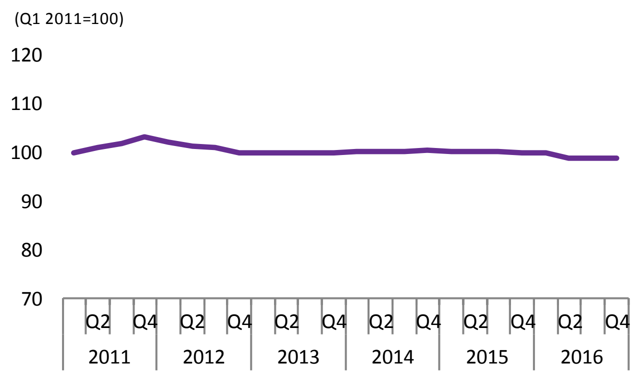
- Total office space supply stands at 78.5 million sq ft as no new supply was recorded for Q4 2016.
- Average occupancy rate increased by 1.7 percentage-points y-o-y to 82.4%.
- Capital value, as well as average rental rate maintained at RM933 per sq ft and RM6.03 per sq ft. respectively

Market Commentary

Office rents eased by 1.1% y-o-y to RM6.03 per sq ft. However, it has maintained at the current level since Q2 2016 (Figure 7). The rents were supported by the fewer completions in 2016. The completions in 2016 was 2.5m sq ft, lower than the 4.2m sq ft in 2015. The completions bring the total office stock to 78.5m sq ft as at Q4 2016. Due to the lack of new supply, net absorption fell by 15% y-o-y to 1.5m sq ft. Correspondingly, office occupancy largely remained

Figure 7

Prime rental indices – Kuala Lumpur



Source: NTL Research

stable, increasing 1.7 percentage-points y-o-y to 82.4% (Figure 8).

Potential new supply for 2017 is likely to peak at about 4.8 million sq ft and this will place pressure on occupancy and rental rates (Figure 9).The construction of JKG Tower (NLA: 396,820 sq ft) at Jalan Tunku Abdul Rahman and Menara Ken (NLA: 215,278 sq ft) at Jalan Burhanuddin Helmi are nearing completion. The Certificate of Completion and Compliance for the buildings are expected to be issued in H1 2017. Notwithstanding, some developers may push back their completion dates.

Due to the resilient office rents, the capital value of office buildings also maintained q-o-q, averaging at RM933 per sq ft.

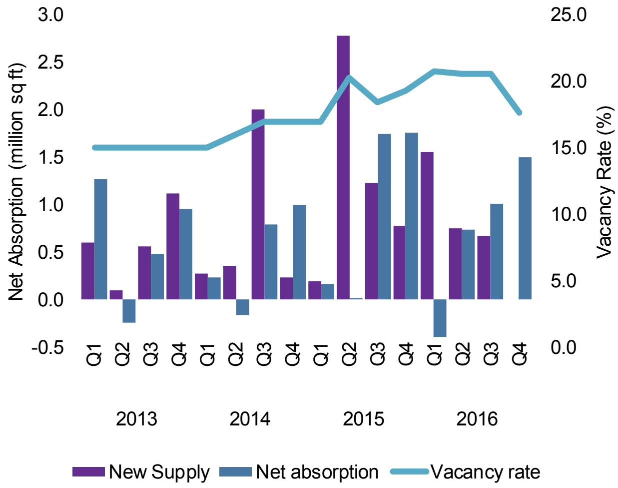
While office occupancy remained healthy at its current level, the upcoming pipeline supply will place pressure on both office occupancy and rents.

Outlook

The city center prime office market demand is highly correlated to the performance of the Oil & Gas sector. The consolidation of the Oil & Gas sector has adversely affected office over the last 1.5 years. With OPEC offering to cut down supply, the sector is likely to show greater resilience. Notwithstanding, there is a need for a significant increase in demand with more upcoming projects in the pipeline, with Mulia Tower, which will anchor TRX district, accounting for 2.65m sq ft of NLA.

Figure 8

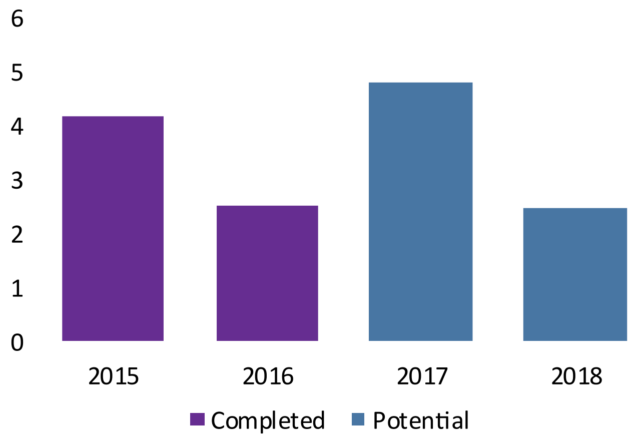
Office net absorption, sq ft (million)



Source: NTL Research

Figure 9

Future pipeline supply, sq ft (million)



Source: NTL Research

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