RESEARCH

Santos Knight Frank

METRO MANILA

MARKET UPDATE Q4 2016

METRO MANILA REAL ESTATE SECTOR REVIEW

PAVING THE WAY FOR A PROGRESSIVE PHILIPPINES

Recent studies show that the Philippines is one of the most attractive hubs for developers and investors, particularly in the office and retail sectors. The country has maintained its good position and is constantly improving, heading towards an even better worldwide standing. Yield-seeking real estate investors are drawn to capitalize on this too good to miss opportunity.

Global Economy

The World Bank projected a 2.3% global growth for 2016. This is 0.6% percentage points below the 2.9% forecast at the beginning of the said year. However, global growth is expected to pick up modestly, reaching 2.7% in 2017, with the stabilization of commodity prices that will provide support to commodity-exporting emerging markets and developing economies.

Philippine Economy

The Philippine Statistics Authority (PSA) reported that the Philippine economy grew by 6.6% year-on-year in the 4th quarter of 2016. This is 0.1% higher than the GDP growth recorded same period last year.

The fact that the 4th quarter year-on-year GDP growth rate is lower than the earlier quarters of the year is not a reason to be alarmed. According to the current Secretary of Socio-economic Planning and Director General of the National Economic and Development Authority, it is normal for the 4th quarter growth rate to be slower than the 1st half of an election year. Investors are said to adopt a wait and see attitude, holding off their investment activities.

In terms of annual growth, the Philippine economy grew by 6.8% in 2016. This is a huge jump from the 5.9% annual growth documented in 2015. Booming construction, moderate inflation, influx of tourists, expansion of the retail market and continuous growth of the Business Process Outsourcing (BPO) sector are some of the factors contributing to the economic growth.

Although exports were down in the last quarter of 2016, domestic demand is expected to remain buoyant. Favorable income conditions is expected to result to an increase in household consumption. Forecasted sustained economic activities across all sectors is a strong basis of bullish economic growth assumptions for 2017. By year 2022, the Philippines is perceived to be already considered as an upper middle income class economy.

In addition, the Philippines experienced the highest inflation rate since early 2015 with consumer prices rising 2.6% year-on-year. This is higher than the 2.5% inflation rate reported in the previous month and .2% above market expectations of 2.4%. Additionally, the Bangko Sentral ng Pilipinas (BSP) predicts inflation to remain within 2 to 4% in 2017. The inflation rate has averaged 8.58% from late 1950s to present.

Consumer spending has greatly increased in 2016 resulting from growth in real income and purchasing power. In 2016, Household Final Consumption Expenditure (HFCE) annual growth escalated to above 7%. Overall, the notable rising of the inflation rate can be mainly attributed to “upbeat consumer demand, higher oil prices and weaker peso” as reported by market economists

The unemployment rate plunged to 4.7% in the 4th quarter of 2016. This is a huge fall from 5.6% same period in 2015 and 5.4% in the previous quarter. From 1994 to 2016, unemployment rate averaged 8.63%, which is about 4% higher than the presently noted unemployment rate.

The number of unemployed reached a record low of 2,040 persons in the 4th quarter of 2016 compared to 2,335 in the previous quarter.

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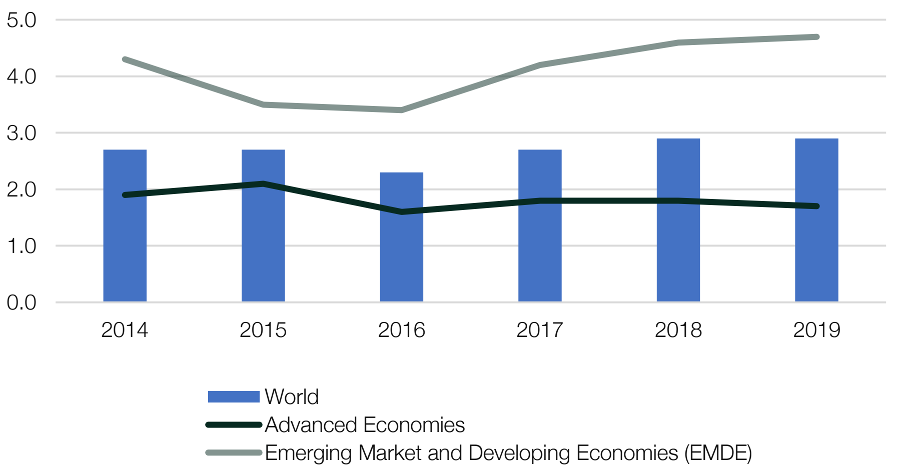
FIGURE 1
Global Growth in Percentage



Source: World Bank

SNAPSHOTS

Economic Indicators

6.8% ▼
GDP
2016

2.6% ▲
Inflation Rate
December 2016

5.1% ▲
OFW Remittances
2016

5.7% ▲
Ave. Bank Lending
December 2016

1.6% ▲
91-Day T-Bill
December 2016

49.11 ▼
Ave. PHP-USD
Q4 2016

A large number of jobs were created, increasing the number of employed in the country. In the 3rd quarter alone, 33,590 jobs were expected to be generated. 83.2% of this was anticipated to come from foreign investors.

Interest rates reached an all-time low of 3% in June 2016 and remain unchanged to date. Decreasing unemployment rate, growing real income and higher purchasing power despite increasing inflation were constantly notable in the past months of the year. These reduced the demand for credit. To increase bank lending and to encourage spending and investment, interest rates were subsequently lowered. The upbeat and steadily improving drivers signify that interest rates will remain low even in 2017.

The World Bank expects to see the slowest remittance expansion in the past decade primarily due to the decline in Oversees Filipino Worker (OFW) deployment. The World Bank likewise attributes the slowing remittance inflow to globally cheap oil and de-risking. In spite of these, an estimated $29.7 Billion OFW remittance was sent during the holiday season. Moreover, the Bangko Sentral ng Pilipinas (BSP) is confident that the robust BPO sector, which is a top dollar-earner, will compensate for the slowing remittance growth.

Philippine Real Estate Market

Sound macroeconomic fundamentals are enticing businessmen to invest in the Philippines. The positive economic indicators create a conducive business environment that consequently attracts investors to be key players in the local real estate industry.

The office market remains vigorous as the BPO industry continues to expand and overall office vacancy rates remarkably decline. The Philippines remains one of the leading countries in the BPO industry with noted movement towards more complex work skills and no record of investment cancellation. The local BPO industry is projected to shift to non-voice services with higher-value such as Engineering Services Outsourcing (ESO), Data Analytics, Gamification, Legal Process Outsourcing (LPO) in consideration of US policies aimed at bringing jobs back to the US.

The local BPO industry maintains its strong position despite US President Donald Trump's plan to impose a sizable tax on US companies that will outsource production to foreign countries. It is still more practical and profitable for companies to outsource service due to high labor cost in the US. Investments from China are likewise expected to keep coming in as the Philippine government intensify efforts to create a commercial alliance with China.

The residential and retail markets similarly pose positive standings and project optimistic outlooks. The sustained investor interests, growing investments from OFW, robust BPO Sector and the influx of millennial workforce create a notable residential condominium sales demand, urging property developers to spice up their residential portfolios. In terms of retail, the consistently increasing consumer consumption and real income demand expansions in both local and foreign brands thus drawing additional commercial and retail space development.

Relative to the steady increase of consumer spending evident this year, manufacturing firms were compelled to expand operations and increase size of storage facilities. As a result, developer real estate portfolios diversify towards industrial investment ventures positively affecting the industry sector.

OFFICE MARKET REMAINS STABLE, VACANCY FURTHER DECLINES

Office | Upcoming spaces to satisfy office demand in the coming periods

Office sector demand was sustained in the 4th quarter of 2016. Take up of office spaces remains vigorous as overall vacancy rate continued to decline by 1.48% in the said quarter from 3.7% same period in 2015. The positive take-up was due to new developments being turned over in the latter part of the year.

More than 20 office projects were expected to be delivered in the remaining three months of 2016, including two developments that were delayed from the previous quarter. However, only four buildings scheduled to be delivered in the 4th quarter were able to start operating before yearend. The remaining projects are expected to commence operations between the 1st quarter of 2017 up to the 1st quarter of 2018. Lack of skilled workers in the construction sector is still the main reason for the delays in the turnover of the office spaces.

A bulk of office spaces, with over 1.6 million square meters of Gross Leasable Area, is expected to be available in the market within the year 2017. Most of these office spaces are already pre-leased and the remaining available units will mostly cater to the demand of new entrants in the market and other companies who are expanding their businesses in Metro Manila.

Large supply of office spaces will be available in Bonifacio Global City (BGC) and it is expected that vacancy rate will slightly inched up in this district as it comprises 43% of the total square meters of the upcoming developments. Additional 697,694 square meters of gross leasable area are expected to be delivered in BGC for the whole year of 2017.

Amidst new developments in the Metro Manila office market, Makati remained to be the top destination for investors, regardless of the evidently few newly-launched developments in the area. Continuous demand drove vacancy to a rate of 0.88% y-o-y, with prime offices as the key choice of most occupiers. Tight available prime office spaces linger as vacancy rate is now recorded at 1.57% y-o-y, with rents growing to 12.71% y-o-y. On the other hand, Grade A office posted a 0.31% y-o-y vacancy rate lower than 2015 4th quarter's 1.42% y-o-y. Seven office developments are expected to be completed on 2017, including 100 West Building, Circuit Corporate Center 1 and 2, City Gate Phase 2, Insular Building, Franz de Salcedo, and M1 Tower.

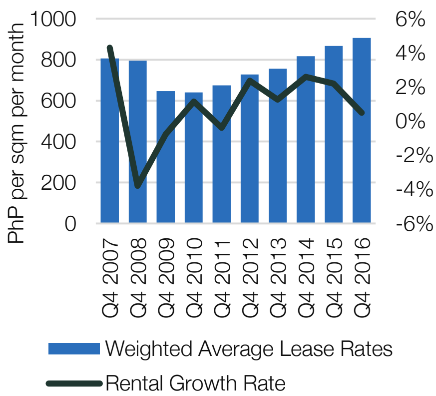
Lease rates are continuously increasing and it varies depending on its location and current state of each business district.

Makati remains to be the Central Business District (CBD) with the highest asking rates amongst all major CBDs in Metro Manila. Weighted lease rate of Makati CBD in the 4th quarter was pegged at Php 1,226.57 followed by Bonifacio Global City with Php 931.28, Quezon City with Php 710.98, Bay City with Php 691.28, Alabang with Php 666.81, and Ortigas with Php 631.24.

Heightened demand was recorded in the Business District of Alabang as vacancy rate significantly dropped from a double-digit number of 17.07% in the 4th quarter of 2015 to a low of 1.65% in the same quarter of 2016.

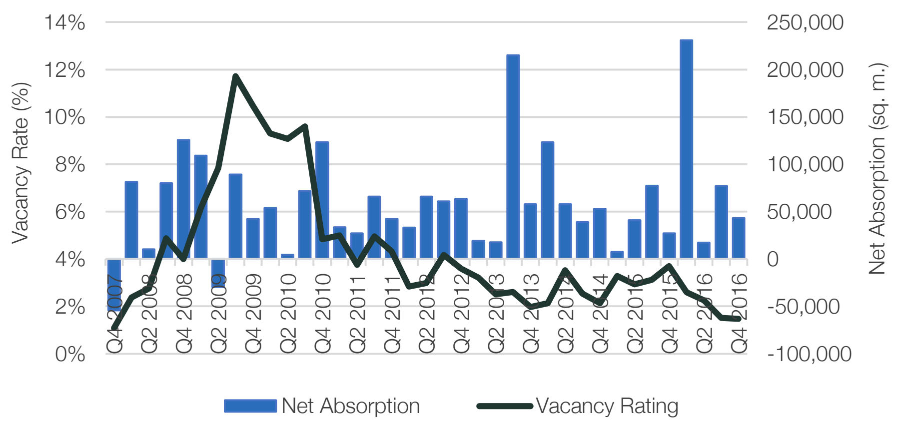
The lowest recorded drop in vacancy was on the 3rd quarter of 2014, with a 0.90% vacancy rate, where Alabang became the alternative BPO destination of Makati and Bonifacio Global City. Alabang and other business districts are expected to grow further as more outsourcing companies see great opportunities in transferring to buildings that can offer larger office spaces.

FIGURE 2
Weighted Average Lease Rates vs. Rental Growth Rate



Source: Santos Knight Frank Research

FIGURE 3
Net Absorption vs. Vacancy Rating



Source: Santos Knight Frank Research

Office Sector Benefits from Philippine GDP Ending Strong in 2016

The Philippine gross domestic product concluded with a strong number of 6.8% for 2016. This is the fastest growth recorded in three years. Service and industry sector remained to be top contributors to the growth of the country and are both expected to further expand in the following year even with the rising uncertainties in the market. Different crisis and issues, both in the political and economic aspect, are arising in most of the developed countries in the western and eastern side of the globe, which makes some of the investors skeptical in the market. With these happenings, what some call “hot money” or more commonly known as investments are being spilled in to the developing country such as the Philippines. Foreign and domestic investors are enticed to expand operations and set up area offices in the Philippines as expectations increase that Philippines will continue to be one of the fastest growing economies in Asia.

Upcoming Office share per CBD

Outlook for the Philippine office sector remains robust amidst different threats in the global market. This is backed by a continuous growth of the sector which now has more than 150 office developments in the pipeline, adding over 3.4 million of gross leasable area for 2017 to 2020. This growth is driven by strong domestic demand and sound macroeconomic fundamentals in the Philippines.

Bonifacio Global City remained to be the fastest developing CBD and an alternative to Makati. BGC has a total share of 32% of the total upcoming developments until 2020. Makati and Bay Area are tied on the same spot, having a share of 15% each of the total gross leasable area. Quezon City takes up 14% of the pie while Alabang and Ortigas take up 12% and 8%, respectively. The remaining share is distributed among the rest of Metro Manila.

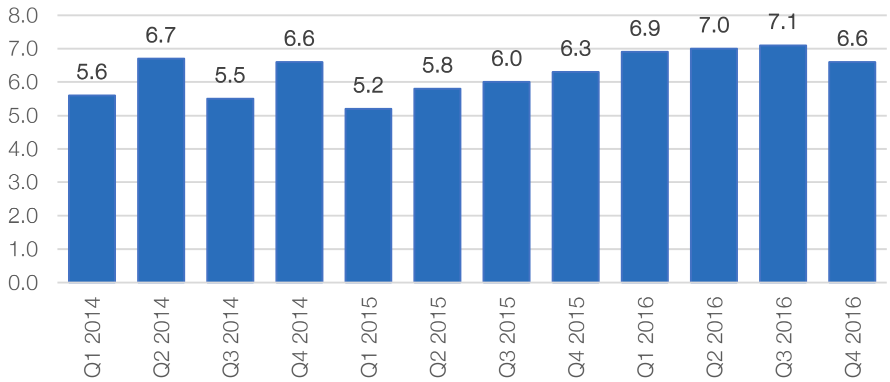
Bright Future for Bay CBD

The Bay area is being eyed as the next Makati or BGC in the Metro, with the area’s huge revenue and development potential. Currently, the three top developers in the Reclamation Area are SM Prime Holdings Inc., Filinvest Land Inc., and DM Wenceslao and Associates Inc. The Bay Area will not only be the center of entertainment in the Philippines but also a world class community, where new offices, residential spaces, and retail establishments are soon to rise.

The Philippine Reclamation Authority targets to carry out a total of 80 reclamation projects in the country which includes the Solar City Commercial and Business District.

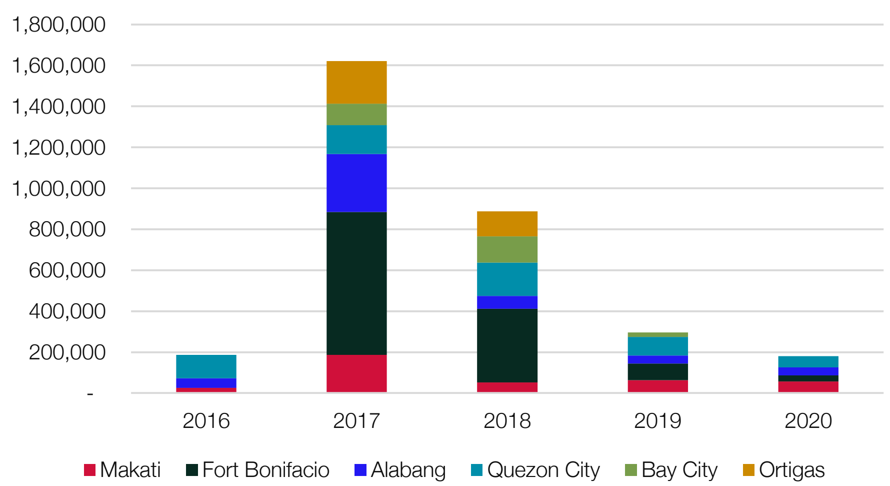
Solar City was recently approved by the city government and will be located in the Manila Bay area. It will have a total area of 148 hectares. Further to this, lined up road infrastructure projects connecting 2 proposed international airports, one located in Sangley Point, Cavite and the other in Bulacan, will pass through the Bay Area. These roads will cut travel time from the two airports to the entertainment center of the country.

FIGURE 4
Philippines’ GDP Growth Rate



Source: Philippine Statistics Authority

FIGURE 5
Development Pipeline (sq. m)



Source: Santos Knight Frank Research

STRONG MACRO FUNDAMENTALS OFFSET MARKET CONCERNS

Residential | Residential sector ends 2016 resilient

Source: DMCI Homes Website

Investors and buyers continue to venture in the residential market supported by the country's sound macroeconomic fundamentals. Foreign investors further moved out from their wait-and-see stance after a commendable GDP growth from the previous quarter. At the same time, remittances from overseas Filipinos rebounded on the back of improving global economic conditions. The latter having been able to post a 7.6% growth in December from the previous month's USD2.12 billion, bringing the full year total to grow by 5% from last year's record of USD25.61 billion.

As a result, the local condominium sales market displayed resiliency amidst the uncertainties from the previous quarter. The low interest rate environment has also helped residential sales demand to remain on healthy levels. The weaker peso during the spending season likewise enticed investors and buyers to further venture in the residential market, all the while taking advantage of the flexible payment schemes being offered by various developers.

Considering all of these, a variety of investors and buyers became rather active in acquiring residential properties particularly high-end and mid-end projects; from foreigners to overseas Filipinos, to young professionals, to BPO employees, up to local individuals and companies who are intending to operate their acquired units as a hotel for short-term guests.

High net worth locals and individuals also continued to express their confidence in the luxury segment. Though concentrated in the country's top tier cities, Makati City and Bonifacio Global City (BGC), about 90% of the luxury residential stock has already been exhausted towards the end of the last quarter. Although majority of the luxury inventory are still in the construction pipeline, indicative selling prices currently range from PhP210,000 to PhP340,000 and PhP190,000 to PhP350,000 per sq. m in the said cities, respectively.

On the supply side, the limited stock of developable land in Metro Manila's prime areas continue to urge property developers to consider undertaking projects in areas with ample land resource coupled with upbeat market activity. Bay Area and Quezon City became viable options as most of the residential launches during the 4th quarter were situated in the said areas such as Infina Towers North Tower by DMCI Homes, Towers 1 and 2 of Vine Residences and Shore 3 Residences by SMDC, and Six Senses Resort Tower 6 by Federal Land.

Bay Area and Quezon City also contributed the most number of residential units launched for the whole year of 2016. Approximately 76% originated from the 2 cities out of the 11,728 units that were unveiled to the market during the year.

Residential property turnovers, meanwhile, slightly picked up during the last quarter. Several projects were able to meet their schedules including Signa Designer Residences Tower 2 by Robinsons Land in Makati City, Park West by Federal Land in BGC, Amaia Skies Cubao Tower 1 by Amaia Land in Quezon City, and Zitan by Greenfield Development Corp. in Ortigas.

However, delay in building completions were still evident as some developments that were slated to be delivered within the last 3 months of 2016 rescheduled to open their doors in about a quarter to a year from target. Such delays can be considered as a matter of developers' management and discretion. Knowing they have commitments, delays do not usually take long and normally extend only for a short period of time.

So much for the movements in Metro Manila, the idea of pursuing residential projects in the countryside has never been more notable than in the last quarter of 2016. Major property developers expressed and began revealing plans of spicing up their residential portfolios by targeting relatively new market segments outside the country's prime areas such as Cebu, Davao, and Central Luzon. This is expected to continue in the short to the medium term as big-ticket infrastructures are currently being put in place, and developers are slowly adopting the current administration's stance of looking for "New Sources of Growth".

REAL ESTATE DEVELOPERS KEEN TOWARDS RETAIL EXPANSIONS

Retail | Gradual increase in expenditure during the holiday season

Expansion in the retail sector is sustained as strong consumer-based demand becomes evident in the market. Vacancy in Metro Manila shopping malls reached almost 5% due to several new openings in the month of December. Consumer spending has further increased, with the inflation rate rising to 2.6%, which is a recognizable trend in the economy during the holiday season.

With an optimistic business outlook sustained in the market, retailers become very aggressive in new launches and retail expansions. Developers strive to penetrate untapped consumer demand in areas inside and outside of Metro Manila. Upcoming retail supply is expected to reach almost 500,000 sq. m. of gross leasable area in Metro Manila up until year 2018.

Rental rates for retail spaces in Metro Manila is seen to be stable with minimal increases in the areas of Ortigas, Makati, BGC and Quezon City. Average rent in Metro Manila was recorded at a little above Php 1,400 per sq. m.

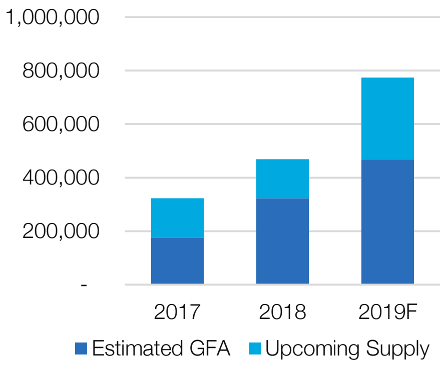
The retail segment of the Avida Towers Altura, a mixed-use development in Muntinlupa City, known as the South Park Mall, with a gross leasable area of approximately 47,000 sq m, had its soft opening in late November, making it in time for the holidays and before the turnover of the 2nd tower of its residential segment. Selected stores are already open, with majority of the stores waiting for their respective soft and grand openings. Brands like Daiso, Terranova, Mia Maison, Petrol and other well-known brands, consumer services and recreational activities are expected to open soon together with supermarket and some clothing and accessory bazaar that make-up the shopping mall.

SM East Ortigas, formerly the site of Ever Gotesco, opened in early December. It is the 60th mall of SM Prime Holdings Inc. and is located in Sta. Lucia, Pasig City. The shopping mall has a gross floor area of 80,000 sq. m. with leasable areas already pre-committed to both local and foreign brands. Brands like Bon Chon, Baskin Robbins, Mcdonald's, Miniso, Starbucks, Wrist Pod, Memo, Oxygen, and other mainstay brands have already occupied retail spaces in the mall. Other retail openings and expansions are likewise anticipated by majority of the people in the area.

With some shopping malls undergoing renovation, a number of stalls were closed down, increasing vacancy in the district but only at a minimum. Certain stalls under renovation would either be taken up by the previous occupant or is already pre-committed to another expanding brand. Some unfinished stalls are already being occupied by pop-up stores of known brands in the market. This is in order to attain space efficiency. Moreover, brands like Own days, Stradivarius, Wrist Pod, Pandora, Miniso and other international brands continue to expand in different locations penetrating much of the consumer market.

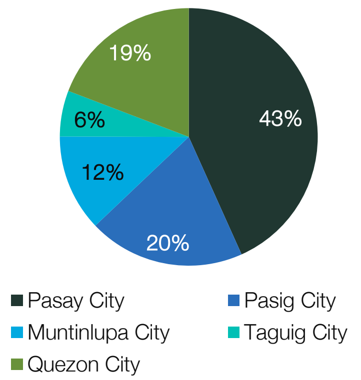
Retail openings are still evident in the areas of Makati, BGC/Taguig and Ortigas/Pasig City while a number of shopping malls and retail components in mixed-use developments are still anticipated in the areas of Bay City and Quezon City. Prime locations outside of Metro Manila, including Central and North Luzon, Cebu and Davao are areas to consider as new developments turn up, presenting possible retail opportunities in the area.

FIGURE 6
Upcoming Retail Supply*



*Cumulative value since 2016
Source: Santos Knight Frank Research

FIGURE 7
Upcoming Retail Openings Per Location



Source: Santos Knight Frank Research

SUSTAINED GROWTH IN THE INDUSTRIAL SECTOR

Industrial | Industrial sector flourishes amidst uncertainties

Macroeconomic fundamentals remain positive in the country despite concerns over foreign policy incidences and local economic reforms. The industrial sector recorded a 7.6% growth rate, significantly higher than the 6.5% growth from the previous year, which is considered the fastest among the major economic sectors. Expansion in the industry was brought about by undertakings in manufacturing, real estate, trade, renting and business activities in the 4th quarter.

Approved FDIs (Foreign Direct Investments) reached approximately Php 93.3 Billion for the first 9 months of 2016. Countries like South Korea, United States of America (USA) and Singapore are the top investing countries putting in as much as 56.8% of the total approved foreign investment. The largest amount of investments approved was under Manufacturing amounting to Php29.1 Billion or 31.2% of the total approved investments, followed by Electricity, Gas, Steam and Air conditioning supply and Administrative and support service activities. Investments were still directed towards the NCR region but is seen to grow and spread across other regions.

Volume of Production Index (VoPI) and Value of Production (VaPI) for manufacturing picked up by 14.6 and 10.6% year-on-year growth rate, respectively, which was mainly attributed to the expansion in the production of petroleum products, transport equipment, food manufacturing and beverages, rubber and plastic products, tobacco products and textiles. The bulk of operations by firms, or 81.8% of the total firms, in the industry operated at 70% to full capacity.

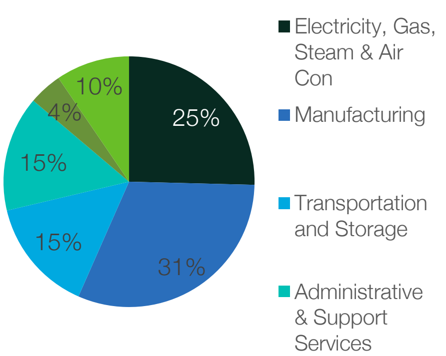
Furthermore, notable economic zones in the country are still at full occupancy with a number of firms wanting to invest more in industries like power/energy and manufacturing. Real Estate developers like Ayala, DMCI and Filinvest expressed further expansion in their respective real estate portfolios by investing in industrial sector more specifically in power ventures.

Noticing the need for more industrial zones due to influx of foreign investment, China, one of the partner countries of the Philippines already, expressed their intention in developing an industrial zone in the country. Not limiting their proposal to one project, cooperation between the two may also lead to developments of airport, seaport, railway and a highway. With international relations with other countries warming, more economic benefits will be coming in to the country.

A number of infrastructure proposal have already been laid out by the government in the hopes of boosting the country's economy and to resolve issues in traffic, unemployment and increasing price of food. Agencies such as the Department of Public Works and Highways (DPWH), Department of Transportation (DOTr), Bases Conversion and Development Authority (BCDA), Presidential Communications (PCO) and the government in general are expected to prioritize and spend for infrastructure projects. Projects like Iloilo-Guimaras-Negros-Cebu Link Bridge, Regional Airport Development in Visayas and Mindanao, Sta Monica-Lawton-BGC Link Bridge and Subic-Clark Cargo Railway Project are some of the promising projects that are expected to be finished within the next 6 years. With the completion of these infrastructure projects, logistics cost of moving supply and inventory from plants and warehouses to distribution areas will be significantly reduced.

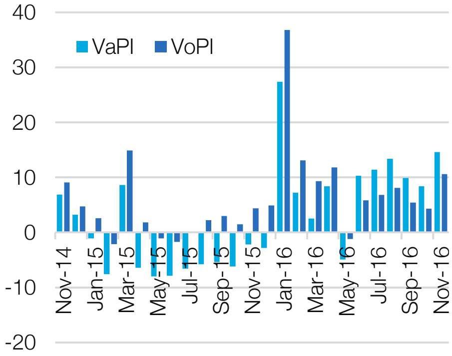
The industrial sector continues to promise robust growth as macroeconomic fundamentals improve further, entry of foreign investments maintains its momentum, and infrastructure projects are already undergoing construction. Much awaited improvements in and out of Metro Manila will spur expansion in the industrial sector specifically in prime areas like Clark, Subic, Bataan, CALABARZON and other areas in Visayas and Mindanao.

FIGURE 8
Total Approved Foreign Direct Investments by Industry



Source: Philippine Statistics Authority

FIGURE 9
Industrial Production y-o-y growth



Source: Philippine Statistics Authority

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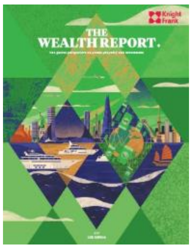

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