PROPERTY INSIGHTS

Kuala Lumpur | Quarter 4, 2017

Retail sector was undergoing stress test

Market Overview

- Malaysia's Gross Domestic Product (GDP) rose 6.2% y-o-y in Q3, supported by a continued growth in domestic demand and net exports, with overall growth for 2017 expected to be above 5.5%. Consumer confidence remained subdued despite the stronger GDP growth and a stable labour market. The Ringgit rose over 9% in 2017, backed by an improvement in economic conditions, rising oil prices and the prospect of an interest rate hike.
- The KL office market faced headwinds due to a supply glut.
- Retail sales are expected to grow by 2.2% y-o-y, while occupancy stayed stable at 87% in Q4 2017.
- Prices and rents for high-end strata homes eased marginally by 1.9% and 1.3% q-o-q to RM 762 per sq ft and RM3.06 per sq ft/month respectively.

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Trends & Updates

The Economy

Key Highlights in Q4

- Malaysia's economy expanded by 6.2% y-o-y in Q3 2017 (Q2 2017: 5.8% y-o-y).
- Unemployment rate remains unchanged at 3.4% in Q3 2017.
- Headline inflation, measured by the annual change in the Consumer Price Index (CPI), moderated to 3.8% in Q3 (Q2 2017: 4.0%).
- The Consumer Sentiment Index declined to 77.1 in Q3 from 80.7 in Q2 2017.
- In 2017 the Ringgit appreciated by 9.2%, to RM4.08 per US dollar.

Market Commentary

Malaysia's GDP recorded a growth of 6.2% y-o-y in Q3 2017 (Q2 2017: 5.8%), driven by continued expansion in domestic demand and net exports (Figure 1). On a q-o-q seasonally adjusted basis, the economy grew by 1.8% (Q2 2017: 1.3%).

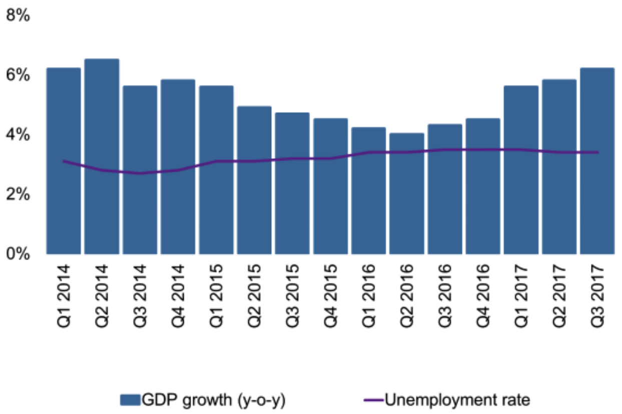
The growth of domestic demand increased to 6.6% y-o-y in Q3 (Q2 2017: 5.7%), as both private sector spending and public expenditure registered higher y-o-y growth of 7.3% and 4.1% respectively. Net exports rose 1.7% y-o-y, partly driven by the stronger demand for electrical and electronic (E&E) products.

Supply-side growth was led by the manufacturing and services sectors, which grew at a faster rate of 7.0% and 6.6% respectively. Growth of construction and agriculture sectors moderated to 6.1% and 4.1% respectively. The mining sector improved significantly with a y-o-y growth of 3.1%, due to higher natural gas production in Sabah and Sarawak.

The labour market remained stable with a net employment gain of 69,000 in Q3. Unemployment rate is expected to remain at 3.4% by the end of 2017. Notwithstanding, the Consumer Sentiment Index (CSI) declined in Q3 after increasing for two consecutive quarters (Figure 2).

Figure 1

Malaysia GDP growth and unemployment

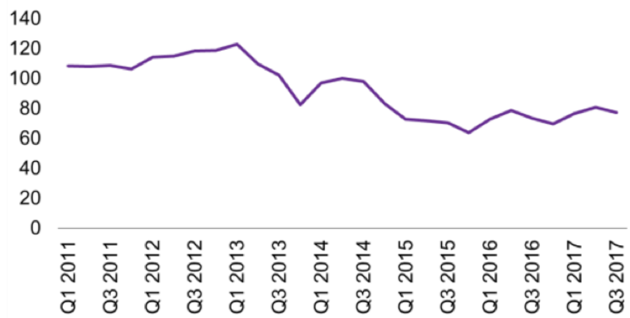


Source :Bank Negara Malaysia, Department of Statistics Malaysia, NTL Research

The Ringgit is expected to continue its uptrend in 2018, supported by the encouraging GDP growth, higher oil prices and potential rate hike

Figure 2

Consumer Sentiments Index



Source: Bank Negara Malaysia, NTL Research

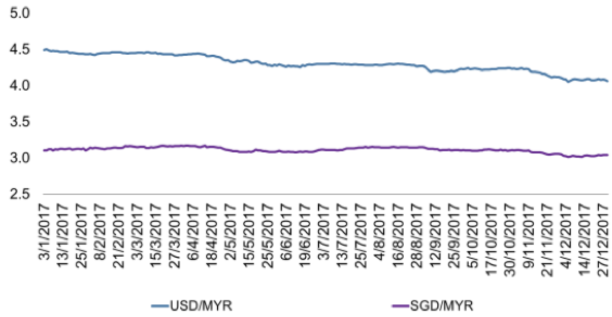
Lower domestic fuel prices have contributed to the inflation rate moderating to 3.8% (Q2 2017: 4.0%). With the rising global oil prices, Bank Negara Malaysia (BNM) expects the full-year headline inflation to be at the upper end of its projected range of 3% - 4%.

While BNM maintained the Overnight Policy Rate (OPR) at 3%, it has signaled a potential review on the current OPR given the improving economic conditions

Between 29 September and 29 December, the Ringgit appreciated against the US dollar by 3.9%. Overall, the Ringgit rose over 9% in 2017 (Figure 3), amid stronger economic performance, rising oil prices and the prospect of an OPR hike in 2018.

Figure 3

Malaysian Ringgit Exchange Rate



Source: Malaysian Institute of Economic Research, NTL Research

Outlook

Malaysia will be closely watched due to its upcoming general election, which must be held by August 2018. Nevertheless, with the sustained domestic demand and strong export performance, Malaysia's GDP growth for the year 2018 is projected to range from 5.0% to 5.5%.

Residential

Key Highlights in Q4

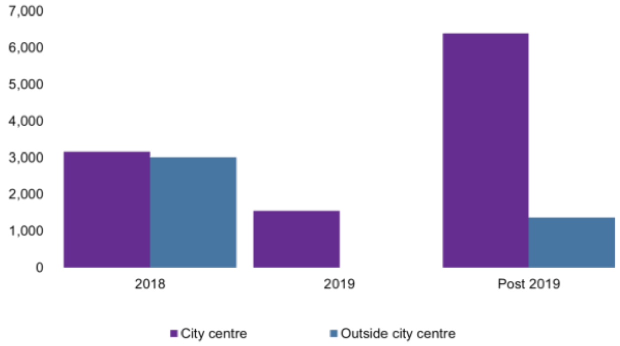
- In Q4 2017, three residential projects with a total of 1,432 high-end condominium units were completed, two of which are in the city centre.
- Of the 9,693 units that were initially expected to complete throughout the year, only 5,315 units (or 55%) from 11 high-end residential projects were completed. Some 6,176 units of high-end condominiums are expected to come on board throughout 2018, with 51% of the upcoming supply coming from the city centre (Figure 4).
- Prices for high-end condominiums remained stable at RM762 per sq ft in 2017, improving by 2.7% y-o-y (Figure 5).
- Nonetheless, rents for high-end condominiums recorded a small decline of 2.3% y-o-y at RM 3.06 per sq ft per month.

Market Commentary

Buyers and developers remained highly cautious in 2017, as sales and new launches continued to slow, especially for high-end and luxury properties. This is largely due to the increasingly saturated market amid a challenging marketing environment and a mismatch in price expectations.

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 recent residential projects launches leveraged on the financing schemes in the mass market where the Government has put in more resources in the last two National Budgets to help the predominantly lower (B40) and middle (M40) income earners.

This is further reinforced by the latest initiative made by the Government in the recently announced National Budget 2018 to allocate a sum of RM2.2bn for the public housing sector, particularly to strengthen home ownerships among B40 and M40 groups. Out of the sum budgeted, some RM1.5bn is allocated for PR1MA housing to build 210,000 units priced at RM250,000 and below. Other initiatives announced during the Budget included the "step-up financing scheme", an end-financing scheme of which eligible buyers will get access to higher loan amounts. The scheme is established in collaboration with Bank Negara Malaysia, the Employees Provident Fund (EPF) and four banks (Maybank, CIMB, RHB and AmBank). Initially provided to PR1MA, the scheme is now extended to private developers, and some 2,000 units are allocated for MyDeposit and MyHomes. This will encourage developers to build more affordable housing.

The Government's initiatives such as PR1MA Skim Pembiayaan and MyDeposit Programme will assist the first-time home buyers with their deposit and instalment plans when purchasing a home. These initiatives will help boost home ownership.

Outlook

The general weak outlook for the market is likely to extend until at least H2 2018. Concerns over the affordability of private homes will be a persistent theme for the housing sector and a source of political discontent especially for those living in urban areas. Separately, the glut in the high end residential market may lead to a downturn in price, which could have a wide-ranging impact on the economy.

The residential market is expected to remain subdued throughout 2018. The increase in home prices is likely to continue to moderate, if not weaken, as developers and property speculators unload unsold completed stock.

Retail

Key Highlights in Q4

- Retail sales contracted 1.1% in Q3 2017, swayed from projections of 2.9% and 4.0% by the Malaysia Retailers Association (MRA) and Retail Group Malaysia (RGM), respectively.
- Malaysia Retailers Association (MRA) forecasted a 3.8% growth for the final quarter of 2017.
- Total retail stock in Kuala Lumpur remained at 31 million sq ft with no new completion during the quarter.
- Occupancy of retail malls in Kuala Lumpur lingered at 87%.

Market Commentary

The Consumer Sentiment Index (CSI) fell to 77.1 in Q3 from the year-high of 80.7 in Q2. The recovery in Q2 was unable to sustain as the slide in retail sales coincided with the eroding sentiments amid escalating cost of living, especially in key cities such as Kuala Lumpur. Despite the quarterly decline, the CSI has moved up 5% y-o-y.

Decline in sales was reported in all retail sub-sectors except pharmacy, personal care and other specialty retail stores, which recorded a 6% growth.

In November 2017, five Giant outlets closed down upon lease expiration as part of a consolidation plan. The five premises that were closed were located at Sri Manjung, Sungai Petani, Sibu, Selayang Lama, and Shah Alam City Centre Mall. GCH Retail (Malaysia) Sdn. Bhd. asserted that the decision to discontinue the leasing contracts was made to improve efficiency and productivity. The company also owns three other brands, namely Mercato, Cold Storage, and Jasons

Food Hall. Other major retailers such as AEON and Tesco have implemented similar plans in 2017.

The iconic Ampang Park, one of the oldest malls in Kuala Lumpur, closed down at the end of the year to make way for the construction of a new MRT station.

Notwithstanding, the retail scene in Johor Bahru was boosted with the opening of Paradigm Mall (NLA: 1.3 million sq ft) and an IKEA at Tebrau, the largest one in Southeast Asia, spanning an area of over 502,700 sq ft. The Swedish furniture giant currently has three outlets in Malaysia and is making its way to the North, with the fourth outlet in Batu Kawan, Penang, which is expected to complete in 2019.

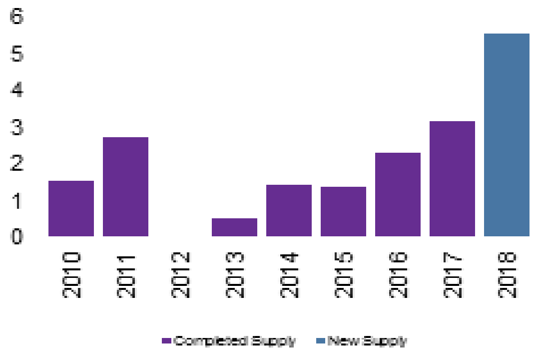
Recovery of the Malaysian retail market in 2018 is highly dependent on the outcome of the general election, external economic demand and Ringgit performance.

Outlook

More retailers are reviewing their business strategy, including downsizing, considering the challenges faced by the retail sector. Retail Group Malaysia (RGM) estimated a 2.2% growth for the year 2017. This is the third downward revision since its initial estimate of 5.0% made in late 2016. The upcoming supply in 2018 further adds pressure to the rents (Figure 6 and Table 1).

Figure 6

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



Source: NTL Research

Table 1

Selected upcoming retail malls in Klang Valley

Name of development	Est area (NLA, sq ft)	Location	Est year of completion
Tropicana Gardens Mall	1,000,000	Selangor	2018
Central Plaza @ i-City	1,000,000	Selangor	2018
Damansara City Mall	2,500,000	Selangor	2018

Source: NTL Research

Nevertheless, RGM also projects a 6.0% growth rate in retail sale for 2018 but reaffirms that the recovery of the Malaysian retail market next year is highly dependent on the outcome of the general election, external economic demand and the Ringgit's performance.

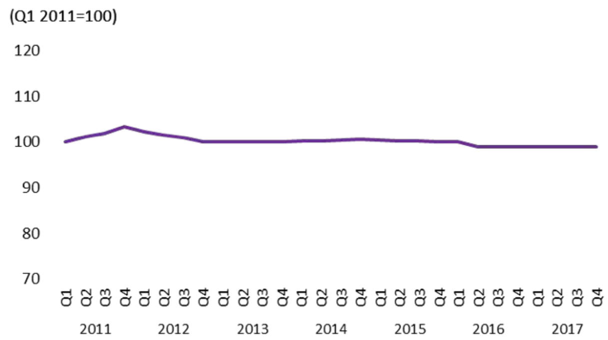
Office

Key Highlights in Q4

- The total office stock amounted to 81.7 million sq ft, with 2.3 million sq ft completed by end 2017.
- Average occupancy rate of office space declined to 80.4% from 81.4% in Q3 as weaker market conditions persisted despite a recovery in economic growth and oil prices. On a y-o-y basis, the occupancy rate trended downwards from 82.3% in Q4 2016.
- Capital value and average rental rate stayed flat y-o-y respectively at RM933 per sq ft, and RM6.03 per sq ft (Figure 7) in Q4 2017.

Figure 7

Prime rental indices – Kuala Lumpur



Source: NTL Research

Market Commentary

With the latest additions in Q4 to the KL office stock, namely KL Eco City Corporate Office Tower 3 (NLA: 420,000 sq ft) and KL Gateway Tower 2 (NLA: 396,000 sq ft), the total office stock amounted to 81.7 million sq ft as of end 2017.

Average occupancy rate continued to decline, dropping to 80.4% in Q4 2017 from 81.4% due to the weak absorption rate in 2017 (Figure 8). While the recovery in oil prices boosted economic prospects, the improved outlook has yet to be translated to higher demand of office space.

Average rental rate for prime office space maintained q-o-q at RM6.03 per sq ft per month in Q4 2017, and likewise the non-prime buildings at RM4.25 psf per month. The rents also stayed flat on a y-o-y basis. Capital values of prime office buildings remained unchanged since 2016 at RM933 psf. Correspondingly, office yield maintained at around 6.00-6.25%, which has remained unchanged since 2015.

In H2 2017, there were only a handful of office buildings transacted in KL. The capital market beyond KL was similarly subdued with few transactions. However, a notable transaction in Q4 was the sale of Bangunan Affin Bank, Shah Alam in October 2017 for RM531 per sq ft.

The new financial district of TRX continued to gain traction in 2017 with the launch of two new office buildings for Prudential and HSBC Bank beside Exchange 106, the tallest building when completed in 2018 (Figure 9). To be ready by 2019, Menara Prudential (NLA: 560,000 sq ft) at TRX is reported to have secured close to 90% pre-commitment as of date.

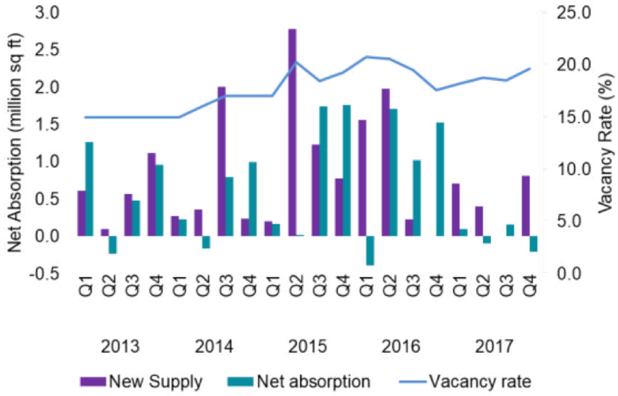
Outlook

The recently announced freeze on new office approvals will mitigate the current oversupply to a certain extent but the impact will only be felt over the medium term. This is because the pipeline supply currently under construction remains high and works are not likely to stop completely.

Beyond 2017, the KL office market is likely to remain subdued due to the supply glut, with developments such as TRX, Merdeka PNB 118, and Sapura Tower (KLCC Lot 91) nearing completion.

Figure 8

Office net absorption, sq ft (million)

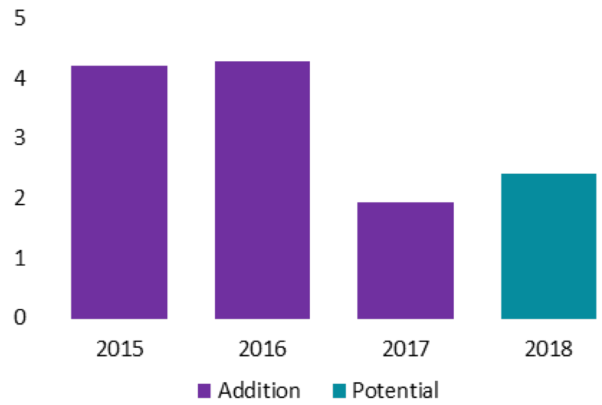


Source: NTL Research

Beyond 2017, the KL office market
will be challenging due to the upcoming supply.

Figure 9

Future pipeline supply, sq ft (million)



Source: NTL Research

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