Malaysia Sector Update

21 August 2023

Property | Real Estate

Real Estate

Overweight (Maintained)

Knight Frank: Upbeat On Iskandar Malaysia

Stocks Covered	11
Rating (Buy/Neutral/Sell):	8 / 3 / 0
Last 12m Earnings Revision Trend:	Positive

- **Still OVERWEIGHT.** Knight Frank shares our positive view that interest in the Iskandar Malaysia property market is gaining momentum. Improved connectivity – upon the completion of the Rapid Transit System (RTS), the strong SGD and (hence) the positive spillover effects are key drivers of real estate demand in this area. The Malaysian Government will likely make further updates on the Johor-Singapore special economic zone, the review of the Malaysia My Second Home programme, and high-speed rail project in the coming months after the recent conclusion of the state elections.
- **"A lot of things are happening in Johor".** We recently invited Amy Wong, Knight Frank Malaysia's Executive Director of Research & Consultancy, to share the company's outlook and her insights on the Iskandar Malaysia property market. The property consultant has noted a spate of developments on the ground, and that various parties are planning different projects. It was also mentioned that there is a new light rail transit (LRT) proposal on the table.
- **The RTS effect is real.** The RTS link has begun to increase property prices and rental rates in areas surrounding the station. Knight Frank shared that transactions on a few high-rise projects have reached MYR900-1,100psf – which are almost on par with property prices in the Klang Valley. Demand for high-rise units in the Johor Bahru (JB) city centre is very much "SGD-driven". Meanwhile, the expensive rental rates in Singapore have also started driving rental demand in the JB city centre. Given the scarcity of available land for development surrounding the RTS station, some parties have also offered to acquire certain old neighbourhoods for redevelopment.
- **Residential segment.** It was highlighted that planned and incoming supply of serviced apartments amounted to 71k units, which is about 57% of the current stock. Although the numbers appear somewhat worrying, the supply entering the market should be spread over 3-5 years. In our opinion, today's demand is also backed by infrastructure development – the RTS – that is ongoing, providing visibility for future cross-border connectivity.
- **Retail segment.** Again, driven by the strong SGD, The Mall, Mid Valley Southkey is very popular among the visitors from Singapore. Wong shared that the rental rates at certain major shopping malls are now on par with the rates of some shopping malls in the Klang Valley. Some strategically located malls in the JB city centre such as Komtar JBCC and R&F Mall should see a better performance, as greater connectivity and the encouraging prospect of higher shopper traffic should boost their occupancy rates.
- **Going green.** Johor, as one of the leading investment destinations in Malaysia among the multi-national corporations, is seeing greater demand for green industrial properties and data centres. Knight Frank is relatively positive on this segment, and customised industrial properties built for manufacturers should see more sustainable demand.

Company Name	Rating	Target (MYR)	% Upside (Downside)	P/E (x) Dec-24F	P/B (x) Dec-24F	ROAE (%) Dec-24F	Yield (%) Dec-24F
Eastern & Oriental	Neutral	0.33	(26.7)	9.5	0.3	3.4	-
IOI Properties	Buy	1.46	(0.1)	10.0	0.4	3.8	4.3
LBS Bina	Buy	0.56	4.7	6.4	0.6	9.3	4.7
Mah Sing	Buy	0.77	1.8	8.6	0.5	5.7	4.8
Matrix Concepts	Buy	1.75	18.8	7.9	0.8	11.0	6.3
Sime Darby Property	Buy	0.67	(0.3)	15.0	0.5	3.1	2.7
SP Setia	Buy	0.93	8.4	12.5	0.2	2.0	1.9
Sunway	Buy	2.65	38.0	14.6	0.9	6.0	2.9
Tambun Indah	Neutral	0.90	(6.9)	6.7	0.5	8.0	6.7
UEM Sunrise	Buy	0.92	47.8	36.4	0.5	1.2	-
UOA Development	Neutral	1.71	3.4	16.8	0.7	4.2	6.1

Source: Company data, RHB

Top Picks

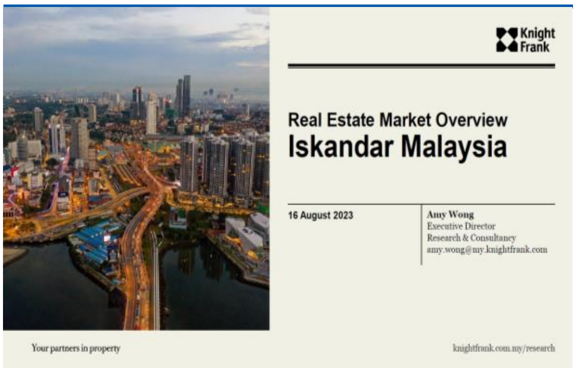
Top Picks	Target Price
UEM Sunrise (UEMS MK) – BUY	MYR0.92
IOI Properties (IOIPG MK) – BUY	MYR1.46
Matrix Concepts (MCH MK) – BUY	MYR1.75

Analysts

Loong Kok Wen, CFA
+603 9280 8861
loong.kok.wen@rhbgroup.com

Wan Muhammad Ammar Affan
+603 9280 8871
ammaraffan@rhbgroup.com

Knight Frank recently shared its views on the Iskandar Malaysia market with us



Source: Knight Frank

Iskandar Malaysia Property Market Outlook

Major catalyst from a few significant infrastructure developments

Knight Frank is positive on the outlook for the Iskandar Malaysia property market. A lot of infrastructure projects, property developments, facility expansions and investments are "brewing" on the ground. Demand for real estate will be largely driven by the SGD factor, as connectivity is expected to improve significantly upon the completion of the RTS link in end-2026.

It was also mentioned that there is a new LRT proposal on the table, which is mainly planned to enhance inter-city connectivity, complementing the RTS link. The Government has also mentioned that both Singapore and Malaysia will access the viability of a potential new ferry service between Puteri Harbour and Tuas, which is another step to enhance future connectivity between Singapore and Johor (closer to the Malaysia-Singapore Second Link bridge). Wong indicated that the current Desaru-Singapore route is quite busy even during weekdays as tourists and visitors from Singapore – largely ferry users – visit Desaru for golf.

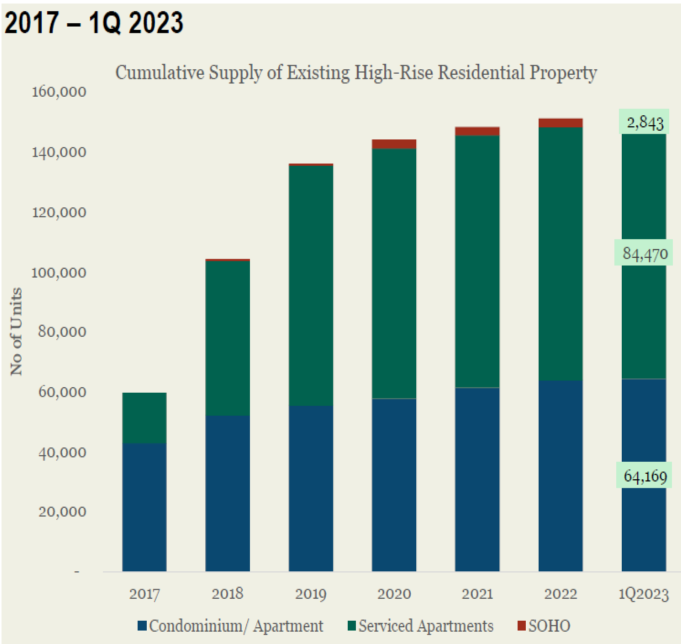
The Kuala Lumpur-Singapore HSR is a major infrastructure development that would have a significant impact on Kuala Lumpur, Johor and Singapore, if it materialises. MyHSR Corp recently conducted a Request for Information (RFI) briefing for the private sector to help develop and operate this project based on a public-private partnership model. In Wong's opinion, the project should attract many big foreign players as funding is the key factor for the viability of this project.

Residential segment

It was highlighted that the planned and incoming supply of serviced apartments amounted to 71k units, representing about 57% of the current stock. Although the numbers appear somewhat worrying, the supply should be spread over a period of 3-5 years.

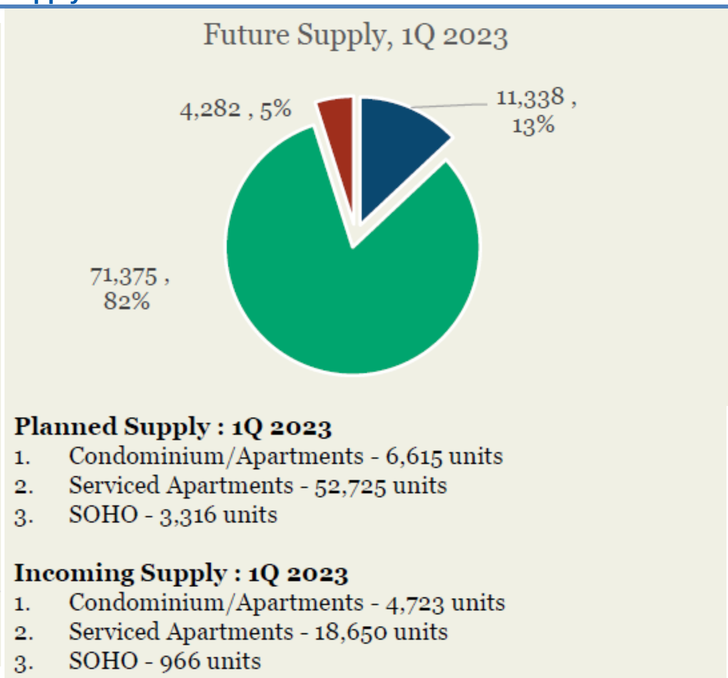
Based on our ground checks, we also gather that many developers are busy planning to roll out projects near the JB city centre over the next 1-2 years, leveraging on the proximity to the RTS station. These projects will likely attract many property investors, and possibly foreign purchasers – if the property units are priced above the MYR1m mark, or if a waiver can be obtained. In our opinion, today's demand for property in the JB city centre is backed by the infrastructure catalyst, ie RTS, which is crucial in enhancing cross-border connectivity in future, thereby boosting the demand for property and lifting rental rates..

Figure 1: Cumulative supply of existing high-rise residential properties in Johor



Source: Knight Frank Research

Figure 2: Breakdown of future planned supply and incoming supply



Source: Knight Frank Research

Retail and hospitality

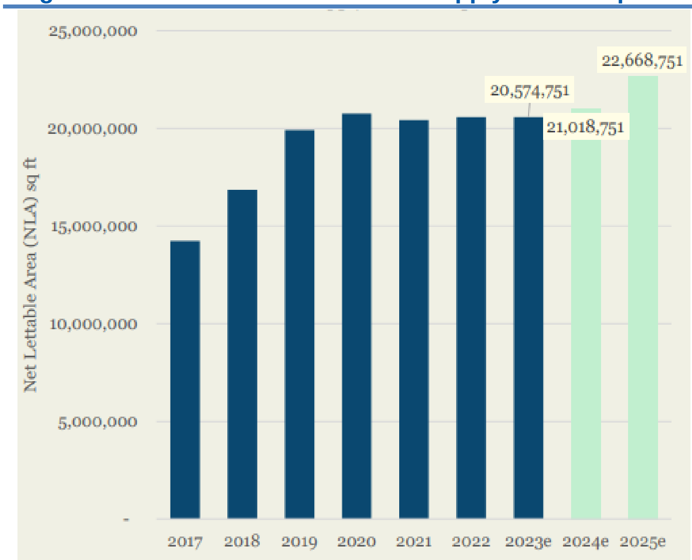
Singaporeans' strong spending power is a big boost for retail spending and retail traffic footfall in JB, especially with the relatively weaker MYR. Malls such as AEON Mall Tebrau City and Mid Valley Southkey are extremely popular among Singaporeans, and are often packed during school holidays.

There is currently 20m sqf of space in the JB retail market with 1.8m sqf of incoming supply over the next two years. This number includes The Gem @ Coronation Square (1.2m sqf), but we understand that there are no concrete plans in place yet for the mall and, as the situation is still fluid, the actual incoming supply may be lesser.

According to Knight Frank, landlords and tenants are increasingly moving away from traditional rental structures to a profit-sharing one with a higher percentage of turnover rent – accelerated by the pandemic. This shift could potentially benefit both landlords and tenants by contributing to a more sustainable and profitable retail market. That said, some obstacles for the industry include inflationary pressure and labour shortage which could negatively impact consumer sentiment and purchasing power.

For hotels, the number of hotel rooms in the city has not changed significantly over the past six years, but room rates have picked up considerably, especially for the 5-star hotels. This was attributed not just to the recovery in tourist arrivals from Singapore, but also to strong domestic demand. The property consultant also stressed how both hotels and malls are complementing each other to ensure high occupancy rates for hotels and high footfalls in malls. As such, most of the newly completed hotels and incoming hotels in JB are integrated with retail malls such as St Giles Hotel with Mid Valley Southkey Mall, and Hyatt Place Hotel with Paradigm Mall JB.

Figure 3: Johor Bahru's cumulative supply of retail space

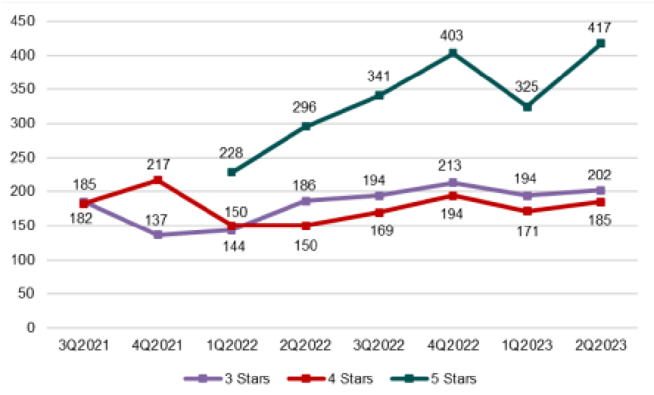


Source: Knight Frank Research

Figure 4: Incoming supply of retail space (2023-2025)

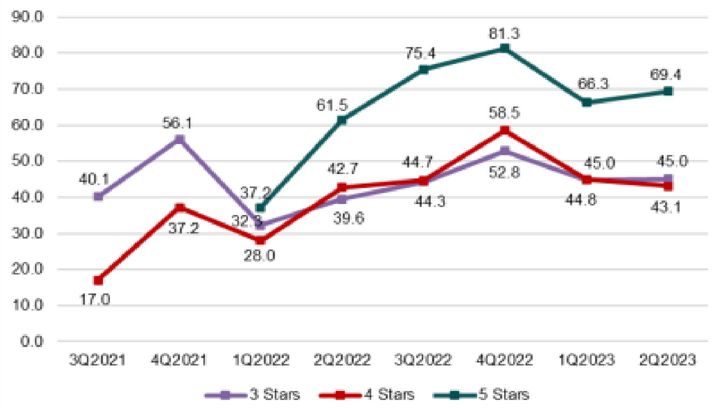
Source: Knight Frank Research

Figure 5: Hotel average daily rates (ADR)



Source: Knight Frank Research

Figure 6: Hotel average occupancy rates (AOR)



Source: Knight Frank Research

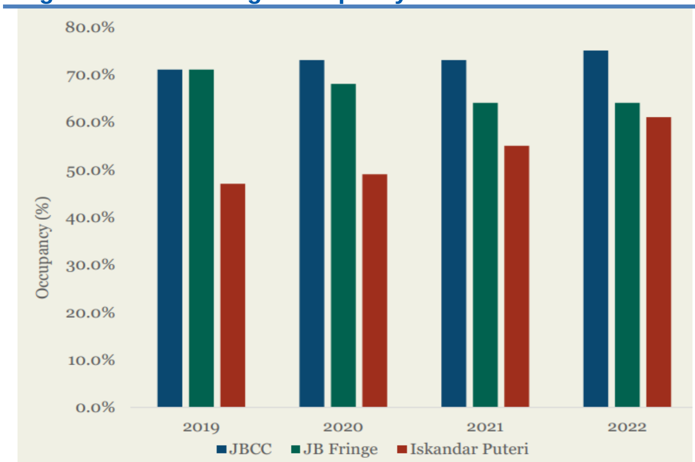
Office segment

Despite being located close to Singapore, the office sector in JB does not really benefit from any spillover from Singapore in contrast to the retail and hospitality sectors, as companies prefer to take up space in Kuala Lumpur instead. The size of the market is also much smaller with c.8.7m sqf of office space in JB compared to >100m sqf in Kuala Lumpur.

The average occupancy in the JB city centre steadily risen to 75% in 2022 from 70% in 2019, while the average occupancy rate in the fringes of JB has declined to 60% from 70%. The sharpest increase was seen in Iskandar Puteri (from 45% to 60%), which is the location of many new quality office spaces that is attracting more interest from companies. This is also reflected by the higher average rental rates in Iskandar Puteri compared to JB city centre and the fringes of JB.

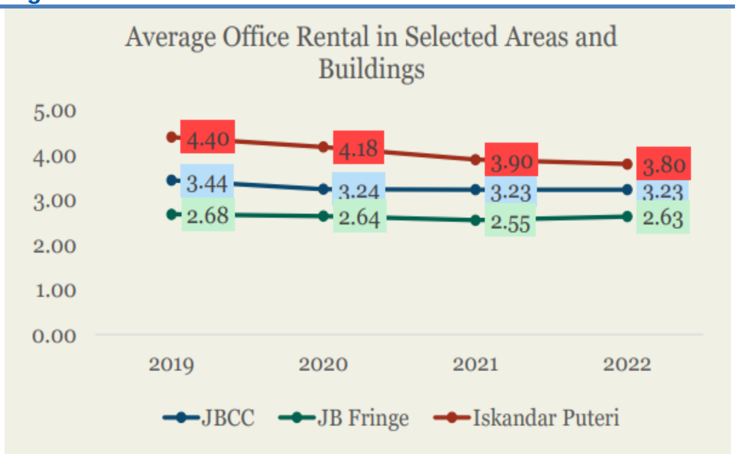
Recent relocations and expansions in the market is a sign of improvement for the purpose-built office (PBO) sector in JB city centre. For example, the newly completed MVS North Tower, a premium quality office space, saw new entrants by companies from various industries such as logistics and accounting firms, but the biggest space taken up was from a co-working space operator. This is consistent with Knight Frank's view that the demand for co-working spaces should continue to grow as companies prefer the flexibility to take up office space according to their business needs. However, with landlords competing for a relatively smaller pool of tenants in JB, the increase in new premium office supply will inevitably lead to higher competition.

Figure 7: PBO average occupancy rates in Johor Bahru



Source: Knight Frank Research

Figure 8: PBO rental rate



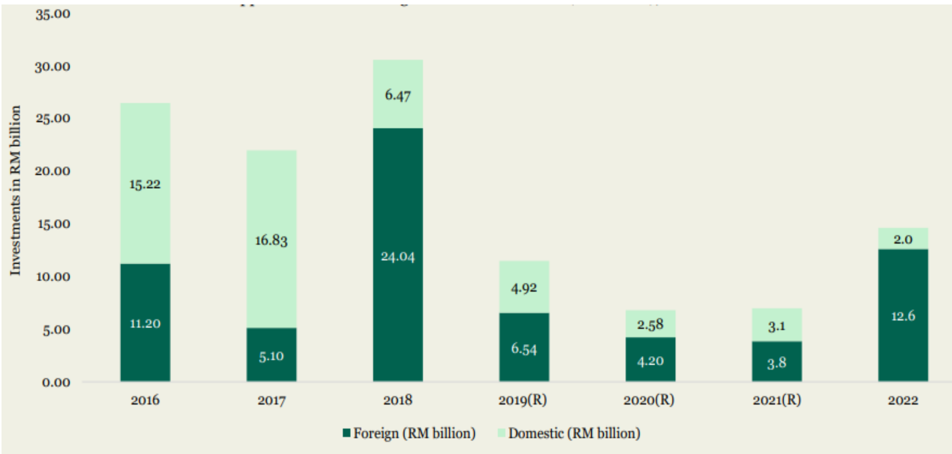
Source: Knight Frank Research

Industrial segment

The notable industrial areas in Johor are at Senai, Kulai, and Iskandar Puteri. These areas house industrial parks such as i-Park @ Senai Airport City, i-Park Indahpura, and Nusajaya Tech Park. A key strength for industrial parks in Johor is that they are generally very forward looking, with new facilities and green developments. As the ESG trend is expected to continue gaining importance globally, the green developments will be crucial to draw demand from MNCs. According to Malaysian Investment Development Authority or MIDA, most manufacturing investments in JB is mostly driven by foreign investments.

Purpose-built worker accommodation has emerged to be a relatively new asset class in the industrial segment, available in Johor. The overall industrial sector should remain strong with active land and industrial property transactions, and an encouraging performance from logistics warehouses. When asked about a potential oversupply situation in the industrial properties segment, Knight Frank believes that the risk is mitigated as a lot of new developments are constructed on a built-to-suit basis for specific tenants. Previously, developers would build more generic terraced factories, but these are no longer the preferred products.

Figure 9: Foreign and domestic manufacturing investments into Johor Bahru



Source: MIDA, Knight Frank Research

Data centre

The moratorium for new data centres in Singapore between 2019 and 2022 was the key catalyst for the growing data centre industry in Johor in the recent years. This moratorium has led to the spillover of such facilities into Johor as companies look for the next best option (to set up data centres) in the region. Knight Frank has created an inaugural SEA-5 Data Centre Opportunity Index (excluding Singapore) which ranks Malaysia first for the most attractive destination for data centre investment. This takes into account the number of international sub-sea cables, GDP growth, and ease of doing business. Malaysia also has a massive head start with 113MW of take-up in 2022 – four times higher than the next highest market, which is Thailand with 25MW. The strong growth moving forward is mainly focused on both Johor and the Klang Valley region.

Currently, Indonesia and Malaysia are surging ahead in terms of space and supply for data centre investment, while the Philippines, Thailand, and Vietnam are constrained by land ownership laws and telecoms deregulation which have hindered their growth potential. In Malaysia, as listed down in our Rise of Data Centres thematic report published in Apr 2023, some of the data centre investments in Johor include Airtrunk at Southern Industrial Logistic Clusters (SiLC), Yondr at Sedenak Tech Park, and Equinix at Nusajaya Tech Park.

Figure 10: Incoming data centre facilities in Johor

Company Name	Facility Name	Live IT (MW)	U/C IT (MW)	Committed IT (MW)	Early Stage IT (MW)	Landbanked Area (Hac)
AirTrunk	JHB1	-	-	50	100	-
Bridge Data Centres	MY06	19	42	39	4	-
CSF Group	CX3 (Menara MSC Cyberport)	0.186	-	-	-	-
Equinix	Nusajaya Tech Park	-	-	3.5	-	-
GDS Holdings	Iskandar (Green Data Centre Park)	-	-	-	112	-
GDS Holdings	Site 1 (NTP1/2/3)	-	63.999	-	-	-
GDS Holdings	Site 2	-	-	-	-	4.129
Keppel Data Centres	Johor 1	7.8	-	-	-	-
Open DC	JB1 (Menara MSC Cyberport)	1.1	-	-	14.9	-
VADS	Iskandar Puteri Core Data Centre (Nusajaya Tech Park)	4.98	-	8.210	-	-
Yondr	Sedenak Tech Park	-	-	50	150	-
YTL	SEA Data Centre	-	48	-	-	-

Source: Knight Frank Research

A key issue with data centres is the conflict between digitalisation and sustainability as data centres infamously consume a lot of electricity and water. The Climate Neutral Data Centre Pact was made and implemented by over 22 EU trade associations and 57 data centre operators to commit to making data centres climate-neutral by 2030, and hence green data centres are the way forward. One interesting challenge Knight Frank highlighted is that even in Malaysia, there are only four hours of sunlight that is strong enough to power data centres, which speaks to the viability of green energy.

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KUALA LUMPUR

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Bank Berhad (Singapore branch)
90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531
Fax: +65 6509 0470