

# *Lessons for Iskandar from Shenzhen-Hong Kong's Development Success*

December 2016





In attempting to predict Iskandar's growth and development, Shenzhen comes to mind, owing to the many similarities found between the two areas. As Iskandar is still in the initial phase of development, Shenzhen's fast-paced economic growth and real estate development can provide some insight and serve as a guide for Iskandar's progress.

## Shenzhen opens doors to Hong Kong

Shenzhen has a locational advantage in being sited in proximity to the fast-paced global financial centre of Hong Kong. At the same time, Shenzhen has access to a vast pool of relatively cheap labour that can be organized and drawn to work in factories set up by Hong Kong or foreign entrepreneurs and MNCs.

It was only in 1979, when Shenzhen opened its doors to Hong Kong and the world and was declared the first liberalised Special Economic Zone (SEZ), that its destiny began to change. Some of the bold reforms that were introduced in Shenzhen to attract cross-border investments in export-oriented industries such as electronics, machinery, food processing, and textiles were lower tax rates (15.0%) in contrast to the significantly higher 55% in neighbouring areas. To attract talented staff for the industrial and supporting service sector, the city levied no income tax on professionals such as lawyers, accountants, designers and other creative people.

## Iskandar's strengthening relations with Singapore

Like Shenzhen, Iskandar has a unique locational advantage as it is situated in close proximity to Singapore, touted as the Switzerland of Asia. With the economic rise of China, East and South-east Asia, Singapore is fast emerging and may even rival Switzerland as the world's wealth management capital.

In 2006, Iskandar Malaysia was zoned for development into a world-class and dynamic metropolis in southern Johor and Khazanah was entrusted by the Malaysian Government with driving this growth. A Comprehensive Development Plan was formulated to transform Iskandar from empty tracts of land in the southern part of the country into a world-class tourism, education and financial hub. Iskandar receives special incentives such as tax breaks for companies that develop land and buildings in the new Central Business District in Medini and a 15.0% tax rate in contrast to the 25% personal tax rate for the highest income bracket to attract qualified personnel. Most importantly, the strengthening relations between the Malaysian and the Singapore governments has and will be a key driver for the development of the Iskandar region. This is slowly gaining traction as can be seen in the joint-venture investments between sovereign wealth funds, Khazanah and Temasek and the High Speed Rail collaboration between the two countries.





## Hong Kong the largest investor

Since the publication of the earliest Chinese statistics, foreign investment in Guangdong province, where Shenzhen is located, has been less than half of total investments since 1995. However, this was still higher than the foreign investments of 15.0% recorded nationwide in 1995. Both foreign and local manufacturing investments increased in tandem but foreign investments have generally stayed below a 50% share. The largest foreign investor in China is Hong Kong, especially in the Pearl River Delta Region. In the two decades after the implementation of the “Open Door Policy” by China, the total value of exports produced by Foreign-Invested Enterprises (FIE) exceeded the export of the entire domestic industrial sector for the first time. By 2001, or more than two decades later, 70.8% of the industrial enterprises were funded by Hong Kong investors.

## Locals driving investment activity

Johor’s overall growth as a state has not been spectacular, growing slightly faster than the nation with a 4.6% CAGR from 2005 to 2015. In 2013, it saw a spurt in the growth of the manufacturing sector and attracted the highest total approved investment in the manufacturing sector nationwide at MYR 14.4bn, overtaking Selangor. Johore continued to capture the lion’s share of the manufacturing investments the following year, growing by 46.5% to RM21.1 billion in 2014.

In 2015, the total investments into the manufacturing sector rose by 47.3% from MYR 21.1 billion to MYR 31.1 billion and Johor continued to retain its position as the leading manufacturing state in the nation. In the past two years, the bulk of manufacturing investments have been from domestic investors.

The services sector has also been rising noticeably faster than manufacturing, with the share of services rising from 43.0% in 2005 to 47.0% in 2015.

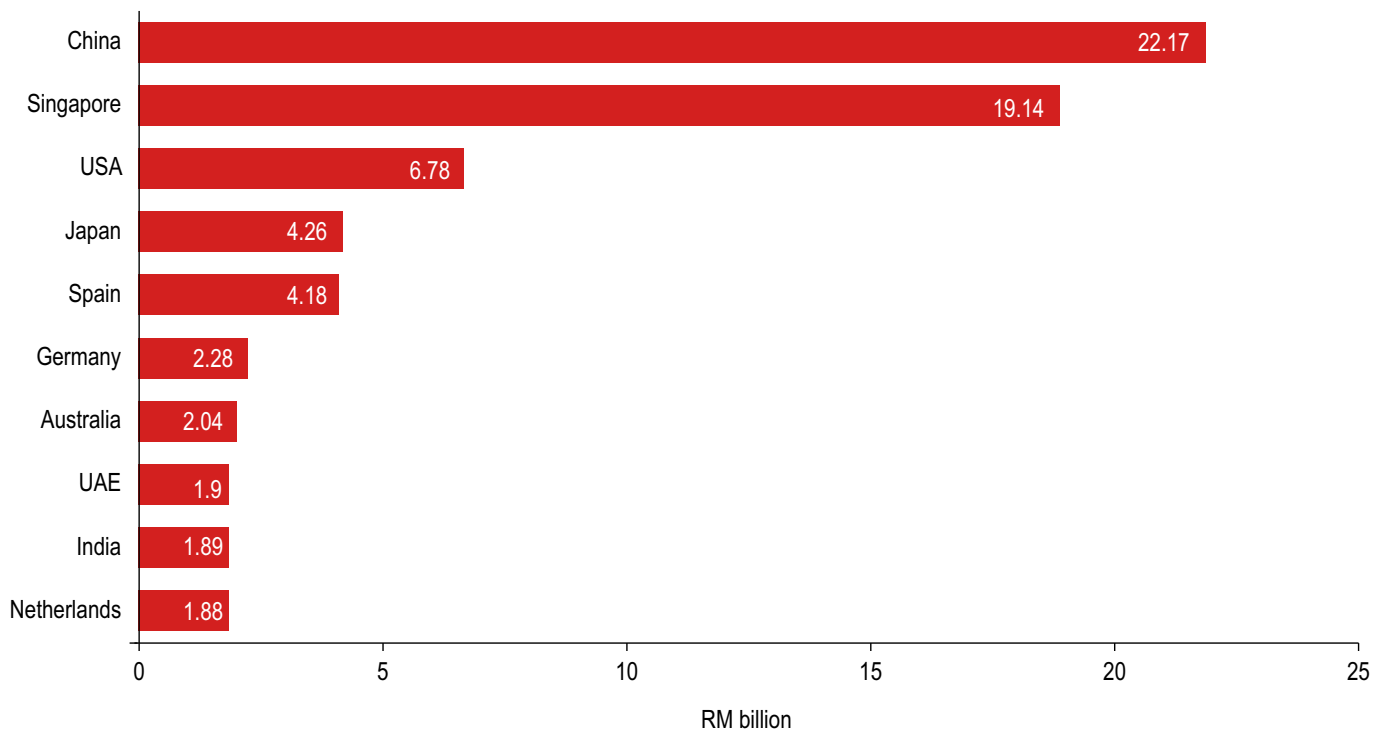
## Singapore not the only catalyst for Iskandar

The potential for foreign manufacturing investments has yet to be tapped. Iskandar has an advantage over Shenzhen in that it can capitalise on the good relations that Malaysia has with China and Singapore.

Since its establishment in 2006, the combined cumulative investments from China and Singapore total MYR 41.3 billion. Singapore's position as the biggest foreign investor in Iskandar was overtaken by China in 2015. Other significant foreign investors are from the US, Europe and India.



Chart 1: Top 10 Foreign Investors in Iskandar Malaysia



Source: Iskandar Regional Development Authority May 2016

## Shenzhen's economic growth and its impact on the real estate market

Shenzhen's growth from a poor fishing village into one of the wealthiest Chinese cities has had a significant impact on all its real estate sectors. For the first 15 years, its land use was transformed from agriculture to industrial as Shenzhen's Special Economic Zone took off. As the supporting service industries began to thrive together with the more youthful workforce residing in Shenzhen, the demand for residential and commercial properties began to grow.

While Shenzhen had the initial advantage of cheaper labour, it only began to attract technology companies and R&D and develop as a world-class city two decades later, thereby attracting expatriates and the innovative talent needed for its industries. High-end residential development began to rise with growing demand from expatriates and the local workforce.

In 2014, Shenzhen was selected as one of the top ten cities in China most popular with expats. Today, Shenzhen is perceived as an ideal place for both domestic and international entrepreneurs to start businesses. It has been named China's Most Dynamic City and the City Most Favoured by Migrant Workers.

The strong demand for real estate and surge in property prices is probably a good indicator of the impact of Shenzhen's economic activity on its real estate. With a youthful population (average age 30 years) of 10 million, the rising numbers of young migrants spurred demand for housing in Shenzhen. House prices in Shenzhen, also known as China's Silicon Valley, soared by almost 50% in 2015 – the fastest growth in residential property prices worldwide. In the past decade, average housing prices in the city have risen fourfold.

To cite an example, Peninsular Phase 3, a newly launched residential project facing Shenzhen Bay built by Nan Hai Corporation, sold units at an average price of more than RMB 10 million. Phase I of the project was sold at an average price of RMB 10,000 per sqm in 2006. Ten years later, average selling prices for Phase III are RMB 100,000 per sqm.

## Realistic Expectations on Iskandar

Not surprisingly, foreign investors have high expectations for Iskandar. Prior to 2011, the growth in property prices in Johor was generally one of the slowest of all states. (Chart 2) Following the establishment of Iskandar Malaysia on 30 July 2006, several important highways were built including the Iskandar Coastal Highway linking Iskandar Puteri from Danga Bay, the Eastern Dispersal Link and the Senai-Desaru Expressway (SDE) linking Johor Bahru to the Desaru tourist areas. These were completed from 2011-2012. The tipping point came in 2013 when property prices rose by double-digits as Iskandar began to fulfil its promises with the opening of world-class universities in Educity, world-class hospitals and internationally known amusement parks such as Legoland and Hello Kitty.





## Residential properties

Based on the Malaysia House Price Index of the Valuation and Property Services Department, investors who bought residential properties in Johor may have seen a capital appreciation of 70.0% in the past five years (Chart 2). In comparison, the country's average residential value has increased by 50.0% in the same period.

More recent figures by National Property Information Centre (NAPIC) show that sentiment in 2015 has now reversed and there has been a much sharper decline in property values in Johor (-34%) than in other states such as KL (-8%).

The situation was made worse by oversupply, particularly of high-end residential properties. The massive construction of new residential buildings preceded the expected rise in the workforce and jobs and economic activity that is supposed to take place in Iskandar over the next five years. To cite one example, Country

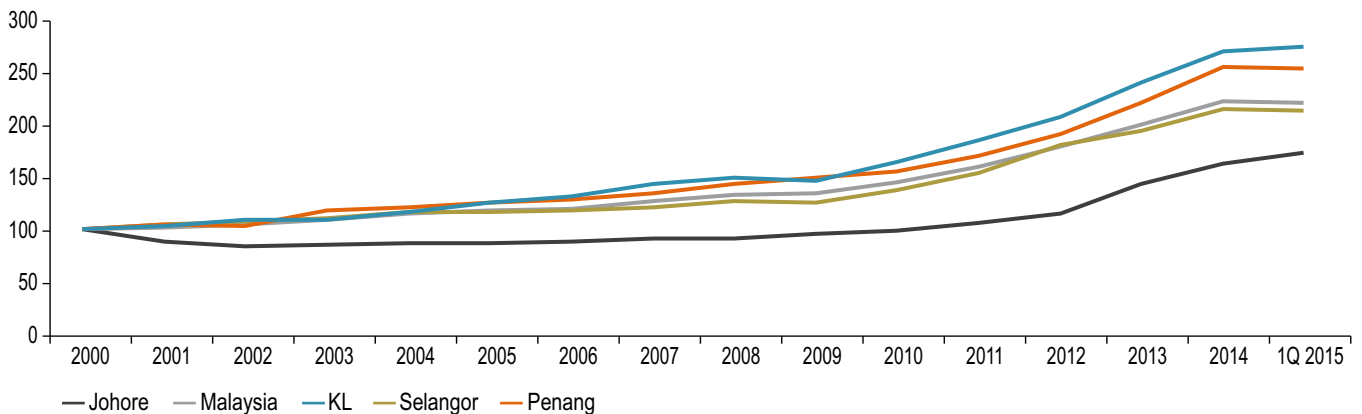
Garden's launch of 9,000 units in Danga Bay in August 2013 was one of the first massive launches ever done in Johor and is equivalent to 130% of the quarterly demand for residential property in JB, if transactions can be used as a good gauge of demand.

While the residential property overhang in states like KL and Johor is generally declining, the overhang in Johor is three times that in Kuala Lumpur. It would appear that this overhang contributed to the weaker sales in Johor as the percentage of units sold stood at 75.0% in 2015, lower than in the other states.

Nevertheless, Iskandar has a good future in the longer term but the expectations for Iskandar's real estate performance may need to be revised to more realistic levels in the near term.

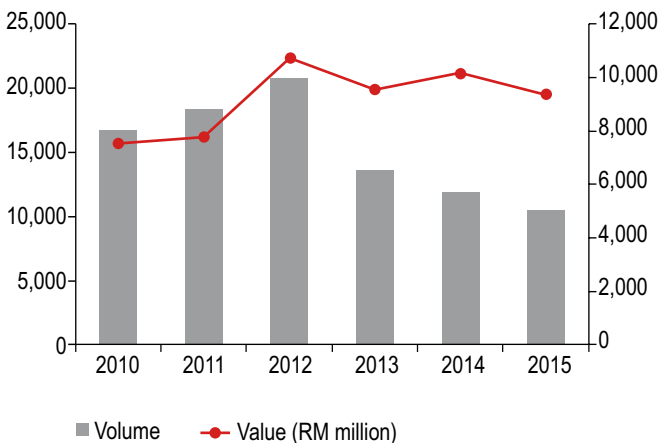
The investment commitments attracted by Iskandar have met their mid-term targets but it should be borne in mind that almost half of these are attributable to real estate investments and other services, thereby exacerbating the highly cyclical downturn in real estate during the economic slowdown.

Chart 2: House Price Indices of Malaysian States



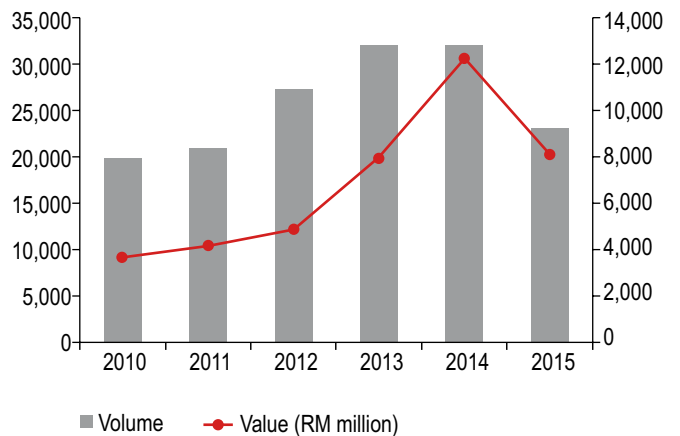
Source: Valuation and Property Services Department, Tables for the Malaysian House Price Index Data, Jan 2015 - Mac 2015

Chart 3: Volume and Value of Residential Property Transactions in Kuala Lumpur



Source: NAPIC, JLL

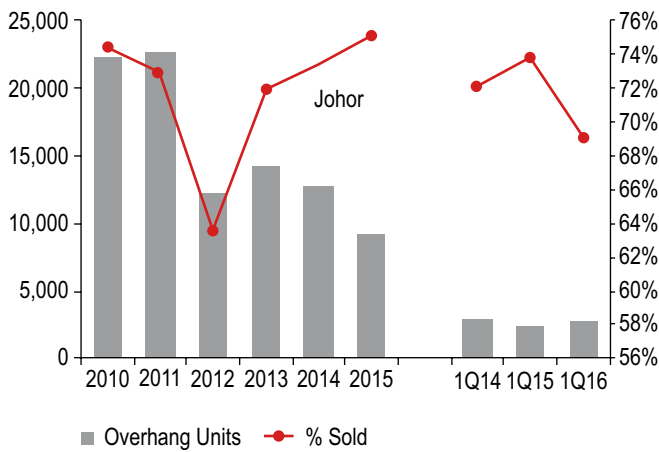
Chart 4: Volume and Value of Residential Property Transactions in Johor



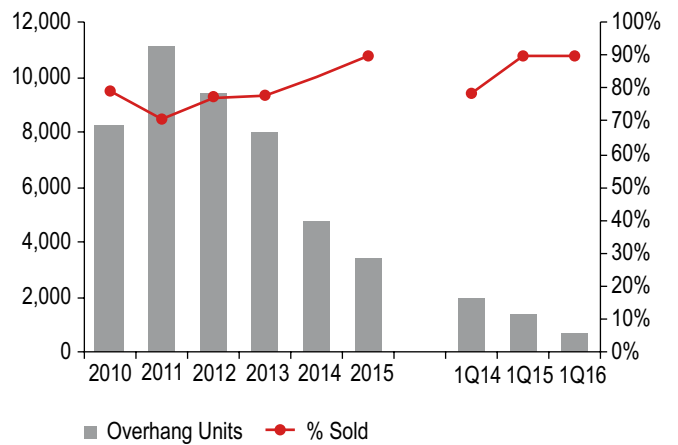
Source: NAPIC, JLL



**Chart 5a: Overhang units and Percentage sold in Johor**

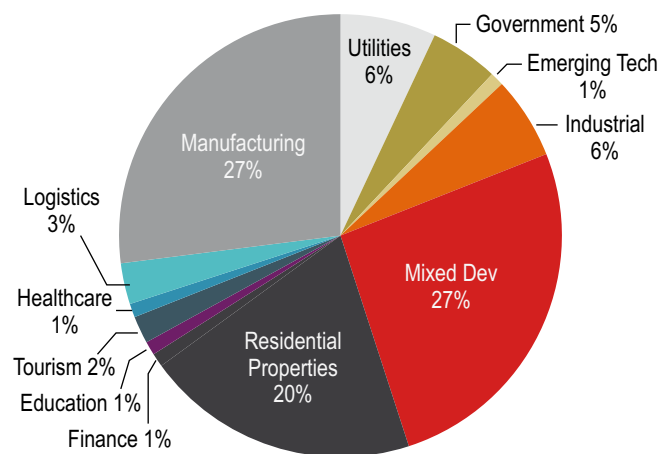


**Chart 5b: Overhang units and Percentage sold in KL**



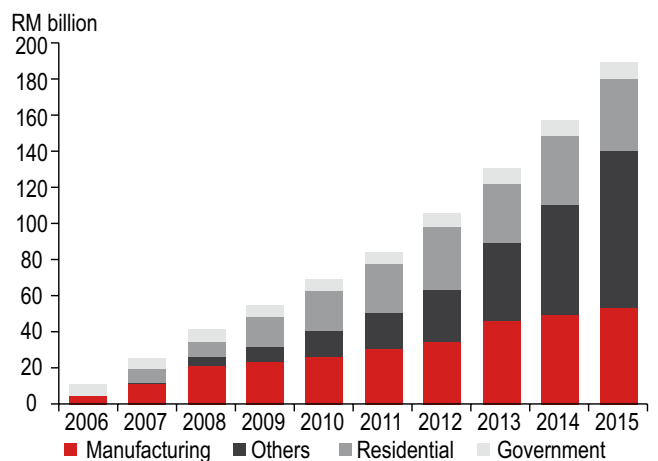
Source: NAPIC, JLL

**Chart 6: Cumulative Investment Sector Breakdown in Iskandar**



Source: Iskandar Regional Development Authority May 2016

**Chart 7: IRDA Cumulative Committed Investments (RM bil)**



Source: Iskandar Regional Development Authority May 2016

## Commercial Properties

On the commercial front, the value of transactions of commercial properties rose substantially from 2011 to 2013 but the situation reversed in 2014 and 2015 according to the Valuation and Property Services Department. Despite this, there was genuine demand as overall annual take-up in Johor firmed up from 77.5% in 2014 to 79.9% in 2015. Despite rents holding, office transactions were weak in the face of a 4.3% increase in purpose-built office space supply to 1,080,843 sqm in 2015.

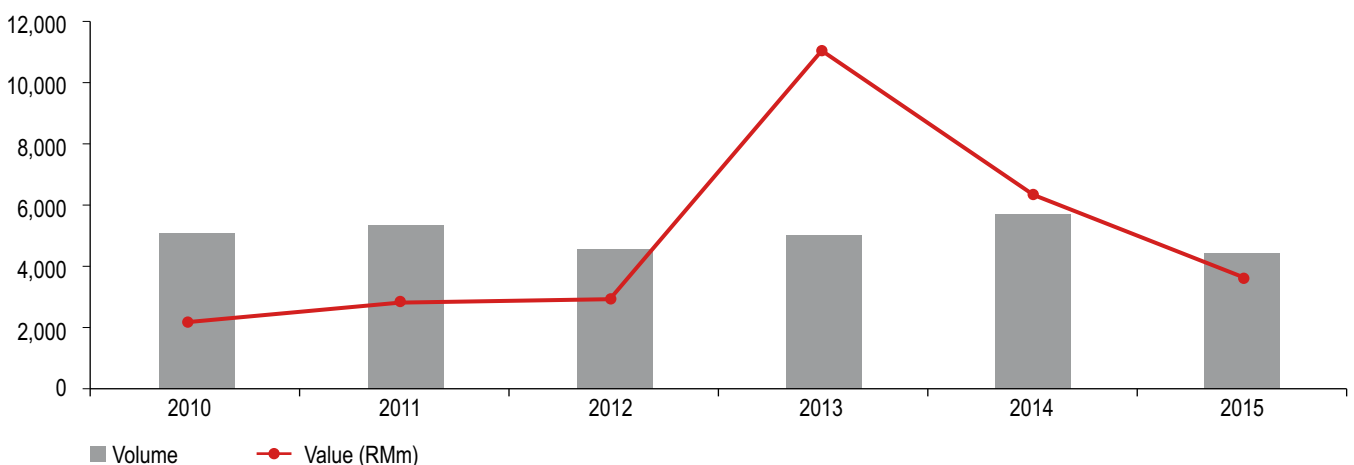
## Industrial properties

Although the market for industrial properties was soft, it showed the highest resilience probably because the supply for the nation grew at a moderate pace of only 2.5% from 14,159 sq ft to 14,509 sq ft in 2015. Incoming supply came largely from Johor Bahru at 2,160 sq ft out of a total of 3,124 sq ft.

At the same time, in the first half of the year, approved FDIs by the Malaysian Investment Development Authority (Mida) reached 83.3% of the total approved for the whole of last year. In the first six months of this year, FDIs totalled MYR 28.2 billion. Among the committed manufacturing investments in Johor were the new production base in Tanjung Langsat for Japanese manufacturer SDP Global Co Ltd that started construction this year; the relocation of the Coca-Cola Singapore Beverages plant to Iskandar Malaysia from Singapore; a new manufacturing facility by Fuji Oil Group in Senai Airport City leased for a period of 60 years; and a new MYR 1.1 billion sugar refinery to be completed by end-2017 in Tanjong Langsat by MSM Malaysia Holdings Bhd.



Chart 8: Volume and Value of Transactions for Commercial Properties



Source: Valuation and Property Services Department, Property Market Report, 2015



## The best is yet to come

Historically, agriculture has been an important contributor to Johor's GDP but this share has been declining. It has only been ten years since Iskandar was established and we can see that Johor's economic activity has been veering towards manufacturing and services in contrast to agriculture. Iskandar has benefited more from this structure shift than the rest of Johor as seen in the rise in the number of skilled workers (Chart 9). Johor's per capita income has also grown faster at 42.4% in two years while that in KL grew by 30.3%. (Chart 10). As a result, Johor has edged up to the fifth spot, after KL, Selangor, Putrajaya, and Labuan in two years, overtaking Penang on the list of states with the highest per capita income.

If Shenzhen is to be a guide for Iskandar, then the next wave of foreign manufacturing investments have yet to reach its shores and Singaporean companies have yet to invest in Iskandar in a big way.

Businesswise, the costs are persuasive.

For the services sector, Iskandar Puteri, formerly called Nusajaya is a good value proposition that should attract global business services with its prime office space costing approximately a fifth of the median prime office space in Singapore's CBD. Strategically located in the heart of Southeast Asia, Iskandar Puteri is an ideal location for Global Business Services (GBS), including shared services centres, regional headquarters back-offices, customer services operations and corporate centres of excellence.

With the provision of prime office space that is lacking in the Johor region, the Medini CBD is poised to integrate well with the overall Iskandar development. Iskandar Puteri's development as a Smart City is in line with the global trends needed to attract young and talented people and foreign multinationals. For companies with

headquarters in Singapore which are looking to expand, Johor's proximity and cost effective location are very favourable factors. i2M Ventures Sdn Bhd, set up by Khazanah to attract nearshore outsourcing companies have brought in Frost & Sullivan, Brandt International, Kannal, Vision Technology Consulting, IDM Lab, Nityo CoE and Vistra Group to Iskandar Puteri.

i2M via its GBS ISKANDAR initiative, facilitates companies to meet their GBS location requirements, covering key areas such as talent, infrastructure, liveability and incentives. Additionally, qualified companies will enjoy privileged access to customised incentives provided by GBS ISKANDAR.

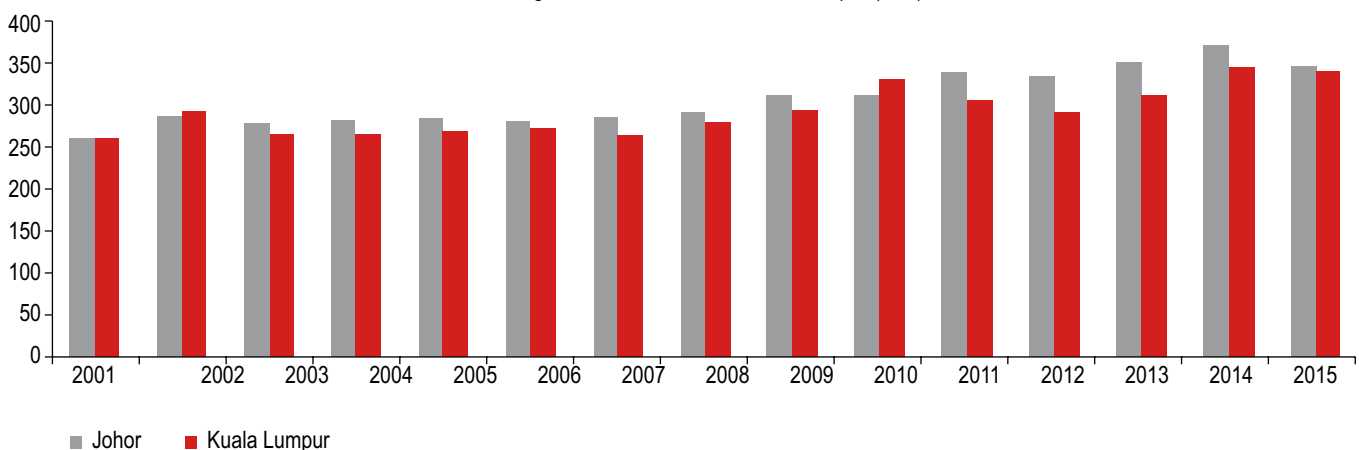
We think that the services industry in Iskandar would see an uplift when the manufacturing industry develops further. The rise in the cumulative investment in manufacturing has been encouraging and this is likely to benefit trading, wholesale and retail activity. It is likely that the services industry would mimic the growth of Selangor which supports the growth of Kuala Lumpur city centre.

While the Refinery and Petrochemical Integrated Development (RAPID) project in Pengerang, Johor may be delayed, we think the project will still continue, albeit at a slower pace. Once Petronas proceeds with Pengerang, a host of suppliers and spin-off traders would also start to flourish.

In the next decade of the Comprehensive Development Plan, 2005-2025, Iskandar's population is expected to grow faster at 3.8% per annum as opposed to the 1.0% per annum in Johor. With more job opportunities created in the manufacturing and service sectors such as in the education, health and tourism sectors via the universities in Educity, the world-class hospitals, hotels, Legoland and Pinewood Studios, Iskandar's growth is likely to be faster than the rest of Johor with higher value-added job opportunities.

**Chart 9: Comparison of Skilled Workforces in Johor and Kuala Lumpur**

Number of Professional, Technical, Administrative and Managerial Workers in Johor, Kuala Lumpur ('000)

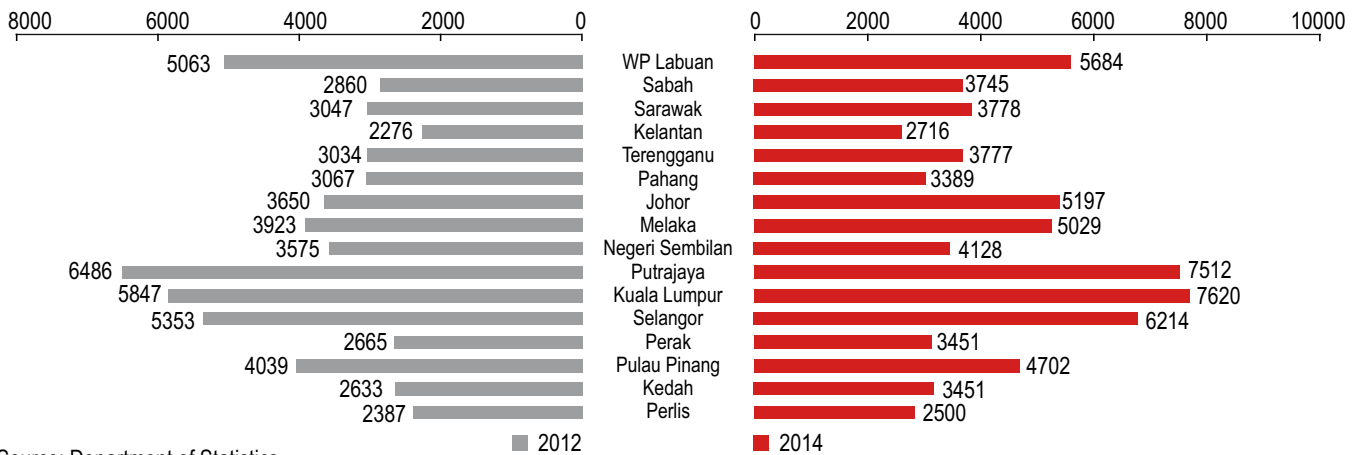


Source: Department of Statistics, 2001-15

Within the Malaysian borders, the Federal and State governments, as well as government-linked companies, have worked closely to ensure that good infrastructure is in place. The leaders from both Malaysia and Singapore had the foresight to connect the nations' capital cities with a high-speed railway network. As highlighted by Lee Hsien Loong, the high-speed railway will be a potential game changer and create greater economic opportunities, investments and bilateral trade, particularly in services. Enhanced access and amenities, including a new CBD and world-class schools, universities, healthcare institutions, and hospitals would encourage more Singaporeans to commit to the Iskandar property market.

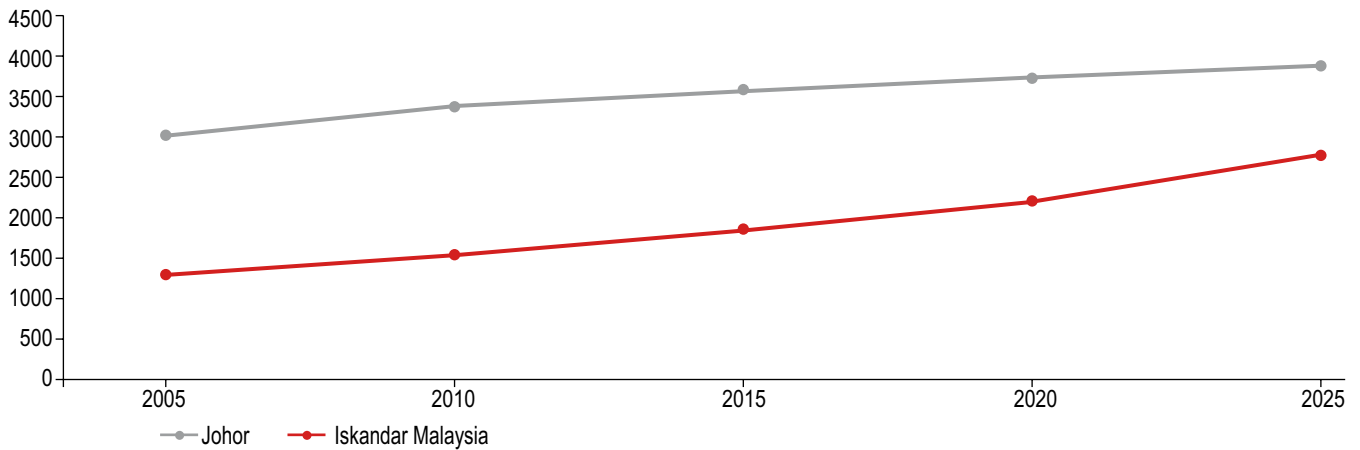
While Iskandar's destiny may pan out differently from Shenzhen, it will depart from its old image and the rest of Johor. Iskandar already is a recognised brand and is moving at a fast pace, surrounded by a more international presence since the introduction of several global companies like Legoland. Many of the developments have also set new benchmarks and standards for green and sustainable cities within the nation. Properties have and will be built with aspirations that reflect a world-class metropolis, served by supporting world-class healthcare and education services, award-winning golf courses and exclusive marinas.

**Chart 10: Median Household Income – Johor grows faster than KL and overtakes Penang**



Source: Department of Statistics

**Chart 11: Population Projections in Iskandar and Johor**



Source: CDPii 2014-2025

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