KUALA LUMPUR Q3 2019

Investment sales remain robust in subdued economy

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2019 Q3 snapshot

The Malaysian economy performed encouragingly in Q2 2019, growing at an improved 4.9 per cent year-on-year (y-o-y), supported by the expansion of its domestic demand at 4.6 per cent.

Investment sales **improved** to

RM1.3bn

277 per cent growth from RM352 million in Q2 2019.

Major sale listings were noted both in the **industrial and healthcare sectors**.

Office

The total stock in Kuala Lumpur (KL) increased to **84.8m sq ft**.

Retail

Overall occupancy for shopping malls in Klang Valley saw a decline to **85.3 per cent**.

Residential

Overhang residential properties in Malaysia (including serviced apartments and SOHO) stood at 52,666 units as of Q2 2019, **increasing by 10.9 per cent from the total overhang stock of Q1 2019**. Majority of the overhang units are priced between RM200,001 and RM300,000 (22.3 per cent of the total overhang units).

THE ECONOMY

Key highlights

- Malaysian GDP grew at 4.9 per cent in Q2 2019, the fastest in five quarters.
- All sectors recorded positive growth in Q2 2019.
- While the Business Confidence Index (BCI) moderated to 94.2 points, the Consumer Sentiment Index (CSI) saw an improvement to 93 points.

Encouraging signs as the Malaysian economy grew the fastest in five quarters

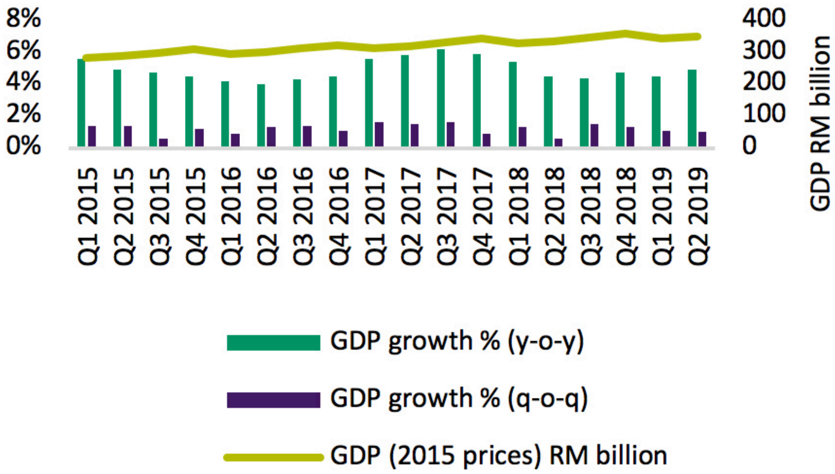
Market commentary

Supported by the continued expansion of domestic demand, the Malaysian economy saw a healthy 4.9 per cent growth in the second quarter of 2019 (Q1 2019: 4.5 per cent). Domestic demand grew at 4.6 per cent (Q1 2019: 4.4 per cent) on the back of higher household spending and higher private investments. Supported by growing incomes and festive spending in the second quarter, private consumption grew at 7.8 per cent (Q1 2019: 7.6 per cent). Expansion in the private investment sector originated primarily from the services and manufacturing sectors.

All economic sectors recorded expansion in Q2 2019. The manufacturing sector grew at 4.3 per cent (Q1 2019: 4.2 per cent) due to an improvement in domestic-oriented industries. The quarter saw higher production of motor vehicles to cater for the increase in demand over the festive season. Demand for metal related materials for existing transport and infrastructure projects supported the higher production within the construction-related cluster.

The services sector retained its place as the fastest growing sector in the country, growing at 6.1 per cent in Q2 2019 (Q1 2019: 6.4 per cent). Wholesale & retail trade and the motor vehicles sub-sector carried the sector in the quarter.

Figure 1: Malaysia GDP Growth



Source: Bank Negara Malaysia, Department of Statistics Malaysia, NAWAWI TIE Research

While construction and agriculture were subdued, mining was a bright spark in Q2. The construction sector remained sluggish, growing at 0.5 per cent, (Q 1 2019: 0.3 per cent) as the residential subsector remained weak due to the high volume of unsold units. Agriculture moderated to 4.2 per cent (Q1 2019: 5.6 per cent) due to the decline in fishing and forestry activities, together with the decline in natural rubber output due to wintering season. The mining sector, however, rebounded from negative growth in the previous quarter to a growth rate of 2.9 percent in Q2 2019 (Q1 2019: -2.1 per cent). The growth was supported by the increase in output after the recovery from the pipeline disruptions in 2018.

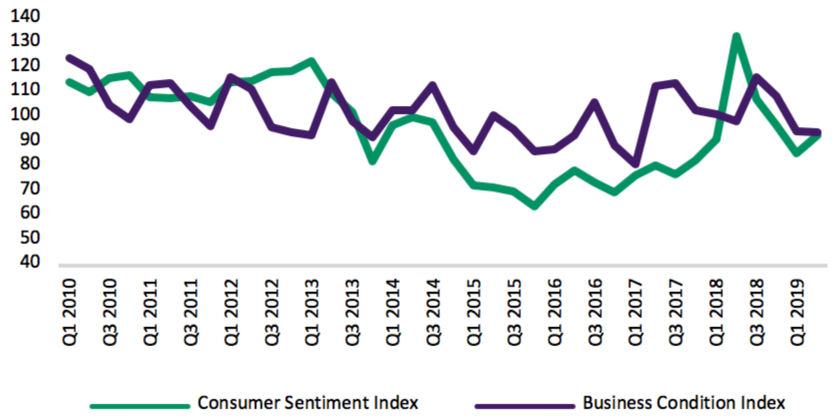
The BCI dipped slightly to 94.2 points in Q2 2019 (Q1 2019: 94.3 points), while the CSI – bolstered by improved consumer sentiment on the current financial situation and optimistic income and employment expectations – reported an improvement to 93 points (Q1 2019: 85.6 points).

The non-resident portfolio of RM5.1 billion caused the ringgit to depreciate by 1.5 per cent in Q1 2019. Despite weak global sentiments, domestic bond and equity markets, supported by domestic institutional investors, remained resilient over the quarter.

Outlook

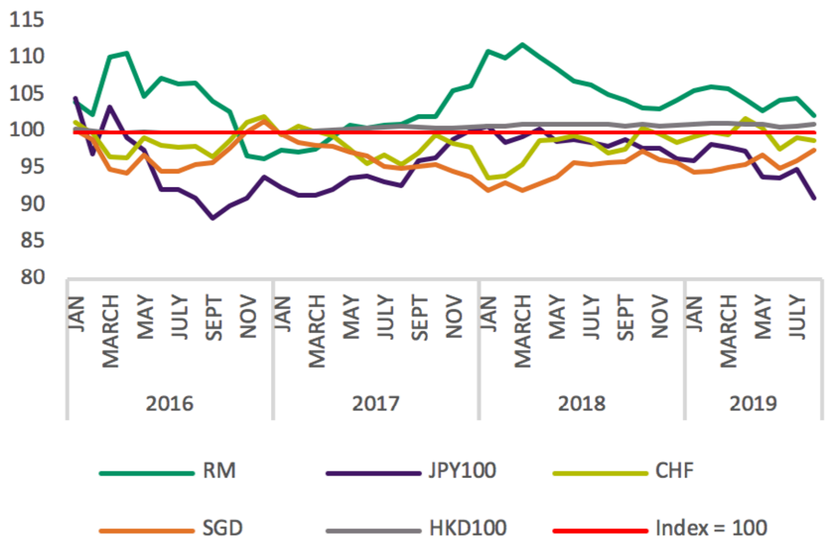
Bank Negara Malaysia expects the GDP growth rate to remain between 4.3 per cent and 4.8 per cent in 2019, mainly driven by the continued growth of private sector activities.

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



Source: Malaysian Institute of Economic Research, NAWAWI TIE Research

Figure 3: Exchange Rate Index of Main Trading Partners of Malaysia vs USD



Source: Bank Negara Malaysia, NAWAWI TIE Research

INVESTMENT SALES

Key highlights in Q3

- Sales volume grew 52.3 per cent y-o-y at RM1.3 billion in Q3 2019 (Figure 4).
- Industrial investment accounted for a huge chunk of total investments in Q3 2019.
- The 2020 budget is expected to have an impact toon the investment outlook of Malaysia.

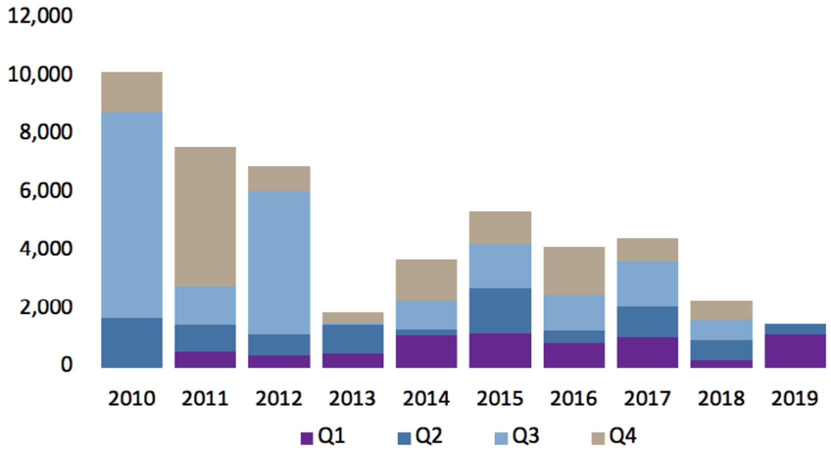
Market commentary

Notwithstanding the on-going trade war and other geopolitical uncertainties, there was an uptake in transaction volume, driven mainly by related-party corporate restructuring. A total of 19 transactions amounting to RM1.3 billion accounted for a 52.3 per cent y-o-y surge, and represented a staggering 277 per cent quarter-on-quarter (q-o-q) increase.

Two major deals were the sale of Prince Court Medical Centre by Khazanah to related party IHH, one of the largest health care operators in the region, whilst a portfolio of industrial assets of UMW, worth RM287 million, were injected to an SPV by the controlling shareholder, PNB. The other major deal, although not strictly real estate, is the sale of a portfolio of 17 Columbia Asia hospitals in the region (of which 12 are located in Malaysia) for RM1.2b to a consortium that includes private equity firm TPG and Hong Leong Financial Group of Malaysia. Another active investor is AXIS REIT, which contributed two industrial, Johor-based deals over the quarter.

Budget 2020 to show the way for investment directions

Figure 4: Investment sales (RM m)



Source: NAWAWI TIE Research

Although several major office and hotel assets were previously reported as being offered for sale, to date, no firm deals have been announced. The recent restructuring by GCH Retail, which operates the Giant and Cold Storage chains of hypermarkets and supermarkets, will involve the closure of some 22 outlets, and will thereby provide opportunities for potential movement in retail assets that are previously transacted on a long-term sale and lease-back arrangement to EPF. The changing retail landscape and consumer behaviour have affected the viability of some retail stores and formats, which necessitates a consolidation. The proposed factory outlet, to be operated by Horizon Village Outlet of the US, has also been shelved as a sign of caution from both investors and retailers.

Attention will be focused on October's Budget 2020, in anticipation of policy changes that could improve ground sentiment in an generally subdued landscape. The Budget is expected to address the issue of catalysing investment in a climate that has been dampened by the protracted trade war.

ASEAN nations are expected to benefit from the relocation of manufacturing plants from China as a way of sidestepping the US tariff hike. As of late, the main winners are Thailand and Vietnam. Thailand is known as the "Detroit of Asia" as it is the global hub of automotive manufacturing. Toyota, Mitsubishi, Ford, Mercedes, BMW and GM are all currently based in Thailand. To further attract investment, the country has also initiated a tax break for companies diverting their manufacturing operations from China and the US. Vietnam is another winner in the trade dispute as its exports saw a 36 per cent hike in the first half of 2019 as compared to the previous year.

To remain competitive vis-à-vis Thailand and Vietnam, investment incentives are expected to play a key role in the coming quarters for Malaysia.

Outlook

While the country may see some interest from Hong Kong-based investors, particularly retail-based individuals seeking to park money offshore in residential property, this is unlikely to have a major impact on overall fundamentals.

Global geopolitics are affecting multiple value chains, and the year is thus expected to continue experiencing subdued investment activity.

Table 1: Investment sales

Development	Buyer	Vendor	Price (RM m)
Prince Medical Centre	Pulau Memutik Ventures Sdn Bhd	Khazanah Nasional Berhad	800
UMW Industrial	Strategic Sonata Sdn Bhd	Permodalan Nasional Berhad (PNB)	288
KPJ Batu Pahat Specialist Hospital	AmanahRaya Trustees Berhad	Johor Land Berhad	78
Maxter Glove Manufacturing Sdn Bhd	Leader Cable	Supermax	65
GKN Engine Systems Component Repair Sdn. Bhd.	Axis REIT	Nusajaya Tech Park Sdn. Bhd	42
Q Avenue	Seal City Sdn Bhd (SCITY)	Dwitasik Sdn Bhd	22
Zoomic Technology (M) Sdn Bhd	Axis Real Estate Investment Trust (Axis REIT)	Ire-tex Corp Bhd	Court 21

Source: NAWAWI TIE Research

OFFICE

Key highlights in Q3

- Following the completion of The Exchange 106, the total stock in Kuala Lumpur (KL) increased to 84.8m sq ft.
- The average occupancy rate in KL dropped to 77.6 per cent.
- Rents remained flat in the Golden Triangle (GT) and KL Sentral area at RM7.23 and RM7.10 per sq ft per month respectively.
- Capital values and yields remained unchanged.

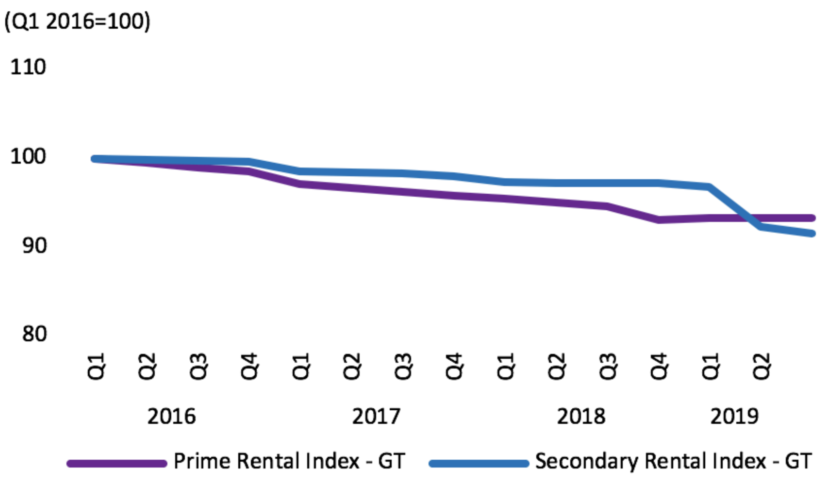
Market commentary

Kuala Lumpur's occupancy saw a fall from 79.7 per cent in Q2 2019 to 77.6 per cent in Q3 2019. The slower than expected take up of the newly completed The Exchange 106 contributed to the fall in occupancy rate. The first batch of tenants are expected to move in by December 2019, while the bulk of other tenants are expected to follow by March and April 2020. Occupancy rates in KL will be heavily influenced by the pulling power of the abundant new space injected into the market.

> Considering the lack of growth catalysts in the near term, the office market remains lacklustre.

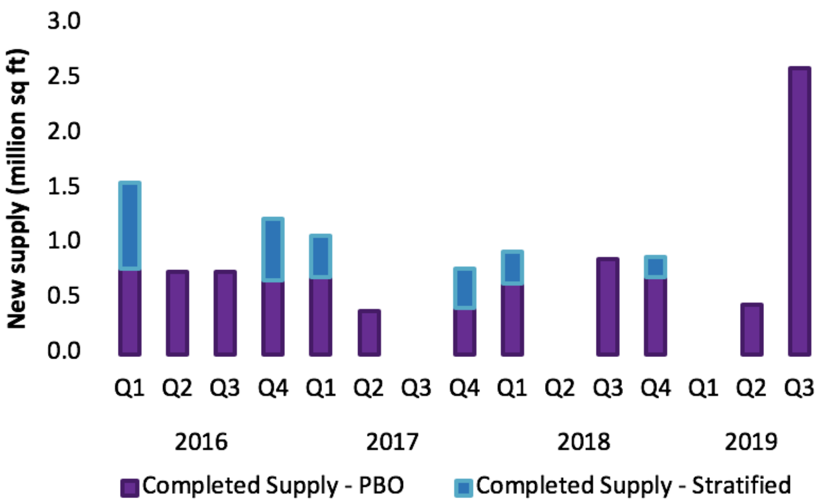
With the rise of supply of office space, InvestKL anticipates the capital city to attract MNCs to settle down in KL. Since its inception in 2011, InvestKL has successfully attracted 85 companies to set up operations in Kuala Lumpur and it is believed that the city is on track to secure 100 companies by 2020. The rise in MNCs is, in turn, expected to spur the demand for prime office space in KL. Getting MNCs to operate out of KL therefore remains priority that needs to be addressed so as to rejuvenate the currently lethargic market.

Figure 5: Prime & secondary rental indices – KLCC



Source: NAWAWI TIE Research

Figure 6: Prime & secondary rental indices – KLCC



Source: NAWAWI TIE Research

In Q3, the office market was mainly driven by the expansion of serviced office/co-working space operators as well as tech firms such as Klook, Agoda and Fave. The expansion is expected to gather momentum as other major tech companies contemplate expanding their presence in Malaysia. Currently the serviced office/co-working space in KL are distributed at 51% and 49% in the Golden Triangle and KL Fringe respectively.

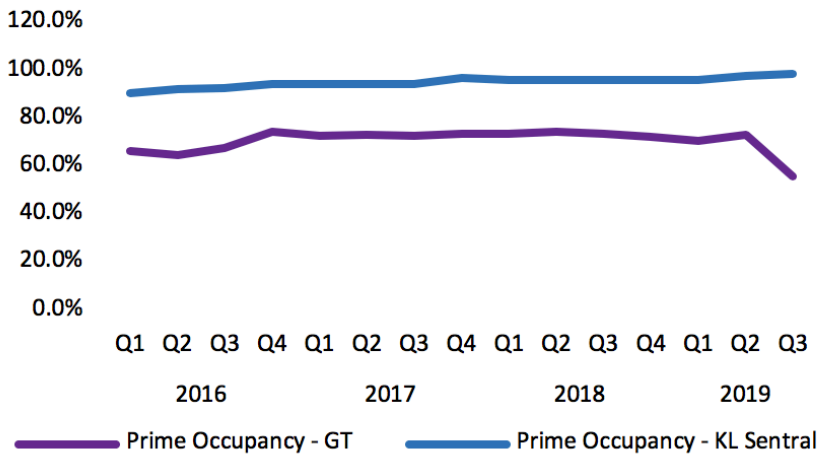
IWG, which is already operating in 30 locations under the Regus brand within Malaysia, will be opening its first SPACES co-working space at Platinum Sentral. Taking up approximately 59,000 sq ft across three levels at Platinum Sentral, SPACES will be the largest office space by IWG in Malaysia. The multinational co-working and office operator also announced its decision to rebrand its Regus Centre in Menara Prestige to SPACES co-working space. British insurance company, Prudential Assurance Malaysia Bhd (PAMB), is said to have taken up approximately 80 per cent of the building. It is moving in stages and is expected to be fully operational by July 2019.

Standard Chartered Bank and Mcdermott have joined WeWork at the Equatorial Plaza with approximately 100,000 sq ft and 60,000 sq ft of space respectively. After opening its first location at Equatorial Plaza, WeWork will expand to KL Fringe with its second location at Mercu 2, KL Eco City. This quarter also saw the entry of regional co-working space operator, Found8, which originated from Singapore, and has opened its first location at KL Sentral Station.

Menara MIDF along Jalan Raja Chulan was put up for sale with an asking price ranging between RM140 million and RM150 million, and with the potential for alternative use or redevelopment.

In line with market conditions, rents in the Golden Triangle and KL Sentral area remained flat at RM7.23 and RM7.10 per sq ft per month respectively. With The Exchange 106 coming on-stream, further contributing to the supply glut, rents and occupancy remain under downward pressure, and landlords continue to face the challenge of securing new occupiers.

Figure 7: Prime office occupancy (%)



Source: NAWAWI TIE Research

Outlook

Global uncertainties compounded by a supply glut are expected to hit office rental and occupancy rates for the rest of the year. Appropriate and timely interventions are needed to jumpstart the current office market.

RETAIL

Key highlights in Q3

- Retail sales in Q2 2019 saw a 4.5 per cent y-o-y improvement.
- Overall occupancy for shopping malls in Klang Valley is estimated at 85.3 per cent. Prime malls have continued to maintain occupancy rates of above 90.0 per cent.
- Projected growth of retail sales in 2019 was revised downwards from 4.9 per cent to 4.4 per cent.

Market commentary

Though remaining below the threshold of 100, the Consumer Sentiment Index (CSI) edged up by 7.4 points to 93.0 in Q2 2019, signalling a potential uptrend. This is reflected in retail sales, which grew 4.5 per cent year-on-year in Q2 2019 as compared to the 2.1 per cent in 2018. Sales for the quarter were mainly boosted by Hari Raya festive shopping. Nonetheless, consumers remained cautious during the festive season, resulting in retail sales falling short of an expected 5.5 per cent growth. Overall, the first half of 2019 registered a growth rate of 4.2 per cent compared to 2.3 per cent a year ago.

Retail growth forecast revised downwards for 2019 to 4.4 per cent

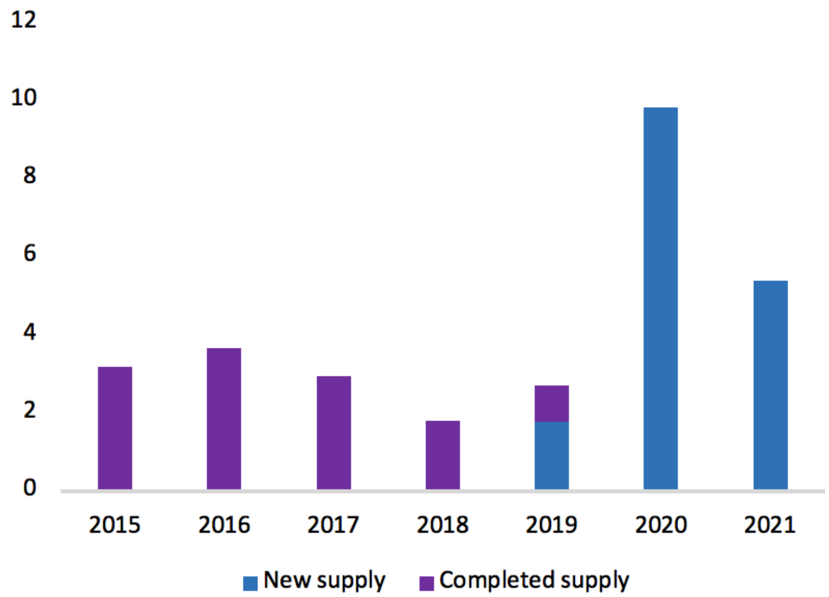
After 18 months, Parkson Puchong at M Square Mall ceased operations as the department store failed to meet its sales targets. Prior, Parkson left Suria KLCC mall after 20 years of operation. Parkson currently operates 43 stores across the nation.

On the other hand, Suria KLCC welcomed Babel to its premises. Following their breakthrough at the rooftop of Menara Ken TTDI, Babel branched out to the city centre, taking up 15,000 sq ft of the mall's ground floor. The innovative fitness club offers gym space that focuses on both mental and physical wellness for its members, and sets itself apart with superlative amenities, premium aesthetics and cutting-edge equipment.

Also, MyTown Shopping Centre recently welcomed a highly touted co-working space operator, Common Ground as its tenant in September. Occupying 18,000 sq ft of retail space across two levels, it is their 15th outlet in Malaysia. Common Ground has previously opened its doors in other shopping centres, such as Citta Mall and Jaya One.

In July, Malaysian co-working space operator WORQ successfully launched its third branch at KL Gateway Mall. Since its inception in 2017 at Glo Damansara, WORQ has rapidly expanded, and now provides an aggregate space of some 18,000 sq ft.

Figure 8: Development pipeline supply (NLA) in Kuala Lumpur (million sq ft)



Source: NAWAWI TIE Research

Other notable operators includes Co-labs, with their flagship space of 20,000 sq ft at The Starling Mall. Co-labs is run by Paramount Coworking, a subsidiary of Paramount Group, whose main business activities are property development and education. The brand currently has four outlets and is expecting an expansion of 15,000 sq ft at The Staling Mall by October this year.

The introduction of non-retail components into shopping malls, such as co-working space, is not uncommon and is now gathering momentum both locally and globally. In the western hemisphere, this trend became a subject of interest following the widespread closures of multiple giant retailers, which resulted in high vacancy rates in shopping malls.

The arrival of co-working spaces to malls represents a win-win arrangement for both operators and landlords. The co-working space enjoys the convenience of a mall, while the mall benefits from the filled vacancy and increased footfall. Locally, co-working spaces in the city centre are primarily integrated with office buildings. In the KL fringe areas, however, there is more diversity, as co-working space may also enter into shop offices and shopping centres. The availability of space and relatively lower rental rates allow the operators to fill the retail space in the fringe area. On the contrary, the same does not apply to malls in the city centre, which mostly enjoy high occupancy rates.

Table 2: Selected upcoming malls in Klang Valley, 2019

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

Source: NAWAWI TIE Research

Outlook

While it is still largely experimental to malls in the KL fringe, integration of co-working spaces into malls in the city centre could potentially happen in the future as a backfill mechanism should occupancy rates deteriorate. Moving forward, RGM is expecting a growth of 3.2 per cent and 4.8 per cent in retail sales for the third and fourth quarter of 2019 respectively, relying on the anticipated improvement in the department store cum supermarket sub-sector. For the full year of 2019, projected growth was revised downwards from 4.9 per cent to 4.4 per cent.

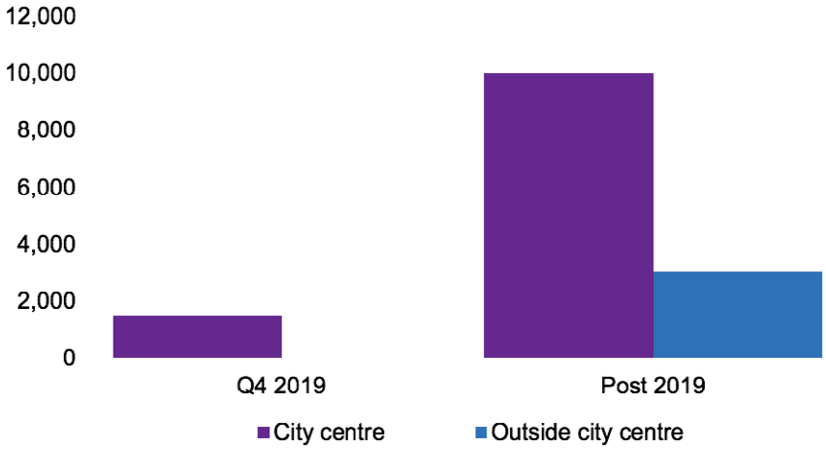
RESIDENTIAL

Key highlights in Q3

- Three high-rise projects completed in Q3 with a total of 2,514 units were added to the stock. The bulk of the supply, comprising 1,516 units, was from three towers of serviced apartments at EkoCheras, located outside the city centre at Jalan Cheras' Mile 5. The other two completed projects were Stonor 3 with 400 units and Aria KLCC with 598 units.
- About 1,510 units are expected to enter the market in Q4 2019, and all will be in the city centre (Figure 9).
- Both prices and rents for high-end condominiums respectively eased marginally by 0.8 per cent and 2.0 per cent q-o-q at RM1,028 psf and RM3.78 per sq ft per month respectively (Figure 10).

Extension of HOC 2019 anticipated to revitalise homeownership in the current soft residential market

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



Source: NAWAWI TIE Research

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

(Q3 2018=100)

Source: NAWAWI TIE Research

Market commentary

Weak market sentiments have resulted in an increase of overhang properties led by the high-end segment, especially in high-rise developments. As of Q2 2019, NAPIC data have shown that the overhang residential properties in Malaysia stood at 32,810 units. This number excludes 18,186 units of serviced apartments and 1,670 SOHO units.

Developers continued to rejuvenate their marketing strategies to clear unsold stocks, by offering attractive discounts, incentives and freebies. The Government, on the other hand, continued to review and introduce policies that could help boost the soft residential market.

Following the success of March's property expo at KLCC's MAPEX-HOC 2019, the Ministry of Housing and Local Government (KPKT) has teamed up with Real Estate and Housing Developers' Association Malaysia (REHDA) to organise another MAPEX-HOC 2019 Property Expo in October 2019. The event is scheduled to be held at the Mid Valley Exhibition Centre (MVEX), Mid Valley Megamall, Kuala Lumpur from 18-20 October 2019. The previous property expo, KLCC's MAPEX-HOC 2019 Property Expo recorded more than 50 participations from residential players, and some 496 residential properties collectively worth RM285 million were booked in just three days.

Various efforts have been put in place since early 2019 to revitalize the subdued residential market, such as the launch of National Housing Policy 2.0 and Home-Ownership Campaign (HOC 2019). The extension of HOC 2019 till the end of the year is expected to stimulate and encourage homeownership among Malaysians.

The recent announcement by Bank Negara Malaysia to maintain the Overnight Policy Rate (OPR) at an accommodative and supportive 3.0 per cent is unlikely to boost the lacklustre residential demand.

Outlook

The residential market is expected to remain gloomy in the last quarter of 2019, as all players are likely to adopt a wait-and-see attitude, given concerns over the weak domestic economy, the US-China trade war, and the National Budget 2020 scheduled for October.

DEFINITIONS

Development pipeline/potential supply:	Comprises two elements: 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:	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. 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).
Prime office rent:	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. (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).
Stock:	Total accommodation in the private sector both occupied and vacant: 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:	Floor space acquired for occupation or investment, including the following: 1. Offices let to an eventual occupier. 2. Developments pre-let or sold. (NB. This includes subleases) Take-up also refers to units transacted in the residential market.
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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