The real estate market in Kuala Lumpur remained subdued but the investment market continues to be active. Is the market bottoming out?
2017 Q2 SNAPSHOT

Malaysia’s economy grew by 5.6% y-o-y in Q1, the highest in past two years. Labour market conditions remained stable with an unemployment rate of 3.5%. Headline inflation rate was higher at 4.3% in Q1, driven by cost-push factors. The Ringgit appreciated against the US Dollar by 3.6% in Q2.

Investment sales grew to RM1.13bn in Q2 2017

Wisma Selangor Dredging was sold at 30% above valuation despite soft market conditions.

OFFICE

Average office rents in central areas maintained q-o-q at RM 6.03 per sq ft.

RETAIL

Retail sales contracted by 1.2% q-o-q, while occupancy maintained at 89%.

RESIDENTIAL

Weak market sentiments dragged prices and rents for high end condominiums down by 1.4% and 6.0% q-o-q to RM743 per sq ft and RM3.01 per sq ft/month respectively.
THE ECONOMY

Key Highlights in Q2

- The Malaysia’s GDP rose 5.6% y-o-y in Q1 2017 (Q4 2016: 4.5% y-o-y).
- Unemployment rate stays unchanged at 3.5% in Q1 2017.
- Headline inflation, measured by the annual change in Consumer Price Index (CPI), trended higher in Q1 2017 at 4.3% (Q4 2016: 1.7%).
- Consumer Sentiment Index increased to 76.6 in Q1 2017 from 69.8 in Q4 2016.
- During the quarter, the Ringgit appreciated by 3.6%, to RM4.27 per US dollar.

Market Commentary

The economy continued its upward momentum in Q1 with a y-o-y growth of 5.6% (Q4 2016: 4.5%), the highest in two years (Figure 1). On a q-o-q seasonally adjusted basis, the economy expanded by 1.8% (Q4 2016: 1.3%).

The stronger economic performance was contributed by the robust domestic demand, which expanded by 7.7% y-o-y in Q1 (Q4 2016: 3.2%). This was driven by higher growth in private sector demand (8.2%) and public expenditure (5.8%). Net exports shrank by 14.5% y-o-y as import growth (12.9%) outpaced the 9.8% increase in exports.

On the supply side, the agriculture sector recorded a y-o-y growth of 8.3% in Q1, a turnaround from Q4 2016 following the recovery of crude palm oil yields from the impact of El Nino. The stronger overall economic growth was further aided by the service, manufacturing and construction sectors, which expanded at a faster pace by 5.8%, 5.6% and 6.5% y-o-y respectively. In contrast, the mining sector grew at a slower pace of 1.6% y-o-y, due to the lower crude oil production.

The Consumer Price Index (CPI) surged 4.3% y-o-y in Q1, higher than the 1.7% recorded in Q4 2016. This can be attributed mainly to the higher inflation recorded in the transport category, driven by the higher fuel prices.

During Q1, total employment in Malaysia rose by 95,300 while the labour force expanded by 98,700 people. The unemployment rate reached 3.5%. The Consumer Sentiments Index (CSI) edged up slightly in Q1 after two consecutive quarterly declines (Figure 2) but remained subdued despite higher growth in private demand.

With the private sector demand anchoring the growth in economic activities, further growth will largely depend on the consumer confidence.

Between 31 March and 9 June, the Ringgit appreciated against the US dollar by 3.6% (Figure 3). While this can be partly attributed to the weaker US dollar, several liberalisation measures introduced by Bank Negara Malaysia (BNM) in the onshore foreign exchange market also helped support the Ringgit. The improved market sentiments among investors further lifted the Ringgit, following the announcement of Q1 economic statistics.

Outlook

The outlook of Malaysia’s economy seems more positive, with domestic demand and exports expected to grow further. Bank Negara Malaysia (BNM) forecasts the GDP to grow by 4.3% to 4.8% in 2017. Noting that the inflation trend will be dependent on the future direction of global oil prices, BNM projects the full-year headline inflation to range from 3% to 4%.
INVESTMENT SALES

Key Highlights in Q2

- Investment sales volume posted a growth of 7% q-o-q at RM1.13b (Figure 4).
- There were a couple of sale-and-lease back transactions, and the reported net yields were lower due to the nature of the sale.
- Stable interest environment and ample liquidity help support more investment deals amongst mainly domestic players.

![Investment Sales (RM Thousands)](image)

Source: NTL Research

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![Source: NTL Research](image)

Market Commentary

The Malaysian investment sales market remain active, with total investment sales amounting to a shade above a billion Ringgit (Figure 4). One of the major transactions include the sale of Wisma Selangor Dredging that was transacted at RM480m, translating to RM1,323 per sq ft of net lettable area. The transacted price is 30% above valuation appraised as at May 2015. The property was sold to Golden Eagle Realty Sdn Bhd (Table 1).

There were a couple of sale-and-leaseback deals. For instance, Majestic Hotel was sold at RM380m, translating to RM1.3m per room, on a sale- and-leaseback basis in a related party transaction to YTL Hospitality REIT at a yield of 7%. The other sale-and-leaseback transaction involved the Lion Group, which had been financially affected by the softened local steel industry. The Lion Group sold their factory for RM45m in Klang to Yinson Corporation with a lease of 5+5 years. Based on the transacted price, the yield was relatively low at 5%.

While the investment market was active, there were concerns of the aborted deal on Bandar Malaysia on the investment sales market. The cancellation of the share sale agreement surprised the market as the decision was sudden and the decision is likely to impact on the ongoing restructuring of 1MDB. The government will retain full ownership of the project and will invite expressions of interest for the role of master developer.

Deals in the pipeline included the proposed sale of an office building belonging to Affin Bank in Shah Alam and an office building in the Golden Triangle.

The profile of buyers in Q2 were mainly domestic, with REITs, and private real estate investors accounting for the larger deals. Separately, corporates that purchased for their own use accounted for acquisitions of lower quantum value. The sellers’ profile in Q2 also comprised developers, with some having an interest in the hospitality industry.

Outlook

The stronger than expected Q1 GDP growth boosted the investors’ sentiments and supported the activity in the investment market. Some of the recent deals suggested that private investors can be quite bullish for good quality assets and are prepared to accept lower yield. It is anticipated that investment sales market to remain active.
OFFICE

Key Highlights in Q2

- Capital value and rent of office stayed flat at RM933 per sq ft, and RM6.03 per sq ft, respectively (Figure 5).
- Office occupancy rate marginally declined to 81.26% from 81.78% in Q1 2017 (Figure 6).
- Sales of strata office suites is trending with two new launches at Ceylonz and The Met Corporate Office.

Market Commentary

JKG Tower (NLA: 400,000 sq ft) at Jalan Raja Laut was the only completion in Q2 2017. With this sole addition, the total office supply in Kuala Lumpur amounts to 79.5 million sq ft.

Office rental rate stayed flat in Q2 with prime buildings averaging RM6.03 psf, while the rents of secondary buildings hovered around RM4.25 psf. The yield stays stable at 6.25% although recent sales suggested a downward trend.

The overall occupancy rate continued to ease to 81.26% in Q2, compared to 81.78% in Q1 with most new buildings still trying to improve their occupancy rates.

HSBC Bank Malaysia Bhd is building a new US$250m headquarters in Tun Razak Exchange, marking the first phase of land acquisition.

Outlook

Office space supply will continue to increase, with Public Mutual Tower and KL Eco City completing soon in H2 2017 (Figure 7). The increase in supply is likely to outpace demand in the short to medium term, while occupancy rate continues to slide to a level not seen since the late 1980s recession. Whist there is no immediate risk to the financial sector, it could be useful to address further deterioration to the situation by having a general moratorium on new approvals not dissimilar to that for the hotel segment.
RETAIL

Key Highlights in Q2

- Retail sales contracted 1.2% y-o-y in Q1 2017, which performed worse than expectations.
- Retail Group Malaysia (RGM) forecasted a 2.5% growth in sales in Q2 2017 and anticipated H2 2017 to remain challenging for retailers.
- Total retail stock in Kuala Lumpur remained at 30.29 million sq ft without new completions in Q2 2017 (Figure 8 and Table 2).
- Occupancy of retail malls in Kuala Lumpur maintained at 89% q-o-q.

Market Commentary

The Consumer Sentiment Index (CSI) recorded a marginal improvement to 76.6 in Q1 2017, a 6.8-point jump Q4 2016. Although this remain below threshold level, the CSI improved by 7 points y-o-y, supported by sales of big-ticket items such as cars. Sales from pharmacy and personal care sub sectors also grew by 3.7% y-o-y. Notwithstanding, the other retail sub-sectors reported decline in sales.

Tous Les Jours unexpectedly bid farewell to Malaysia when the French-inspired Korean bakery closed all its four outlets in May. The chain opened its first outlet in Malaysia back in 2013. The departure was followed by the sudden closure of True Fitness, a Singapore outfit which have multiple branches in the Klang Valley, and Tiam Ho Wan, a popular 2 star Michelin dim sum restaurant, which have two outlets.

Notwithstanding, the international brands continue to be attracted to KL. The KL retail scene welcomed the first YSL Beauté flagship store and PAUL, a renowned French bakery. Both stores are located at Pavilion KL. The 1,057 sq ft YSL Beauté store features its entire range of makeup, fragrance, and skincare.

Retail market requires improved ringgit performance for recovery in the second half of the year

The channels that consumers used to shop showed signs of changing, as evidenced during the festive of Eid al-Fitr by the end of Q2 2017. Online shopping surged a couple of weeks prior to the fasting month of Ramadhan and the online sales value peaked in the third week. Criteo, a performance marketing technology company, reported a 128% and 75% increase in sales and visitors for e-commerce during mid Ramadhan. 11street in Malaysia reported over 2.5 times uplift in sales during this period in 2015 and 2016. The top performing categories during the festive period include fashion, home and living, electronics, health and beauty, as well as e-vouchers particularly for Ramadhan buffet.

Outlook

Moving forward, the expected recovery in H2 2017 may turn into a tough journey for retailers, evidenced by diminishing sales in Q2. The growth of E-commerce in the years to come may be at the expense of slower sales in physical retail stores further. To stay competitive, more retailers are offering omni-channel platforms for sales.
RESIDENTIAL

Key Highlights in Q2

- Total completions amounted to 1,247 units in Q2, emanating from two developments located in the city centre. The newly completed developments are M City (1,118 units) and The Manhattan Residence 61 (29 units).
- Some 4,847 units of condominiums are expected to enter the market in the 2nd half of the year, with 58% of new supply will be in the city centre (Figure 9).
- Prices for high-end condominiums eased slightly by 1.4% q-o-q to RM743 per sq ft (Figure 10).
- Rents for high-end condominiums declined by 6.0% q-o-q at RM3.01 per sq ft/month.

Market Commentary

During the first half 2017, the residential market remained challenging amidst uncertainty, with no sign of respite yet. Sales were also relatively slower and developers remained cautious on new launches.

Lending facilities from the housing developers are still very limited and lending from financial institutions was largely for buyers of low-to-medium housing. Overall sales volume and values of residential transactions were adversely affected by the tight lending conditions. The rejection rate on housing loans was relatively high at 20.6% in the period of January to February 2017.

Developers continued to introduce more attractive packages to clear the unsold units to achieve their sales target, as well as, launch smaller and more affordable units in Q2.

Developers are introducing smaller and more affordable units to push sale rate, with some providing some form of financing solution to bridge loan gap

Outlook

The residential market is expected to remain weak through 2017, given the uncertain external environment, regional political tension, and growing inflation. The lack of financing, the negative media coverage on market excesses and an impending General Election that is predicted to be held sometime in year-end further dampen the market sentiments. This resulted in a “wait and see” approach among buyers.