Property Times
Kuala Lumpur Q3 2011
Market turns cautious

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- The Malaysian economy continued to expand but at a slower pace of 4.0% year-on-year (YOY) in Q2 2011, down from 4.9% YOY in Q1 2010 due to the global slowdown. The growth was driven mainly by domestic demand reflected in strong private consumption and investment activities. The growth forecast of 5-6% for 2011 is still being officially maintained.

- Prime office rent is stable, at RM6.22 per sq ft per month, with no new completions adding to competitive pressure but demand has slowed down reflecting caution in the market (Figure 1). Leasing activities were driven by mainly the oil and gas, IT and finance sectors with the outlook likely to be more sombre in the light of substantial pipeline supply in 2012.

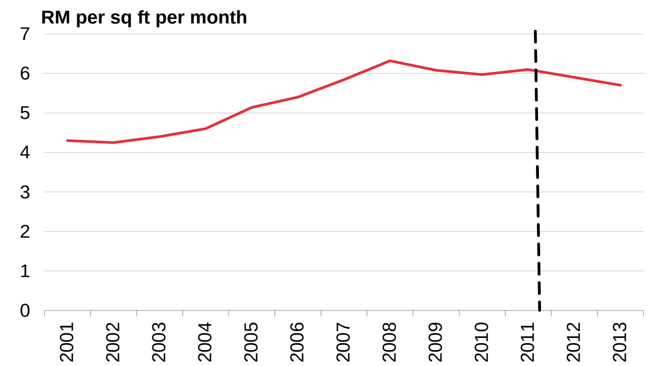
- The retail sector is expected to remain optimistic due to a stronger Ringgit and total retail sales being forecasted to grow from RM182.44bn in 2011 to RM279.83bn by 2015.

- The residential sector experienced significant completions in the quarter and this will put pressure on rental especially in the larger prime condominium units where demand has not keep pace. Generally while price remains stable, new pressure to sell is expected as some owners taking delivery of completed units and wishing to exit their investments. There remained selective demand for new launches.

- The investment market was more active with strong deal flows from investors and also supported by end-users buying for own occupation. Going forward the market is expected to be dominated by local investors as foreign investors have become more cautious.

Figure 1

Average prime office gross rents



Source: DTZ Research

Economic overview

- The Malaysian economy expanded at a slower pace of 4.0% YOY in Q2 2011, down from the YOY growth of 4.9% in Q1 2011 due to the deteriorating external environment (Figure 2). The growth was driven by domestic demand reflected in strong private consumption and investment activities which will offset the slowdown in export momentum. The growth forecast of between 5-6% for 2011 is maintained by the Government.

- The services and agriculture sectors registered a strong growth of 6.3% and 6.9% YOY respectively. The manufacturing sector grew by 2.1% YOY, despite lower electrical & electronics exports. The construction sector posted a marginal growth of 0.6% due to slower civil engineering activities. The mining sector contracted 9.2% following lower production of crude oil.

- Headline inflation, measured by the Consumer Price Index (CPI), moderated slightly to 3.3% YOY in August compared with 3.4% in July, after peaking at 3.5% in June. On a month-to-month basis, the CPI in August increased by 0.2% compared with July contributed by higher prices for miscellaneous goods and services, as well as housing, water, electricity, gas and other fuels. The inflation in 2011 is expected to hover around 3.2-3.4% and fall to 2.5% next year.

- Amidst weak external economic conditions, employment conditions remain favourable. The unemployment rate fell to 3.0% in July compared with 3.2% in June.

- The industrial environment remains attractive to foreign investors. The Malaysia Industrial Development Authority (MIDA) reported that total capital investment in January 2011-July 2011 was RM31.7bn with foreign direct investment amounting to RM15.8bn. The foreign investments are primarily in the electrical and electronics industry, metal-based products, food processing and chemical and chemical products. The top three investing countries were Japan, USA and Singapore.

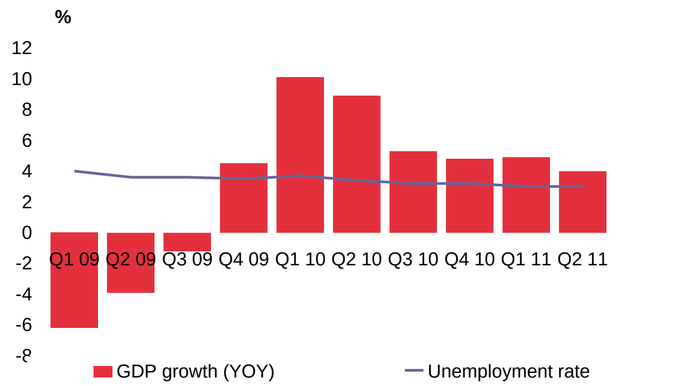
- Taking heed of increased risks of slower growth, the Overnight Policy Rate (OPR) is kept steady at 3.0% and Bank Negara has said that it would continue to pursue accommodative monetary policy accordingly to ensure the sustainability of growth of the Malaysian economy amid uncertain financial conditions.

- Under the Economic Transformation Programme (ETP), eight new investment projects in various sectors such as agriculture, education, aerospace, wholesale, retail and manufacturing worth RM1.4bn were recently announced.

- Amidst the weak and uncertain external environment, domestic demand will continue to sustain economic growth with the aggressive implementation of the 10th Malaysia Plan as well as the ETP. The economy is expected to continue to grow as Malaysia has strong fundamentals with low unemployment rate, strong financials and low external debt.

Figure 2

GDP growth and unemployment rate



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

Offices

- Leasing activities appeared to have tapered off during Q3 2011 with most of these being relocations. There appeared to be minimal net absorption during the review period as the average vacancy of office buildings remained stable at 13.10% (Figure 3). The oil and gas and professional services sectors were the main drivers of demand.

- No new completions were noted during the review period after the first half of the year which saw 1.1 million sq ft completed. Total stock stood at 61.74 million sq ft.

- Three office buildings are expected to be ready by Q4 2011, which will add 1.1 million sq ft to the year's total supply of approximately 2.5 million sq ft. These are namely D'tiara Amanaraya Corp Tower, Crest Tower and Lot E @ KL Sentral of which the first and the third properties will be substantially owner occupied.

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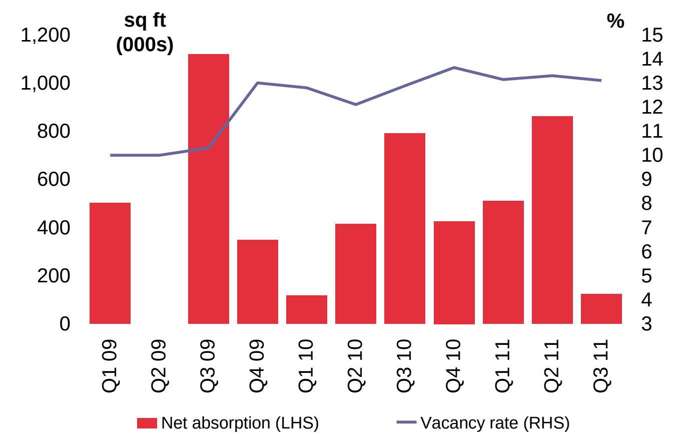
- Rents remained stable, with prime gross rental rates at RM6.22 per sq ft per month (Figure 4). Major leases and relocations include RHB Insurance at The Icon for 100,000 sq ft and Touch n Go, an IT prepayment company, taking up 67,000 sq ft at The Horizon, Block 6, Bangsar South.

- There is no change in capital value. Good quality suburban offices were sold at RM600 per sq ft to RM700 per sq ft while the average capital value of prime office stood at RM807 per sq ft.

- With external headwinds creating uncertainties, the overall net absorption rate could further slow down in Q4 2011, which will not provide comfort to a market that is expecting 2012 to be a potential tipping point with some 7.4 million sq ft in projected completions (Figure 5).

Figure 3

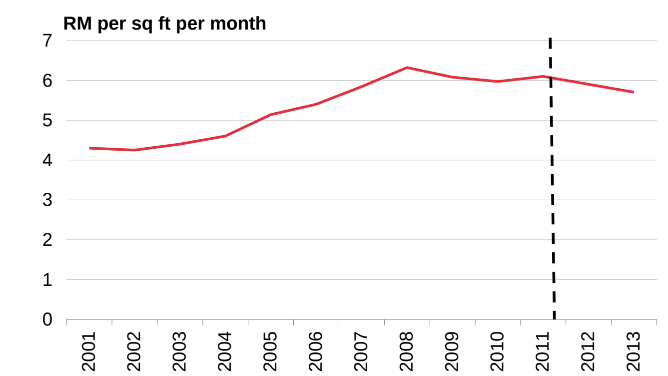
Office net absorption and vacancy rate



Source: DTZ Research

Figure 4

Average prime office gross rents



Source: DTZ Research

Figure 5

Office development pipeline

Source: DTZ Research

Retail

- The Consumer Sentiment Index (CSI) slipped marginally to 107.9 in Q3 2011 compared to 108.2 points in the previous quarter, reflecting concerns over the rising cost of living and inflation. Consumers will be more prudent and selective in their spending plans especially with concerns over growing household debt burden.
- The average occupancy rate of retail centres registered a slight increase to 91% in the city and 88% outside of Kuala Lumpur. However, newly completed centres experienced slow leasing rate given the increasing market saturation of retail facilities, even in good suburban locations.
- About 860,000 sq ft of new space was added in the quarter in Kuala Lumpur with the completion of three major retail centres, namely Suria KLCC (extension), Solaris 2 and 1 Shamelin Shopping Mall. The total stock reached 45.8 million sq ft in Klang Valley (Table 1, Table 2 and Figure 6).
- To help lower income urban households cope with the increasing cost of living, the government will expand the network of the 1Malaysia retail outlets (KR1M) to 22 more outlets nationwide by end of the year. KR1M was introduced in June 2011, offering goods under its branding at 30-50% lower than the prices at normal retail outlets to enable people to purchase necessities at affordable prices.
- According to the Retail Group Malaysia, despite slower economic growth and inflation, retail sales in Q3 2011 is expected to grow by 7%. This will be largely contributed by consumers' spending for the Hari Raya celebrations.
- The growth in online shopping poses challenges to domestic retail industry faced with increasing costs of goods and operations. In 2010, there were about 1.1 million online shoppers with an average of RM2,500 spend per head. According to research by AC Nielson, the online purchasing market had reached RM1.8bn in 2010 and this trend is expected to increase to RM5bn in 2014. The rising trend is a challenge to local merchants who will have to adopt multi-channel retail strategy to capture the rising online market.
- In line with the growth in online shopping, the recently announced ETP unveiled two investment projects to provide a virtual mall platform and technical support and facilities for small medium enterprises (SMEs) to enter the online trade.
- The latest BMI Malaysia Retail Report forecasts a bright prospect with total retail sales expected to grow from RM182.44bn in 2011 to RM279.83bn by 2015, supported by key factors such as low unemployment rate, rising disposable income and a strong tourism industry.
- Rental growth is likely to be moderate going forward especially with new malls still sprouting up in the suburbs in an increasing tougher operating environment.

Table 1

Selected major upcoming retail centres in Klang Valley

Name of development	Est NLA (sq ft)	Expected Completion
Festival Mall, Kuala Lumpur	450,000	2011
Nu Sentral, Kuala Lumpur	700,000	2012
The Paradigm, Kelana Jaya	500,000	2012
Setia Alam Mall, Shah Alam	700,000	2012
KLIA2, KLIA	350,000	2012
IOI City Mall Putrajaya, Putrajaya	1,300,000	2013
Sunway Velocity, Kuala Lumpur	900,000	2013
The Strand Mall, Kota Damansara	300,000	2013

Source: DTZ Research

Table 2

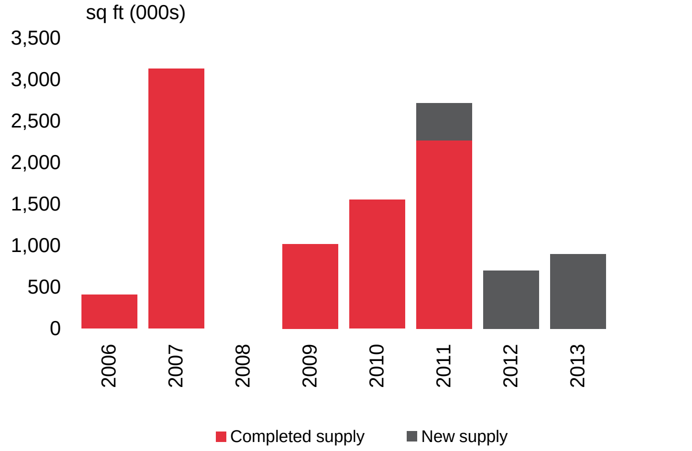
Existing retail stock (NLA)

	Q3 2011 (sq ft)	QOQ change (%)
Kuala Lumpur	23,271,519	8%
Outside Kuala Lumpur	22,548,169	9%

Source: DTZ Research

Figure 6

Retail new supply (NLA) in Kuala Lumpur



Source: DTZ Research

Residential

- The quarter saw the completion of a significant number of projects with an additional 2,278 condominium units in Kuala Lumpur. These included two city centre projects, i.e. Brunsfield Embassyview and The Pearl, eight projects in Mon't Kiara and one in Bangsar.
- Another 52 condominium units are expected to be completed by the end of this year, all of which are in city centre locations (Table 3). In 2012, about 5,384 units are expected to enter the market with a majority 92% (4,952 units) located in the city centre (Figure 7).
- The quarter saw the launch of a boutique luxury condominium along Persiaran Raja Chulan called St. John Woods Residence. It reportedly received strong response with almost half of the 48 units booked within two days. The selling prices of the units are between RM3.3m to RM4.4m per unit (or RM900 per sq ft).
- The average capital value of high-end condominiums in Kuala Lumpur is generally stable at RM626 per sq ft with KLCC properties averaging at RM902 per sq ft. This may experienced short term selling pressure as owners of newly delivered units may exit their investment.
- The average rental value of high-end condominiums in Kuala Lumpur is stable at RM3.50 per sq ft per month but new completions will keep the rate competitive especially for larger units where demand has not kept pace with supply (Figure 8).
- To maintain or increase pricing level, developers have resorted to smaller units marketed under the guise of small office home office (SOHO) label in mixed developments to appeal to younger buyers seeking more lifestyle options and to investors.
- Demand for luxury residential properties is expected to turn cautious given greater economic uncertainty and a tightening of credit by the banks. There is increasing downside risk on prices at the higher end of the market, if conditions get worse next year.

Figure 7

Future supply of high-end condominiums in Kuala Lumpur

Source: DTZ Research

Table 3

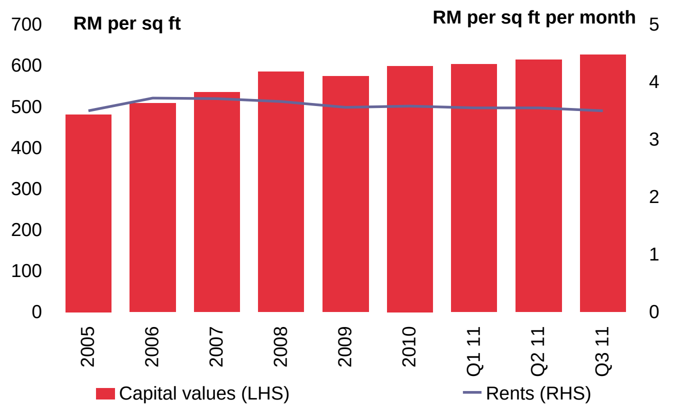
Upcoming high end condominiums in Kuala Lumpur in Q4 2011

Project	Units
Katana II	40
Bandar Park project	12

Source: DTZ Research

Figure 8

Rents and capital values of high-end condominiums in Kuala Lumpur



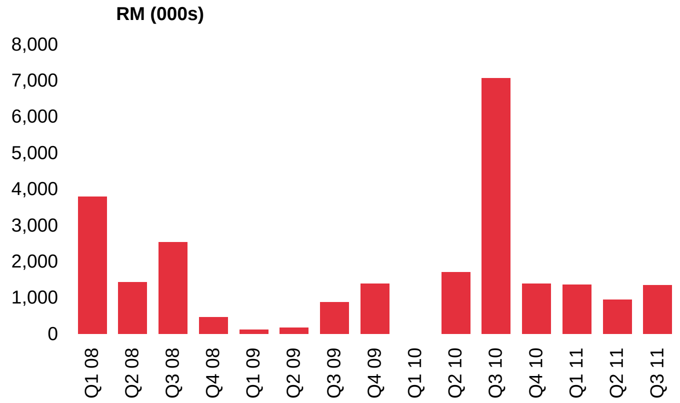
Source: DTZ Research

Investment

- The investment market saw an increase in both value and activities compared to last quarter. Total value topped RM1,349m in Q3 2011, an increase of 39% from Q2 2011 (Figure 9). There were ten deals in the quarter, compared to eight in Q2 2011, involving five offices, two mixed developments, and a retail, industrial and residential property each.
- The biggest deal recorded in the quarter is the sale via public auction of The Putra Place that was successfully sold to Sunway REIT for RM513.9m (Table 4). The property is a mixed development of retail, office, hotel and serviced apartments that has been placed under the hammer repeatedly over the last few years without a successful bidder until now. The property houses MegaMall, one of the most popular malls during the second half of the 1980s before being eclipsed by newer offerings.
- The other major transaction reportedly sold for RM240m is a prime office building in Cyberjaya, Bangunan Lestari Kumpulan Emkay, that is leased on a long term basis to Shell. The estimated initial yield is 5.7%.
- Geographically, most of the properties sold are located in and around Kuala Lumpur, with one transaction recorded in Penang involving a Tesco leased hypermarket at Tanjung Sri Pinang and Johor Bharu where a major prime stratified office, Menara Landmark, was sold via a public auction to local developer Daiman Bhd.
- In terms of pricing, Menara Landmark was sold at RM164 per sq ft which is significantly below the RM600 – RM700 per sq ft fetched by good quality suburban offices in Kuala Lumpur.
- Significantly, three of the transactions this quarter involved mid-sized offices purchased for owner-occupation. The buyers were from the IT, oil and gas, and infrastructure sectors which are key sectors under the ETP.
- Yields reflected in the quarter seem to continue to be compressed, with the Tesco hypermarket in Penang sold at a sub-5.67% yield.
- In a proposed disposal of a portfolio of retail and office properties belonging to Bandaraya Development Bhd to a related party, the yield indicated was 6% and 6.5% for the retail and office properties respectively. This deal has however been aborted due to transparency issue.
- The quarter is dominated by local players on both sides of the transactions, with REITs and listed property companies predominating. Foreign investors have grown cautious with the volatility in the financial market erupting in late August. Domestic investors will continue to be active and dominate the market going forward.

Figure 9

Total investment sales in Malaysia



Source: DTZ Research

Table 4

Significant deals

Property	Purchaser	Vendor	Price
Putra Place	Sunway REIT	Metroplex Bhd	RM513.9m
Tesco Tanjung Sri Pinang	Soaring Profit Sdn Bhd	E&O PIE Sdn Bhd	RM134m
Menara Landmark	Daiman Bhd	T&T Properties Sdn Bhd	RM55m
Wisma IJM	Ewein Bhd	IJM Properties Sdn Bhd	RM50m
The Horizon, Block 6	N2N Connect Sdn Bhd	Bangga Istimewa Sdn Bhd	RM36m
191 Jalan Ampang	MUI (Natloyal Sdn Bhd)	MUI Continental Insurance	RM25m

Source: DTZ Research

Key statistics

Table 5

Markets

	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	QOQ change (%)	YOY change (%)	Directional outlook
Office								
Net absorption (000s sq ft)	790	426	509	862	123	-85.70	-84.43	↔
Occupancy rate (%)	87.1	86.4	86.9	86.7	86.9	0.23	-0.23	↔
New supply (000s sq ft)	1,437	-	240	1,346	-	N/A	N/A	▲
Prime rents (RM per sq ft per month)	5.98	5.97	6.12	6.20	6.22	0.32	4.00	▼
Residential (non-landed resale)								
Average capital value of prime condominiums (RM per sq ft)	600	599	603	614	626	1.95	4.33	↔

Source: DTZ Research

Table 6

Leasing transactions

Address	Size (sq ft)	Tenant	Sector
Bangsar South	67,440	Touch 'n Go	Office
Lot E @ KL Sentral	212,000	SME Corp	Office
Vista Tower	16,785	Project Rapid, Petroliam National Berhad	Office
Pavilion Tower	28,320	Aker Solutions Malaysia Sdn Bhd	Office
Vista Tower	11,283	International Islamic Liquidity Management Corporation	Office
Vista Tower	11,226	Sherwin-Williams Services (Malaysia Sdn Bhd)	Office
Vista Tower	77,240	UOB Singapore	Office
Vista Tower	33,000	UOB Malaysia	Office

Source: DTZ Research

Definitions

Development pipeline
Comprises two elements:
1. Floorspace in the course of development, defined as buildings being constructed or comprehensively refurbished.
2. Schemes with the potential to be built in the future, though having secured planning permission/development certification.

Net absorption
The change in total occupied floorspace over a specified period of time, either positive or negative.

New supply
Total floorspace which is ready for occupation either now or within the next 6 months. Ready for occupation means practical completion, where either the building has been issued with an occupancy permit, where required, or where only fit-out is lacking.

Prelet/pre-commit
A development leased or sold prior to completion.

Prime 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 commercial and public sectors both occupied and vacant.

Take-up
Floorspace acquired for occupation, including the following:
1. offices let/sold to an eventual occupier;
2. developments pre-let/sold to an occupier;
3. owner occupier purchase of a freehold or long leasehold.

(NB. This includes subleases.)

Occupancy rates
The percentage of total net lettable area/units occupied with available stock.

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