Edmund Tie & Company

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REAL ESTATE TIMES

RESEARCH

# KUALA LUMPUR Q1 2018

## Election provides a brief distraction to market challenges

## 2018 Q1 SNAPSHOT

Malaysia's economy expanded by 5.9 per cent in 2017, compared to the 4.2 per cent in 2016. The Consumer Sentiments Index (CSI) reached its three-year high in Q4 2017, given the improved consumer confidence amid higher GDP growth and a stable labour market. In January, Bank Negara Malaysia (BNM) announced a 25 basis-point hike in the Overnight Policy Rate (OPR).

## INVESTMENT

A slow start of investment sales of

**RM0.25bn**

in Q1 2018 compared to RM1.0bn in Q1 2017.

**A major deal in Q1 2018 involved a Middle East entity** while the other smaller acquisitions came from domestic players.

## OFFICE

**Average office monthly rent declined** from **RM6.02 per sq ft (psf) to RM5.98 psf**, translating to a 0.7 per cent drop quarter-on-quarter (q-o-q).

## RETAIL

Occupancy of retail malls in Kuala Lumpur (KL) **eased to 86.0 per cent q-o-q in Q1 2018, compared to 87.0 per cent** in Q4 2017.

## RESIDENTIAL

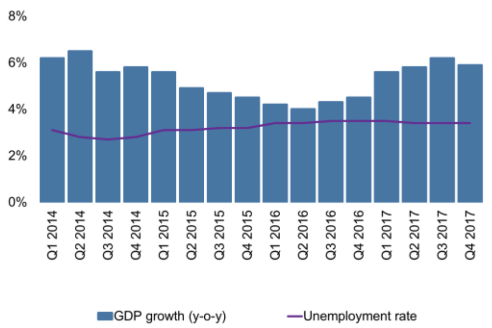
Prices for high-end condominiums decreased marginally by **1.5 per cent q-o-q to RM751 psf** with rents declined by **3.3 per cent q-o-q to RM2.95 psf per month.**

# THE ECONOMY

## Key highlights in Q1

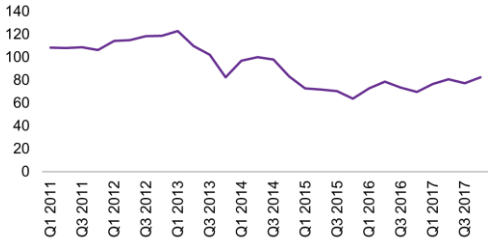
- Malaysia's GDP rose 5.9 per cent year-on-year (y-o-y) in Q4 2017 (Q3 2017: 6.2 per cent y-o-y).
- Unemployment rate remained unchanged at 3.4 per cent in Q4 2017.
- Consumer Price Index (CPI) grew by 3.5 per cent y-o-y in Q4 2017, marginally lower than the 3.6 per cent growth recorded in the previous quarter.
- CSI increased to 82.6 in Q4 from 77.1 in Q3 2017.
- The Ringgit appreciated by 3.8 per cent, to RM3.91 per US dollar in Q1.

FIGURE 1
**Malaysia's GDP growth and unemployment**



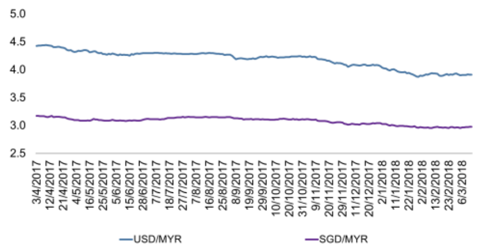

Source: Bank Negara Malaysia, Department of Statistics Malaysia, NTL Research

FIGURE 2
**Consumer Sentiments Index (CSI)**




Source: Bank Negara Malaysia, NTL Research

FIGURE 3
**Malaysian Ringgit exchange rate**




Source: Malaysian Institute of Economic Research, NTL Research

## Market commentary

Malaysia's economy expanded by 5.9 per cent y-o-y in Q4 2017 (Q3 2017: 6.2 per cent), bringing the full year's growth to 5.9 per cent (2016: 4.2 per cent) (Figure 1).

GDP growth was largely anchored by strong domestic demand, which expanded by 6.2 per cent y-o-y in Q4 2017. This can be attributed to the 7.4 per cent expansion in private sector demand, while growth of public expenditure moderated to 3.4 per cent.

The agriculture sector led the supply-side growth in Q4 2017 with a y-o-y expansion rate of 10.7 per cent, driven by higher crude palm oil output. This was followed by services (6.2 per cent), construction (5.8 per cent) and manufacturing (5.4 per cent). Separately, the mining sector contracted by 0.5 per cent y-o-y, due to lower natural gas output.

Unemployment rate remained at 3.4 per cent, as the expansion of the labour force was matched by the net employment gain of 97,000 people. Moving forward, employment growth for Malaysia is likely to remain healthy. The total approved investments of RM197.2 billion in 2017 could potentially create over 139,000 jobs in the long term.

CSI increased to 82.6 points in Q4 2017, its three-year high since Q1 2015 (Figure 2). This reflects the growing optimism among consumers, amid a stable labour market and steady economic growth.

In January 2018, BNM increased the OPR by 25 basis points to 3.25 per cent, on the back of improved economic conditions. This marks the first hike since July 2014.

Growth impetus will remain in 2018, supported by improved consumer optimism and continued increase in employment.

Between 29 December 2017 and 13 March 2018, the Ringgit appreciated against the US dollar by 3.8 per cent (Figure 3). This can be attributed to the OPR hike in January, the uptrend in crude oil prices, and positive economic indicators for 2017.

## Outlook

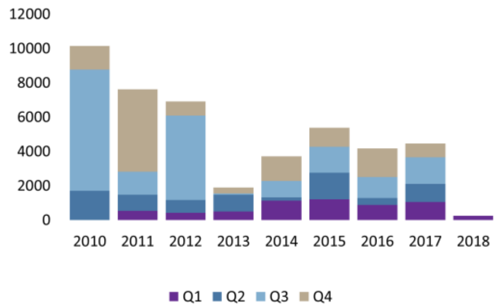
The outlook of Malaysia's economy will remain positive in the election year of 2018, with GDP growth projected from 5.0 per cent to 5.5 per cent. Headline inflation is expected to average from 2.5 per cent to 3.5 per cent, depending on the movement of global oil prices.

# INVESTMENT SALES

## Key highlights in Q1

- Investment sales slowed in Q1 due to cautious investors' sentiments.
- The major deal involved a Middle East entity and small acquisitions were dominated by domestic players.
- The economic outlook seems more promising and a recovering Ringgit will draw investors.
- Interests from Chinese investors remained high, notwithstanding recent capital control, on the back of the Belt and Road Initiative (BRI).
- Outcome of the pending election is likely to have long term implications on the economic direction.

FIGURE 4
**Investment sales (RM thousands)**




Source: NTL Research

TABLE 1
**Investment sales**

| Development | Buyer | Vendor | Price (RM m) |
|---|---|---|---|
| Menara Mont Kiara | Al Rajhi | ARA | 122 |
| Holiday Plaza (retail/office) | Atar Irama | ENRA Group | 51 |
| Holiday Plaza (carparks) | Atar Irama | ENRA Group | 28 |
| Quill 8 | Transmark Corp | MRCB - Quill REIT | 28 |
| Tasco Warehouse | Onostatic | Tasco | 17.5 |

Source: NTL Research

## Market commentary

The Malaysia investment sales market had a slow start in 2018, with total investment sales in Q1 falling to RM246.5m from RM 1.0bn in Q1 2017, a 76 per cent slide decrease y-o-y (Figure 4). The decline in investment sales is likely due to seasonal factors and the uncertainty associated with the upcoming election which could potentially alter the country's direction.

In 2018, there were four notable deals, the largest of which is the sale of Menara Mont Kiara. The mid-sized suburban office at Mont Kiara was sold by Singapore-based ARA Asset Management Ltd, to Al Rajhi, a Middle Eastern entity, for RM122m. Al Rajhi already has a presence in Malaysia, owning several real estate development projects, as well as operating an Islamic bank. The other deals comprised two small industrial properties.

Separately, it was announced that MoF Inc acquired a 51% interest in the development entity undertaking the construction of Exchange 106 Tower, representing 2.8m sq ft net lettable area at Tun Razak Exchange (TRX). It was reported that the value of the transaction was done at book value and that the acquisition allows the Government to have a major stake in the strategic project.

## Outlook

The positive economic outlook and a recovering Ringgit will attract more investors who are on the sidelines, notwithstanding the overall weak property market across various segments. Interest from overseas largely comes from Mainland Chinese investors and developers, as Malaysia is perceived to be an important partner in the BRI and would be unaffected by the recent capital controls imposed in China.

The recent interest rate hike of 25 basis points will not have any major impact on market sentiments but investors will be monitoring the US Fed's intentions. The frequency and magnitude of potential hikes for the rest of the year will have significant implications on local borrowing rates, fund flow and currency exchange rates.

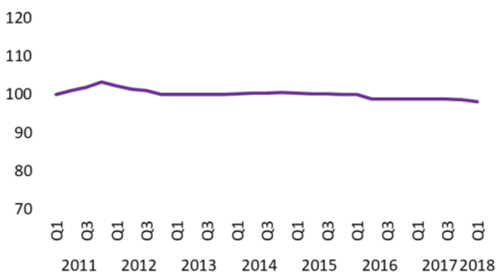
The outcome of the upcoming election will also have long term implications on the economy going forward. Whether there is a continuation of tried and tested policies of the present administration or a drastic overhaul is dependent on the election results.

# OFFICE

## Key highlights in Q1

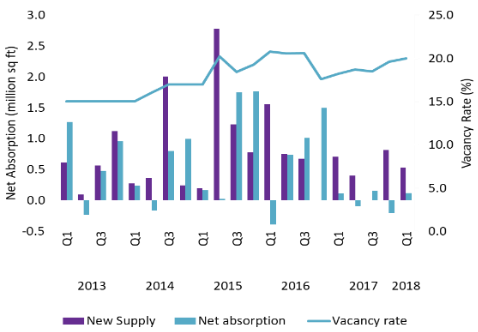
- The completion of KL Eco City Tower 2 has contributed 530,000 sq ft to the total stock of 82.2 million sq ft.
- Average occupancy rate further dipped to 80.0 per cent from 80.4 per cent in Q4 as demand lagged new additions.
- The capital value has been revised downwards to RM875 psf from RM933 psf.
- The average rental rate dropped slightly from RM6.02 psf to RM5.98 psf (Figure 5).

FIGURE 5
**Prime rental indices – KL**



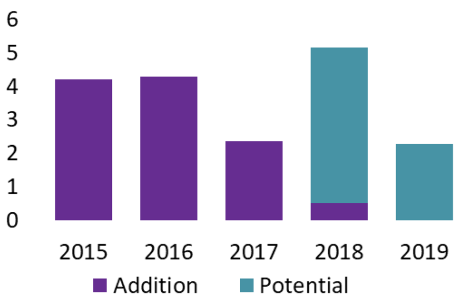

Source: NTL Research

FIGURE 6
**Office net absorption (sq ft, m)**




Source: NTL Research

FIGURE 7
**Future pipeline supply (sq ft, m)**




Source: NTL Research

## Market commentary

The office market remained subdued as average occupancy rate dropped to 80.0 per cent in Q1 2018 from 80.4 per cent in Q4 2017. This was due to the continued low absorption and large amount of supply (Figure 6). In Q1 2018, there was only one completion – KL Eco City Tower 2, adding 530,000 sq ft to the current stock of 82.2 million sq ft.

In Q1 2017, the average monthly rent for prime office eased from RM6.02 psf to RM5.98 psf in Q4 2017 while the average monthly rent for non-prime office declined to RM4.20 psf from RM4.25 psf. Capital value has been revised from RM933 psf to RM875 psf. The yield remained unchanged at 6.25 per cent.

Serviced office/co-working operators will form part of the demand as they seek to open more offices in KL. Singapore-based Centennial Business Suites will open its second serviced office (13,900 sq ft) in KL Sentral at the end of March, after their first office opened in Etiqa Twins tower. Colony is opening its second co-working space (20,000 sq ft) at KL Eco City in June, which opened its first office in Jalan Kia Peng.

With incoming office supply of more than 10m sq ft in the next few years, older buildings will face challenges in attracting new tenants and retaining their existing ones. Refurbishment, creative re-use and the redevelopment of buildings will be a recurring theme for landlords to stay competitive.

It is likely to remain a tenant's market in the office sector, given the upcoming supply. Demand from the co-working space operators may help offset the supply in the market.

## Outlook

The office market is expected to remain challenging on the back of lackluster demand from of oil and gas sector, despite recovery of oil price around US$70 per barrel.

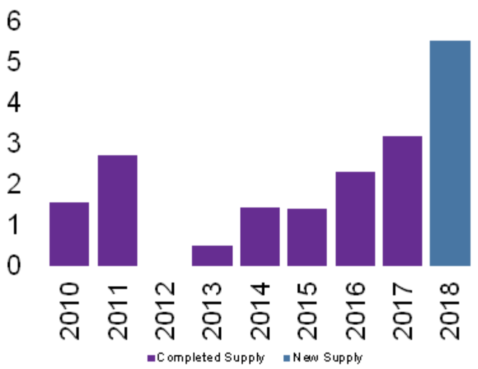
The increasing high supply pipeline is expected to exert pressure on occupancy and rental rates (Figure 7).

# RETAIL

## Key highlights in Q1

- Retail sales recorded a modest growth of 3.1 per cent for Q4 2017, slightly lower than the Malaysia Retailers Association's (MRA) forecast of 3.8 per cent.
- Total retail stock in KL remained at 31m sq ft without any new completions in Q1. Whereas stock outside KL rose to 31m sq ft, with the completion of M Square Mall in Puchong.
- Retail mall occupancy in KL dropped marginally to 86.0 per cent from 87.0 per cent.

FIGURE 8
**Retail new supply (NLA) in KL (sq ft, m)**




Source: NTL Research

TABLE 2
**Selected upcoming retail malls in Klang Valley**

| Name of Development | Est Area (NLA, Sq Ft) | Location | Est Year of Completion |
|---|---|---|---|
| Empire City Damansara | 2,500,000 | Selangor | 2018 |
| Tropicana Gardens Mall | 1,000,000 | Selangor | 2018 |
| Central Plaza @ i-City | 1,000,000 | Selangor | 2018 |

Source: NTL Research

## Market commentary

In Q4 2017, the CSI rose moderately by 5.5 points, to 82.6 points. Even though it remained below the threshold level of 100 points, the CSI hit a three-year high since early 2015 when it dropped substantially to 72.6 points from 83.0 points in the previous quarter.

In 2017, retail sales of brick-and-mortar malls expanded by only 2.0 per cent (2016: 1.7 per cent), which was lower than Retail Group Malaysia's (RGM) revised figure of 2.2 per cent, despite stronger aggregate private consumption at 7.0 per cent. Meanwhile, total sales value recorded was just shy of RM100bn, at RM99.8bn.

Traditionally the best time of the year for retailers, the seasonal festive period was perceivably quieter as consumers tightened their spending. The retail industry experienced more consolidation with the closure of several notable stores. Parkson announced they are closing its stores at Maju Junction and Sungei Wang despite three decades of presence at the latter location. The Malaysia-based department store operator closed both of their city centre stores in February due to shifting market dynamics. This move will affect the short-term viability of Maju Junction as Parkson is a major anchor tenant. An Aeon department store at Quill Mall is also planning to close soon as retailers grapple with slower sales and rising costs.

In January 2018, Milenia City welcomed the opening of M Square Mall, part of an integrated township by Millennium Land. The shopping mall boasts circa 350,000 sq ft of lettable space, banking on the 1.2m population catchment of suburban Puchong. CapitaMall Malaysia Trust will embark on a RM54.5m refurbishment for Sungai Wang Shopping Centre this year to reclaim some of its former glory, once one of the preeminent malls in the city.

Retail sales of brick-and-mortar malls expanded by 2.0 per cent in 2017, lower than what was forecasted earlier despite stronger aggregated private consumption.

The growing popularity of online shopping continues to be a threat to malls. While the rising cost of living is often blamed for the slow growth of retail sales, there are fewer people congregating at the malls due to the convenience of online shopping. As more Malaysians get used to shopping online, the ecommerce retail industry recorded a growth of over 20.0 per cent in 2017.

## Outlook

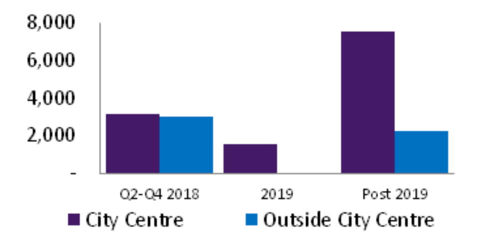
Moving forward, retail sales for the first quarter is expected to expand by 5.4 per cent, after accounting for the festive Lunar New Year season. Whereas for 2018, retail sales are forecasted to grow at 4.7 per cent.

# RESIDENTIAL

## Key highlights in Q1

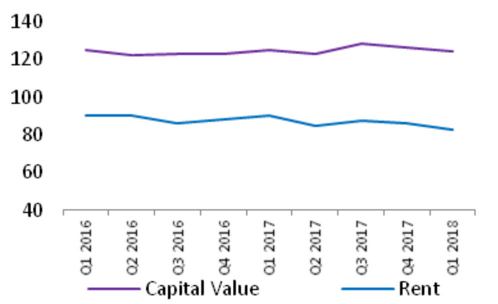
- In Q1 2018, there were no completion of high-end residential projects.
- Total units slated for completion in 2018 remained at 6,176 units. Out of which, about 49.0 per cent will be located outside the city centre (Figure 9).
- There were no new launches for high-end strata residential properties in Q1 2018.
- Average unit price for high-end condominium eased to RM751 psf, down marginally by 1.5 per cent from Q4 2017 (Figure 10).
- Property rent registered a marginal decline of 3.3 per cent q-o-q at RM2.95 psf.

FIGURE 9
**Future supply of high-end condominiums in KL**




Source: NTL Research

FIGURE 10
**Rental and price indices of high-end condominiums in KL**




Source: NTL Research

## Market commentary

The residential market remained subdued due to the relatively large inventory of unsold units and slower demand. According to the National Property Information Centre (NAPIC), condominiums that are priced above RM500,000 contributed significantly to the number of unsold units in the market. Separately, the demand for high-end homes was further curbed due to policy changes. Effective from 1 January 2018, stamp duty for homes costing more than RM1m increased from 3.0 to 4.0 per cent to discourage property speculation, with BNM issuing warning of potential financial risks.

With the current freeze on new approvals for luxury residential properties, developers are focusing on launching more affordable units and clearing completed unsold stock. Thus, sales and new launches of high-end strata residential projects are expected to be subdued in 2018. The last launch of a high-end project that was well-received was Solaris Parq at Mont Kiara, priced around RM1,500 psf in Q4 2017.

Notwithstanding, there has been no new catalyst to drive sales and initiate market recovery. In fact, more units are expected to come on board in the secondary market, and this will exert greater downward pressure on prices.

Developers are phasing out supply so as not to overwhelm the softened market.

## Outlook

With more than 6,000 units of high-end condominiums slated for completion throughout 2018, this significant incoming supply will bring more challenges and is likely to contribute to a larger inventory of unsold residential homes this year.

The residential market is expected to remain weak with no signs of recovery anytime soon. Due to the rising cost of living, there is a mismatch between asking prices and income of prospective buyers. Coupled with growing uncertainties in the environment, the residential market in 2018 is expected to remain subdued.

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