

RESEARCH

July 2019

Kuala Lumpur Q2 2019

Muted global conditions affected the
Malaysian market



Q2 2019 snapshot

The Malaysian economy grew at a moderate growth rate of 4.5 per cent year-on-year (y-o-y) in Q1 2019, with domestic demand remaining as the key driver. Compared to Q4 2018, the economy expanded by 1.1 per cent this quarter.

Investment

Investment sales declined to

RM352.5m

in Q2 2019 by 69.0 per cent compared to RM1.15bn in Q1 2019. Major sales listings were noted in both the industrial and commercial sectors.

Office



The office market inclined towards **repurposing** and **co-working spaces** as the office **average occupancy** rate declined marginally to **79.7 per cent**.

Retail



Retail sales performed better than expected at **3.8 per cent**. The **festive season of Hari Raya** boosted the growth for Q2 2019 at **5.5 per cent** y-o-y.

Residential



Prices and rents for high-end condominiums changed marginally quarter-on-quarter (q-o-q) and stood at **RM1, 036 per square foot (psf)** and **RM3.86 per sq ft per month** respectively.

The economy

Key highlights

- The Malaysian gross domestic product (GDP) grew by 4.5 per cent in Q1 2019 (Q4 2018: 4.7 per cent).
- Unemployment rate increased marginally at 3.4 per cent in Q1 2019 (Q4 2018: 3.3 per cent).
- Both Consumer Sentiment Index (CSI) and Business Confidence Index (BCI) are below optimistic levels recording 85.6 and 94.3 points respectively.

Figure 1: Malaysia GDP growth

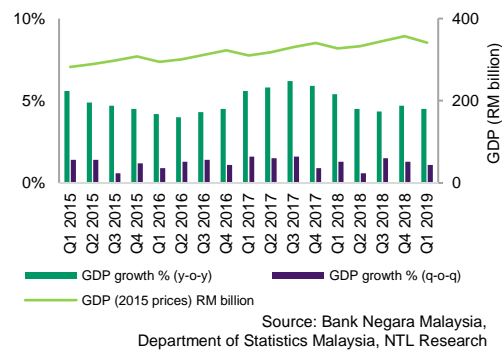


Figure 2: Consumer Sentiments Index (CSI) and Business Confidence Index (BCI)

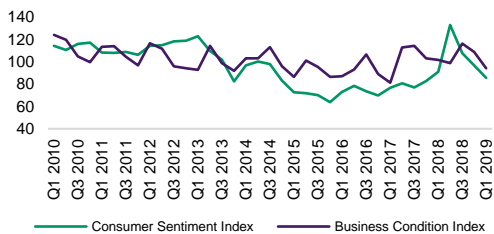
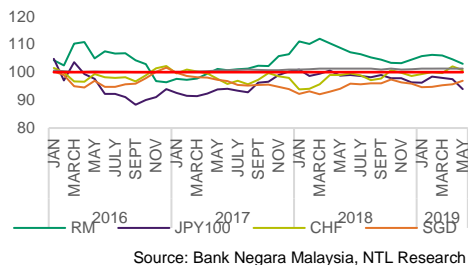


Figure 3: Exchange rate index of Malaysia's main trading partners vs USD



Market commentary

Malaysia's economy grew moderately at 4.5 per cent in Q1 2019 (Q4 2018: 4.7 per cent). Private final consumption regulating domestic demand remained as the economy's main driver with 58.2 per cent share in the GDP. It expanded at 7.6 per cent in Q1 (Q4 2018: 8.4 per cent) on account of the higher consumption of food & non-alcoholic beverages, transport, and restaurants & hotels.

All sectors recorded growth in the economy this quarter except for the mining and quarrying sector, which declined to -2.1 per cent in Q1 2019 (Q4 2018: -0.7 per cent).

Dominated by export-oriented industries, the manufacturing sector grew at 4.2 per cent in Q1 with a marginal decline over 4.7 per cent in Q4 2018. The slowdown was contributed by the slower growth in the electrical and electronics (E&E) industry due to a reduced demand for semiconductors globally. The stricter vehicle emission standards implemented by the EU and China's expiring tax rebates affected the demand of automotive semiconductors.

The services sector grew moderately at 6.4 per cent in Q1 (Q4 2018: 6.9 per cent) as tax holiday normalisation lowered the growth of the wholesale and retail sector. However, the higher car sales in the quarter offset the dip. The unplanned closure of the gas facilities in Sarawak in February and other facilities in Peninsular and Sabah weighed heavily on the refined petroleum production of Malaysia. Slower activities in the civil engineering non-residential and special trade subsectors caused the slowdown of the construction sector to 0.3 per cent in Q1 2019 (Q4 2018: 2.6 per cent). In contrast to the last quarter with -0.5 per cent growth, the Agriculture sector performed significantly well at 5.6 per cent this quarter. The substantial recovery of the oil palm yields and an increase in natural rubber's production along with its prices boosted rubber tapping in the quarter.

Malaysia's economy to remain steady despite challenging global conditions.

Anxiety over the rising prices continued to impact the CSI as it dropped to 85.6 points in Q1 2019, below the optimistic threshold for the second consecutive quarter (Q4 2018: 95.8 points). Similarly, the BCI also slipped below the optimistic threshold to 94.3 points in Q1 2019 (Q4 2018: 108.8 points). Overall, the decline in the BCI is mainly due to the slowdown of the manufacturing sector and moderate investment activities in the quarter.

Ringgit traded at a six-month low towards the end of May as concerns over the US-China trade war and slowing global growth sap demand for risk assets. However, on average, it appreciated slightly by 1.4 per cent in Q1 and was mainly driven by the non-resident portfolio inflows valued at RM13.5bn.

Malaysia's economy is heavily dependent on trades with the US and China, comprising 20.0 per cent of total exports. The recent escalation in the US-China trade war has been impacting Malaysia's exports and resulted in lowered trade in Q1. Q1 saw its total trade to be 0.4 per cent lower in comparison to the same period in 2018.

Net exports for Malaysia grew at 10.9 per cent in Q1, however it was affected by the decline of 1.4 per cent in imports. Q1 recorded a very marginal growth in exports of 0.1 per cent as compared to 3.1 per cent in the previous quarter.

The recent plunge in smartphone demand has also affected the electronics manufacturers who have their export bases in Malaysia.

Diversification in the economy is cushioning the impact of global tensions. The tariff put in place by the nations involved in the trade war are encouraging investments in Southeast Asia. Approved foreign investment in the manufacturing industry in Malaysia increased by 127.0 per cent in Q1 2019 as compared to Q1 2018 (Q1 2019: RM20.2bn, Q1 2018: RM8.9bn).

Outlook

The Malaysian economy is expected to grow moderately at 4.9 per cent in 2019, supported by the continued growth of domestic demand, mainly consumption and investment.

The revival of 640km East Coast Rail Line (ECRL) deal with China is likely to captivate investment growth in the country. The recent cut down of policy rates from 3.25 per cent to 3.0 per cent has also offered monetary ease but more fiscal reforms with the adaption of Industrial Revolution (IR) 4.0 in various industries, are required to keep the interest of investors alive in Malaysia to support the slowing economy.

The shifting interest from China to avoid the tariff imposed by the US may potentially divert investments in Southeast Asia. It has the potential to generate trade and investment spill-overs in Malaysia's trade with both countries.

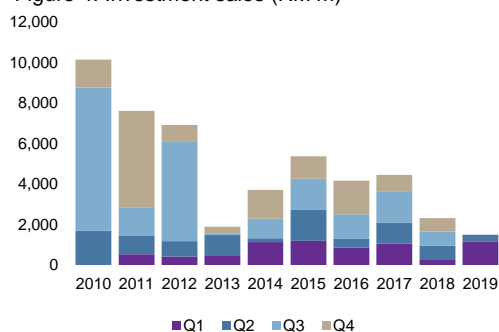
Escalating tensions between the two largest economies (US-China) will continue to affect Malaysia's export demand. Thus, foreign manufacturers having regional distribution or international procurement centres in Malaysia may opt for short- to medium-term adjustments to their exporting activities.

Investment sales

Key highlights

- Sales volume for Q1 2019 declined by 69.0 per cent q-o-q to RM352.5m (Figure 4).
- Major sale listings were noted in both the industrial and commercial sectors.
- The recent drop in the base lending rate (BLR) rate of 25 basis points (bps) will provide a slight incentive to buyers by lowering funding cost for deals. However, with the current noises on trade war, political tensions and the weakening global environment, investors, especially foreign, are thin on the ground.
- Buying opportunities are still available amidst challenging market conditions.

Figure 4: Investment sales (RM m)



Source: NTL Research

Table 1: Investment sales

Development	Buyer	Vendor	Price (RM m)
Somerset Medini and Marina Walk Puteri Harbour	UEM Sunrise	Themed Attractions Resort & Hotels Sdn Bhd ("TAR&H")	145
Advance Synergy	Symphony Warehouse Sdn Bhd	AESBI Power Systems Sdn Bhd	124
Nexgram Tower	IMS Development Sdn Bhd	Nexgram Land Sdn Bhd	67

Source: NTL Research

Market commentary

After a strong Q1, the investment market dropped by 69.0 per cent in value, comprising merely four recorded sales. Of these, two are major transactions of over RM100m namely the sale of an existing factory at Section 22 Shah Alam by Advanced Synergy Bhd to a Mapletree's subsidiary for RM124m and a corporate swap deal for which UEM Bhd purchased retail/commercial space at Puteri Harbour for RM145m. The former deal was for its development land potential with a land area of 15.2 acres, whilst the latter deal involved a building housing the Hello Kitty theme park.

Notwithstanding the scale back in activities in Q2, major sale listings were noted both in the industrial and commercial sectors. Currently still looking for prospective buyers, these are the Sheraton Imperial Hotel, a major parcel of industrial land at Pulau Indah FTZ and a major factory by Western Digital in Sungei Way FTZ. Menara Celcom, a newly completed prime office with a long lease at PJ Sentral, is expected to be attractive to risk-adverse investors in the light of the office market glut.

During the period under review, Senior Aerospace's new build-to-lease (BTL) factory of 180,000 sq ft built up developed by AXIS REIT was officially launched at Subang while we at Nawawi Tie Leung are in the midst of undertaking a similar deal for an MNC client for delivery of a new 116,000 sq ft facility by 2021. Such BTL projects will drive future opportunities for the RE funds.

The recent drop in the BLR rate of 25 bps will provide a slight incentive to buyers by lowering funding cost for deals but with the current noises on the trade war, political tensions, and the weakening global environment, investors, especially foreign, are thin on the ground.

Buying opportunities are available amidst challenging market conditions.

Outlook

We continue to see buying opportunities amidst weakening market conditions, but it will require investors to have more than foresight and gumption to see beyond the current risks. Currently, there is a distinct lack of catalysts to drive momentum so the second half of 2019 may turn out to be lackadaisical after all despite the promising start to the year.

Office

Key highlights

- The total stock in Kuala Lumpur (KL) increased to 82.2m sq ft.
- The average occupancy rate in KL dropped marginally to 79.7 per cent.
- Rents remained flat in the Golden Triangle (GT) and KL Sentral area at RM7.23 per sq ft and RM7.10 per sq ft per month respectively.
- Capital value and yield remained unchanged.

Figure 5: Prime & secondary rental indices – KLCC

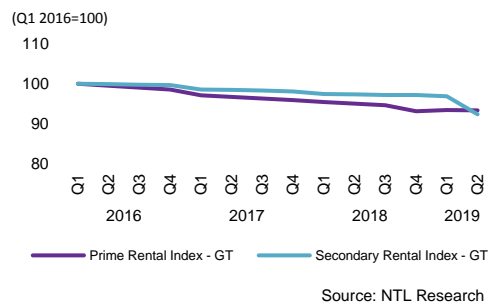


Figure 6: Office completed supply (sq ft, m)

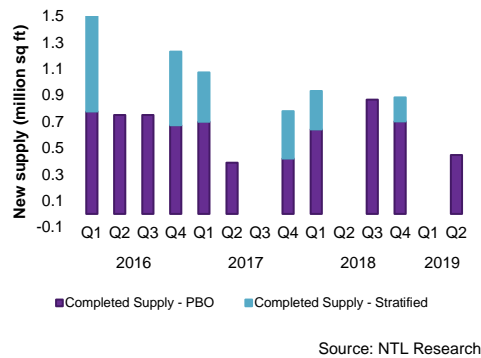
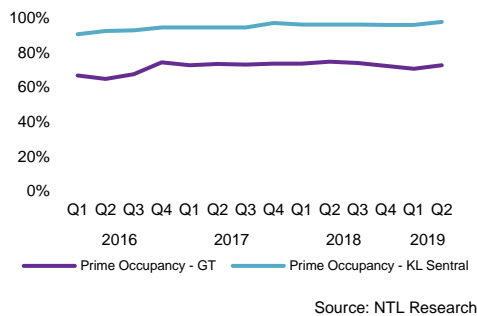


Figure 7: Prime office occupancy (%)



Market commentary

Menara Prudential, a LEED-gold certified and MSC status building with 413,256 sq ft NLA, is the very first building to open its doors in Tun Razak Exchange (TRX) this quarter. With this addition, the total stock in KL increased to 82.2m sq ft.

British insurance company, Prudential Assurance Malaysia Bhd (PAMB), is said to have taken up approximately 80.0 per cent of the building. It is moving in stages and is expected to be fully operational by July 2019.

As net absorption remains soft due to the weak market conditions, many landlords are offering attractive packages and proactively looking to sign up co-working space and serviced office providers. However, the space taken up is relatively small, ranging from 15,000 sq ft to 25,000 sq ft.

MQREIT recently signed up with Spaces, a Regus co-working brand, in Platinum Sentral. Regus also partnered with Tribeca and launched its 34th centre in Bukit Bintang this quarter.

NAZA Tower, a Grade A Green Building Index (GBI)-certified office building located in KLCC, also welcomed a locally operated co-working space, Co-labs, in June. It is occupying 27,000 sq ft of space across 2 floors in the tower.

Tower Real Estate Investment Trust (REIT) is also reinventing and repositioning itself via co-working and co-living spaces. It has planned a makeover of 32-storey Menara HLA into an innovation exchange known as HLX. It is a one-stop facility that converges the corporate and tech start-up communities under one roof, taking up more than 60.0 per cent of the space in Menara HLA. Also, it will offer flexible leases with co-living spaces, food and beverage outlets, a gym, an auditorium and flexible event spaces with a focus on companies in technology. Phase 1 of the makeover will be completed by the end of 2019, which will include digital campus, co-working and co-living spaces, venture capital hub, and curated offices. While Phase 2 will offer exhibition space, innovation lab, media lab, and Founder's bar, which will be opened by 31 December 2020. The company has partnered with AltSpace by Lyfz Co-Living to operate the co-living space.

Tech companies and co-working spaces are driving the office market.

Tower REIT also plans to upgrade Plaza Zurich, formerly known as HP Tower in Damansara Height as part of its asset enhancement initiative.

Flexibility and cost efficiency offered in co-working spaces aptly addressed the demands of the millennial workforce, technology startups and SMEs. In Malaysia, a few companies have tested the use of co-working spaces, but none has set up a corporate office due to concerns about high cost and security.

Malaysia's largest snack company, Mamee Double Decker (M) Sdn Bhd signed up with Colony Space for its Mutiara Damansara centre.

Apart from repurposing, landlords are also exploring alternative use for upcoming or under construction buildings. The office component of the upcoming project, Latitude 8, at Jalan Ampang is repurposed to SoHo and is pending approval.

On the sales front, there are two prominent buildings for sale this quarter which include, The Sheraton Imperial on Jalan Sultan Ismail and Menara Celcom in Petaling Jaya.

The Sheraton Imperial comprising 398 rooms and 138,000 sq ft of office space and newly built 33-storey Menara Celcom with 450,000 sq ft NLA is estimated to be approximately RM500m each.

Outlook

Escalating supply and slowing occupiers demand for office space are expected to impose challenges for the office market in KL for the next few years.

For medium- to long-term security, we expect a growing trend of repurposing old office buildings while the new or under construction building will explore alternative uses.

Tech companies and co-working spaces are anticipated to drive the office market for the coming few quarters.

Retail

Key highlights

- Retail sales for Q1 2019 recorded growth of 3.8 per cent, higher than the estimated growth rate of 3.1 per cent.
- No major completion of new malls in Q2.
- The existing supply of shopping malls in Klang Valley stood at 53.9m sq ft.
- Average overall occupancy of shopping malls in Klang Valley noted at 91.0 per cent.

Figure 8: Development pipeline supply (NLA in KL (sq ft, m) Development pipeline supply (NLA) in KL (sq ft, m)

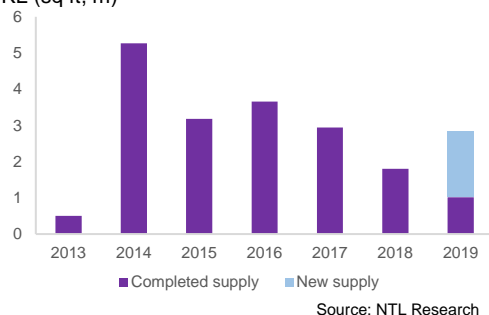


Table 2: Selected upcoming malls in the Klang Valley, 2019 Selected upcoming malls in Klang Valley, 2019

Development	Net Lettable Area (sq ft)	Location
Tropicana Gardens Mall	1,000,000	OCA
Pacific Star	240,000	OCA
KIP Mall Desa Coalfield	213,000	OCA
Galleria	360,000	OCA

Source: NTL Research

Retail growth forecast revised upwards for 2019 at 4.9 per cent.

Market commentary

Q1 turned out a better-than-expected quarter for the retail industry as sales recorded higher growth at 3.8 per cent compared to the previous year (3.5 per cent) and also exceeded the estimated growth of 3.1 per cent for the quarter.

For Q2, Retail Group of Malaysia foresees a growth rate of 5.5 per cent in retail sales as Malaysia celebrated its largest festival, Hari Raya in June 2019.

A couple of new F&B brands entered Malaysia's retail market this quarter. Chinese hot-pot franchise Hai Di Lao opened its first outlet in Sunway Pyramid in Bandar Sunway, Petaling Jaya followed by Pavilion Elite in Bukit Bintang. While Hong Kong seafood restaurant, Xin Dau Ji opened its first outlet in Ecocheras Mall, Cheras.

A Swiss watch brand Baume & Mercier also signed an exclusive 3-year distribution deal with FJ Benjamin this quarter for Singapore and Malaysia. MST Golf also opened its largest store of 13,000 sq ft in Johor, Malaysia in Q2.

On the brand expansion front, Texchem is looking to invest RM36mil this year to increase the number of Sushi King outlets in the country and in Indonesia to 146 from 135 currently.

To address the expected issue of weak performance due to subdued retail activity this year, AEON Malaysia announced to invest USD119 million on new malls and refurbishments of existing malls.

To remain competitive amidst global digitalisation, many F&B brands are also taking measures to be on par. McDonald's bought a tech firm, Dynamic Yield, worth USD300m to improve drive-through sales with personalised outdoor digital menu displays. It will be rolled out first in the US before expanding to other leading international markets.

Similarly, Subway is planning to launch an online platform mid this year. It will be tested in Australia first. Starbucks also launched a 'Starbucks Now cashless program' in China, which allows customers to place an order in advance of their visit and pick up their orders at a selected Starbucks store. Digital repercussions of these brands will also be experienced in Malaysia soon.

Malaysia has been taking steps towards digitalisation as well. Sunway Pyramid launched a navigation app this quarter, which offers real-time directions for visitors, using an indoor version of Google Maps. The navigation pattern of visitors will be analysed to offer relevant targeted promotions at the mall.

Digital e-wallets are garnering the cashless momentum in Malaysia. The most popular Touch 'n Go eWallet or TNG digital has expanded its retail merchant base which includes KFC, Tealive, TGV, Tesco, and JD Sports. TNG digital also promoted cashless Ramadan Bazar in Kampung Baru. Burgeoning acceptance for e-wallets is taking Malaysia one step closer to a fully digitalised nation.

Outlook

The Retail Group of Malaysia has revised the growth rate of retail sales to 4.9 per cent for the year 2019 due to improved sales in Q1.

The year ending quarter is expected to perform significantly better with a 5.8 per cent growth rate owing to the school holidays and year-end sales while Q3 is expected to be moderate with 3.1 per cent.

Due to the growing penetration of e-commerce and the rapid digitalisation in the global retail formats, malls need to be innovative and future ready to accommodate the changes likely to be brought in by the digital wave.

Soon, we are expecting more digitally compliance retail formats in Malaysia's retail industry to adapt to changing consumer shopping behavior.

Residential

Key highlights

- No completion of high-end residential projects in Q2 2019.
- Over 4,000 units are likely to be ready in the remaining 2019.
- Prices and rents for high-end condominiums changed marginally and stood at RM1,036 per sq ft and RM3.86 per sq ft per month respectively (Figure 10).

Figure 9: Future supply of high-end condominiums in KL (units)

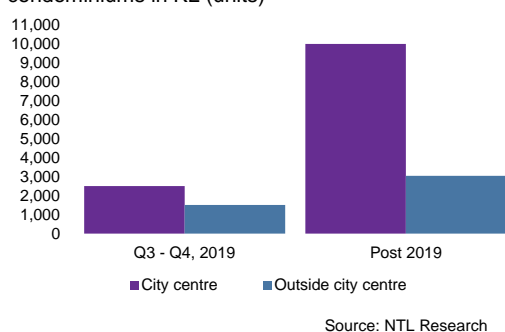
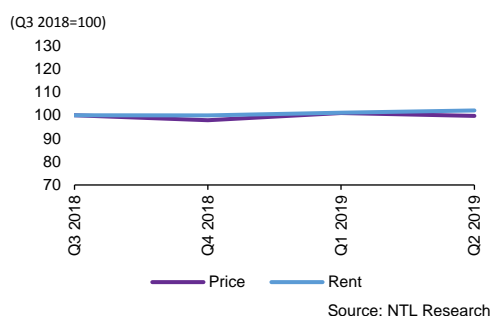


Figure 10: Price and rental indices of high-end condominiums in KL



Market commentary

Residential property market across Malaysia has been undergoing trying times. According to the recently released NAPIC's Property Market Report 2018, the overhang in 2018 increased to 32,313, a 30.6 per cent rise from the previous year. The bulk of this overhang is in the high-rise category (43.4 per cent), concentrated in Perak and KL. The rising overhang is primarily an outcome of demand-supply mismatch and strict lending regulations.

However, there were 197,385 residential transactions, worth RM68.75bn, in 2018. It indicates an increase of 1.4 per cent and 0.4 per cent in transactions volume and value respectively compared to 2017. Thus, at a macro level, the residential property market generated some positive sentiments.

Due to increasing interest from first-time home buyers, the residential market has swayed towards affordable housing. In addition to the other affordable housing initiatives such as affordable housing schemes, funding schemes, House Ownership Campaign (HOC), the Government with Securities Commission Malaysia (SC) released its new property crowdfunding framework recently. Growing confidence has been shown in these initiatives in the last few quarters. As the Home Ownership Campaign (HOC) 2019 ends this quarter, more conclusive statistics are expected to back this up.

Conversely, the high-end residential market sampled in KL continues to remain soft as there was not much activity this quarter. Due to construction delays, projects like Star Residences, Stonor 3 and Aria KLCC that are expected to complete this quarter are likely to be completed in the next quarter or later this year instead.

According to the NAPIC data, house prices continued to rise throughout 2018 with an increase of 3.1 per cent in the house price index against 2017. However, for the sampled high-end residential projects, prices were noted to be stagnant with marginal variation during this quarter.

Sluggishness in the high-end residential market continues.

Outlook

The need for affordable housing is undeniable. However, the demand-supply mismatch is resulting in the rising overhang. Thus, there is a need to evaluate this segment with a realistic approach.

Overall, the high-end residential property market is anticipated to remain sluggish in such conditions for the upcoming quarters.

Definitions

Development pipeline/potential supply:	<p>Comprises two elements:</p> <ol style="list-style-type: none"> 1. Floor space in the course of development, defined as buildings being constructed or comprehensively refurbished. 2. Schemes with the potential to be built in the future, having secured planning permission/development certification.
Net absorption:	The change in the total occupied or let floor space over a specified period of time, either positive or negative.
Net supply:	<p>The change in the total floor space over a specified period of time, either positive or negative. It excludes floor spaces that are not available for occupation due to refurbishment or redevelopment, but includes new supply.</p> <p>New supply refers to total floor space/units that are ready for occupation. Ready for occupation means practical completion, where either the building has been issued with a Temporary Occupation Permit (TOP) or Certificate of Completion and Compliance (CCC).</p>
Prime office rent:	<p>The highest rent that could be achieved for a typical building/unit of the highest quality and specification in the best location to a tenant with a good (i.e. secure) covenant.</p> <p>(NB. This is a gross rent, including service charge or tax, and is based on a standard lease, excluding exceptional deals for that particular market).</p>
Stock:	<p>Total accommodation in the private sector both occupied and vacant:</p> <ol style="list-style-type: none"> 1. Purpose-built office buildings with Net Lettable area (NLA) of at least 150,000 sq ft. 2. Purpose-leased shopping centers, excluding hypermarket and stratified retail. 3. Non-landed residential projects with at least 10 strata dwelling units.
Take-up:	<p>Floor space acquired for occupation or investment, including the following:</p> <ol style="list-style-type: none"> 1. Offices let to an eventual occupier. 2. Developments pre-let or sold. <p>(NB. This includes subleases)</p> <p>Take-up also refers to units transacted in the residential market.</p>
Occupancy rate:	Total space currently occupied or not available to let as a percentage of the total stock of floor space (NB. This excludes shadow space which is space made available for sub-leasing).
Golden Triangle	An area bordered by Jalan Tun Razak – Jalan Ampang – Jalan Maharajalela
KL City Centre	An area bordered by Jalan Tun Razak – Lebuhraya Sultan Iskandar – Jalan Damansara – Jalan Istana.
Outer City Centre	An area that refers to the Federal Territory of Kuala Lumpur, excluding the area of KL City Centre.
Other City Area	An area comprising the districts of Petaling, Gombak, Klang, Hulu Langat, and Sepang in Selangor, and Federal Territory of Putrajaya.

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