PHILIPPINES | TOP 10 PREDICTIONS 2018

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Accelerating success.

Opportunities amidst uncertainties

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The Philippines' property sector recorded mixed results for the first nine months of the year. While we see challenges ahead, opportunities for the sector abound over the next 12 months. Colliers encourages developers to take advantage of opportunities that could arise from the implementation of government policies such as the Comprehensive Tax Reform Package; relaxation of foreign ownership restrictions on retail and construction; and amendments to the existing procurement law and business registration systems which should entice more developers to take part in the government's ambitious infrastructure development programme. We encourage the developers' infrastructure units to explore operation and maintenance (O&M) opportunities involving transportation projects in and outside of Manila. We also recommend that developers be more innovative given the proliferation of townships and expansion of opportunities in alternative markets such as Cebu.

The office sector remains afloat despite slower take-up from outsourcing firms. The void has been filled by offshore gambling firms. However, we do not see offshore gambling as a major demand driver beyond 2018. Residential leasing in Metro Manila remains challenging although we see opportunities in workers' dormitories in key business hubs in major business districts and affordable house and lot developments in urban areas outside of the country's capital. Brick-and-mortar malls continue to attract more customers by providing lifestyle amenities. We see physical stores and e-commerce platforms complementing each other over the medium term. Hotel occupancies and room rates continue to benefit from the influx of foreign travellers though we see occupancies and rates declining marginally in casino-hotels in the next 12 to 18 months given the substantial new supply. Meanwhile, the surge of manufacturing investments is propelling the demand for industrial space and standard factory buildings. However, we project that lease rates in the country's industrial corridor, Cavite-Laguna-Batangas area, will record flattish growth over the near term due to the proliferation of alternative industrial parks in Northern and Central Luzon.

Property Market Drivers for 2018

SECTOR	DRIVER
Office	Flexible Workspace & Non-BPO
Residential	Dorms
Retail	Experiential Retail
Hotel	Resort-Oriented
Industrial	Warehousing & Logistics

Source: Colliers International Philippines Research

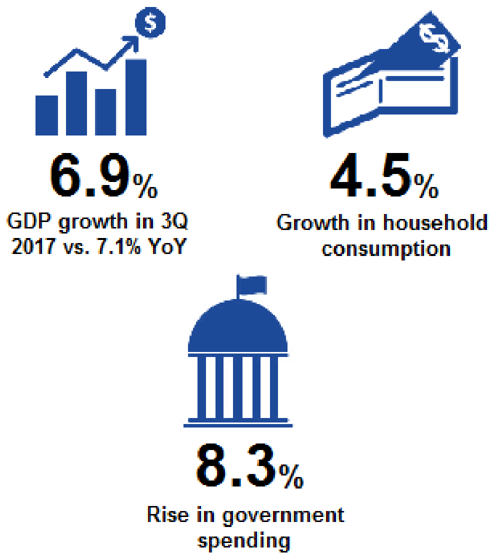
1. Infrastructure-led GDP to buoy property

The Philippines' real GDP rose by 6.9% in 3Q2017, surpassing market expectations. Year-to-date growth stands at 6.7%, well within the government's and multinational banks' projections.

Moving forward, much of the country's growth will hinge on ramped-up infrastructure spending, which should support the Duterte administration's commitment to build crucial projects throughout the country. The ushering in of the "golden age of infrastructure" also lends support to the government's decentralisation push which should unlock land values in areas outside of Metro Manila and stimulate business activities in the countryside. Given this, we recommend that developers zero in on the thriving opportunities outside of the country's capital.

Ultimately, we see the government's infrastructure policy dictating the strategies of both local and national developers.

Philippine GDP Indicators



Source: Philippine Statistics Authority

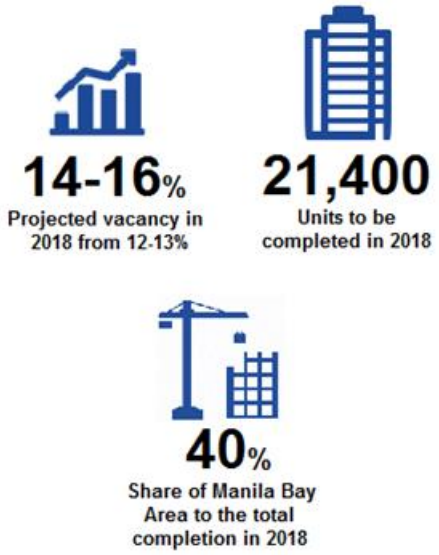
2. Metro Manila condominium leasing to remain challenging

Residential condominium leasing in Metro Manila remains challenging, driven by the influx of new condominium completions in both major business districts and fringe locations. In 3Q 2017, overall vacancy in Metro Manila rose to 12.7% from 11.7% the previous quarter. We see vacancy rising to about 14% to 16% over the next 12 months given the more than 21,000 additional units projected to be completed during the period. Completions in the fringe locations have also been rising, exerting upward pressure on overall vacancy.

Meanwhile, both national and local developers have been active in addressing the rising demand for residential projects in major urban areas in Luzon (ex-Metro Manila), Visayas, and Mindanao. The improvement of road networks and expansion of airports should further unlock land values in these areas, making them more feasible for residential projects. The demand for residential units in these locations will continuously grow as we believe that a significant part of the remittances sent in by OFWs annually will continuously be set aside for Filipinos' housing requirements.

Colliers expects developers to continue venturing into residential projects in second-tier and third-tier cities all over the country, where demand primarily comes from end-user buyers. The markets may be smaller compared to Manila but more stable in terms of end user housing demand.

Residential Sector Indicators



Source: Colliers International Philippines Research

3. Diversified office tenancy mix to be led by non-BPOs

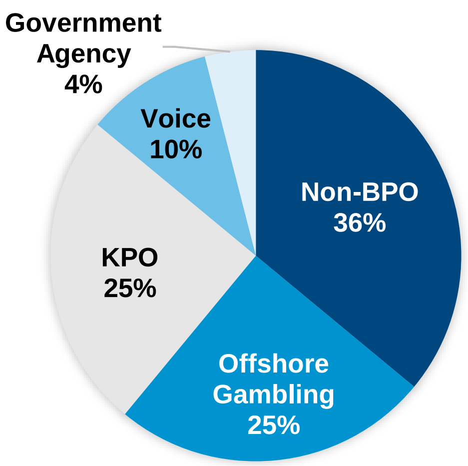
Offshore gambling has filled the void left by the BPO sector. With the Philippine Amusement and Gaming Corporation (PAGCOR) issuing 51 Philippine Offshore Gaming Operators (POGO) licences thus far, requirements from POGOs have sprung across the Metro since late last year, ranging between 5,000 sq m (53,800 sq ft) and 30,000 sq m (322,800 sq ft) per site. A total of 153,000 sq m (1.6 million sq ft) of newly leased space has been recorded from this sector for the first three quarters of the year.

However, given the wide range of space requirement from players in this sector, it has become difficult to predict the sustainability of this demand in the medium to long term. Furthermore, assuming that the legality of their operations is recognized in the Philippines, notwithstanding cases which have been filed with the Supreme Court questioning PAGCOR's jurisdiction over POGOs, concerns about potential crackdowns in home countries such as China and Korea persist even over a year into the expanded mandate of PAGCOR to regulate these entities.

We see less office launches next year following the decline in BPO companies' office space demand. This can be attributed to concerns about the US taking a more protectionist stance, increasing talent recruitment difficulties (and cost); threats to jobs from automation; and delay in Philippine Economic Zone Authority (PEZA) approvals. Although we note some improvement from the BPO sector by 4Q 2017, we expect traditional companies to take on a bigger role in 2018 in terms of demand compared to prior years.

Colliers sees overall vacancy in Metro Manila rising from 3.4% in 2016 to about 7% in 2018. At a vacancy of about 7%, new entrants and companies needing to expand would have a reasonable choice of premises. This is particularly beneficial for non-BPOs which have seen some resurgence throughout 2017. Relocations and consolidations have been more frequent from various firms across industries such as accounting, construction, logistics, legal, and banking, among others.

Office Leasing Transactions, 3Q 2017 YTD



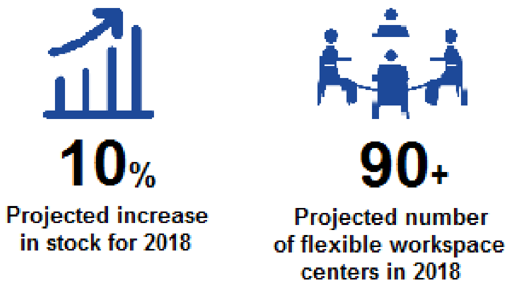
Source: Colliers International Philippines Research

4. Flexible workspace to accelerate

There are over 200,000 sq m (2.15 million sq ft) occupied by flexible office space operators in Metro Manila alone, with many still looking to expand next year. In 2017, approximately 20,000 sqm of new take-up came from flexible workspaces. The profile of tenants using these spaces varies from start-ups, to law firms, Fortune 500 companies and freelancers. Today, there are about 1.3 million freelancers in the Philippines. As mobility, connectivity and flexibility become the norm in working in the 21st century, occupier demands will also change sharply, requiring more flexible office spaces over the near to medium term.

We see a greater demand for flexible workspace over 2018 especially as major international co-working operators enter the local market. The challenge for developers is to adapt to the demands of the market to remain competitive in this growing office segment. Differentiation is key in surviving the surge in new co-working sites. Partnerships between stakeholders are therefore inevitable. Colliers expects more synergies among operators, developers, even schools, and food establishments in order to uniquely cater to a growing customer base.

Flexible Workspace Indicators



Source: Colliers International Philippines Research

5. Growing popularity of e-commerce to drive warehousing and logistics demand

Only 1% of the country's population uses online retail platforms. This presents a massive opportunity that developers and retailers could tap. As more Filipinos embrace online shopping, the need for logistics services and warehousing facilities ought to surge.

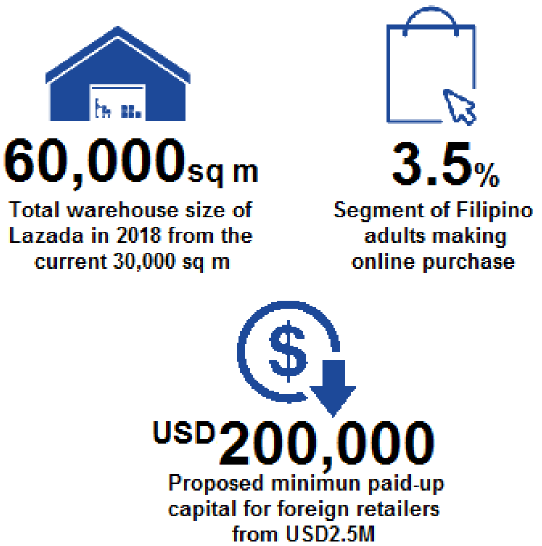
Despite a stock of around 7.8 million sq m (83.9 million sq ft) of leasable area, the warehousing and logistics market in Metro Manila is very tight, operating at an average of 98% occupancy for the various warehousing districts. Warehouses in the country's capital have been dwindling as land values rise and demand for residential and commercial projects increases, crowding out these low-value warehouses.

We expect logistics and warehousing to be a major driver of Northern/Central Luzon economy over the medium term especially in light of the planned expansion of Clark Airport and the construction of the Subic-Clark cargo railway.

The opportunities in this segment abound and are enticing developers to acquire warehousing and logistics businesses. Among the most aggressive are the SM Group and Davao-based businessman Dennis Uy of Udenna.

We also recommend that mall developers complement their online businesses by acquiring logistics and warehousing businesses. This enables retailers to effectively execute last-mile deliveries and cash in on expanding e-commerce.

E-commerce Indicators



Source: Colliers International Philippines Research

6. Industrial park developers to head north of Luzon

Major developers are heading north of Manila. Recently, DoubleDragon acquired a 6.2-hectare lot in Luisita Industrial Park in Tarlac which is about 120 kilometers north of Manila. The site will offer about 32,000 sq m (344,000 sq ft) of industrial space. The project will be completed by 2020.

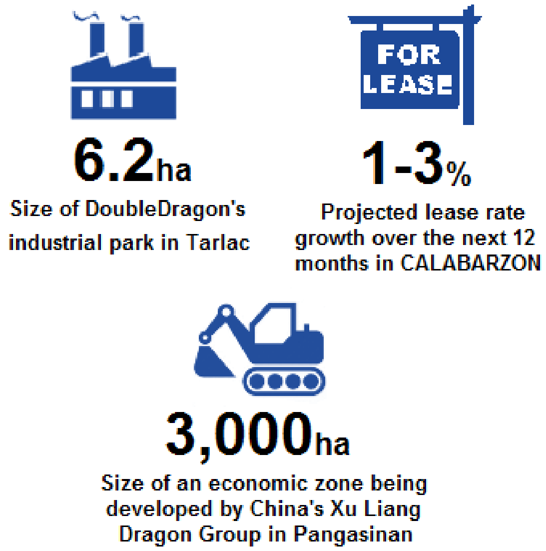
A proof of Northern and Central Luzon's rising viability as an industrial hub is the Xu Liang Dragon Group's commitment to develop a 3,000-ha mixed-use special economic zone in Pangasinan, about 210 km north of Metro Manila. The firm owns China's biggest economic zone in Xiamen province.

Other industrial parks being developed in the Northern Luzon area are Ayala's 31-hectare industrial park within its Alviera estate in Porac, Pampanga and Filinvest's 100-hectare industrial estate within the Clark Green City. Both industrial parks have been attracting high interest from both foreign and local investors that see potential in light manufacturing.

Colliers encourages manufacturing companies to put up facilities in industrial parks located within townships as these integrated communities are near key air and road infrastructure projects that substantially bring down the cost of doing business and serve as catchment areas for skilled manpower and a continuously rising consumer base for manufactured products.

Overall, we see industrial lease rates in Cavite, Laguna, and Batangas recording flattish growth due to the development of more industrial space in the Northern/Central Luzon area.

Industrial Sector Indicators



Source: Colliers International Philippines Research

7. More townships outside Metro Manila

Colliers expects developers to continue pursuing satellite communities in and outside of Metro Manila. Townships offer a better value proposition (live-work-play-shop lifestyle) than standalone projects since they offer mixed-use developments. We believe that this feature makes integrated townships a more attractive option for investors.

We see developers pursuing more township projects in areas outside of Metro Manila such as Cavite, Laguna, Bulacan, Pampanga, Cebu, and Davao over the near to medium term as land values are being unlocked by an aggressive expansion of road networks. We are confident that this will be sustained by the government's push to generate economic opportunities in the countryside anchored on its commitment to usher in the "golden age of infrastructure."

To the south, we see Cavite benefiting from the implementation of rail and road expansion projects which should provide access to properties that could be redeveloped into mixed-use communities. These infrastructure projects include the recently-completed Muntinlupa-Cavite Expressway (MCX) as well as Light Rail Transit (LRT) 1 Cavite extension, Cavite-Laguna Expressway (CALAx), and North Luzon Expressway (NLEX) and South Luzon Expressway (SLEX) connector road which are under construction.

To the north, we see Pampanga cornering the bulk of township-related investments in the region given the government's commitment to develop the North Luzon segment of North-South Railway project and expand the existing Clark International Airport.

Given the increasingly competitive environment, we believe that developers need to distinguish their projects from others. At present, we see more hospitals and schools being built within integrated communities. Other developers have been more aggressive in "differentiating" their communities by integrating entertainment and recreational facilities for outdoor sports such as football and wakeboarding. These townships include Circuit Makati with its skate park; Nuvali with its wakeboarding facility; and Alviera bannered by Sandbox, which features the country's first roller coaster zipline.

8. More resort-oriented hotels across the country

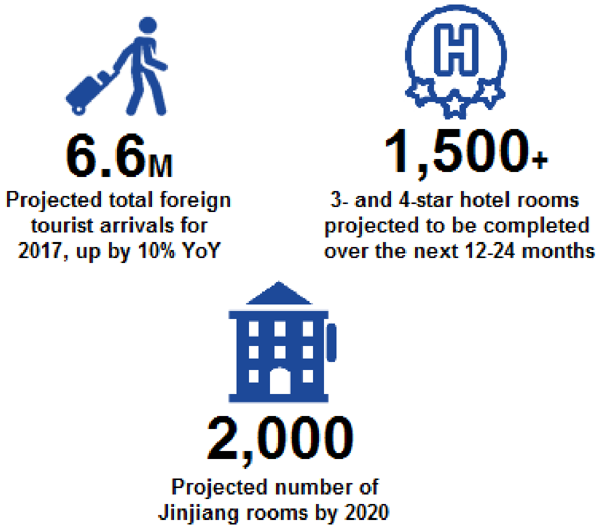
We believe that the development of 3- and 4-star hotels in resort destinations will be more visible over the next two to three years. Colliers believes that among the most attractive locations for these developments are Cebu, Bacolod, Iloilo, Palawan, Davao, and Bohol.

New airport infrastructure is essential in further expanding both local and foreign tourism. While the Mactan-Cebu International Airport expansion project is on track and seven firms have submitted bid documents for the Clark International Airport expansion, other crucial projects such as the Ninoy Aquino International Airport (NAIA) modernisation are still in an exploratory phase. Colliers believes that the expansion of international airports in major destinations such as Bohol, Bacolod, Iloilo, and Davao will allow foreign tourists to bypass Manila. This should raise tourist arrivals in the country which should boost hotel occupancy rates and entice local and foreign businessmen to ramp up their leisure-related investments in the country.

Colliers encourages developers to consider developing hotels in Bohol, Bacolod, Davao, and Iloilo as their respective regional airports are up for expansion and modernization under the current administration.

We also encourage investors to build budget hotels to cater to a continuously growing domestic market that is primarily driven by millennial travellers.

Hotel Sector Indicators



Source: Colliers International Philippines Research

9. Continued growth of e-commerce and experiential retail

Unlike the United States in particular where brick-and-mortar retail malls have closed shops due to the fierce competition brought about by online retail businesses, malls remain an important part of the Filipino lifestyle and continue to attract consumer traffic.

To attract more customers, we encourage malls to provide more lifestyle amenities and technology-driven customer experiences that generate a sense of destination.

Developers and retailers in the Philippines do not migrate totally to e-commerce but in fact use online shopping and social media platforms to complement their physical stores. Millennials, for instance, now shop on the photo-sharing application Instagram. We believe that this is a thriving opportunity that mall operators and retailers should tap.

Despite the growing acceptance of online shopping in the country, only 2.2% use a credit card to make payments; while a mere 4.2% have mobile accounts according to World Bank Global Financial Index. We believe that the opportunity lies in the growing popularity of debit cards and mobile wallets, with close to 12% of Filipinos already using debit cards to make purchases.

We encourage operators and retailers to ramp up the security features of their online sites. If they do so, customers wary of hacking will be encouraged to use their credit cards, debit cards, and mobile wallets more frequently for online transactions.

10. Leisure and Industrial sectors to drive expansion of Cebu property

The completion of the Mactan-Cebu International Airport (MCIA) expansion project should further boost Cebu's attractiveness as a tourist destination. Latest available data show that from January to November of 2016, Cebu attracted some 3.46 million domestic and foreign tourists, making it the most visited destination in the Philippines. The 2016 figure is 12% higher YoY. The continued surge of tourists in the city should provide impetus for developers to ramp up construction of hotels and resort-oriented condominium projects.

With the increase in tourist arrivals, overall occupancy rate for 2016 improved to 68% from 65% in 2015. Robust occupancy rates of Deluxe and First-Class hotels indicate the continued influx of high-spending tourists. Cebu's rising attractiveness as a tourist spot and growing competitiveness as an investment destination should support a 15% to 20% growth in tourist arrivals over the next 12 months. This should sustain hotel occupancy of between 65% and 70% across Metro Cebu over the next 12 months.

Meanwhile, we see the demand for warehouses and container yard spaces becoming more pronounced over the next 12 months.

Mandaue City recently implemented an ordinance that disallows the presence of Warehouses and Container Yards around Mandani Bay area. Several firms involved in shipping, logistics, and container yard are now in a rush to relocate.

Over the next four to five years, Cebu International Port will be transferred to Consolacion, Cebu to decongest the current port area. We see industrial land values in the northern parts of Manduae, Consolacion, and Lilo-an growing by at least 10% annually over the next two to three years. Currently, the range in Mandaue is PHP25,000 (USD500) per sq m while prices in Consolacion and Lilo-an range from PHP 10,000 (USD200) per sq m to PHP 30,000 (USD600) per sq m. The increase in rates will be supported by rising demand from logistics and warehousing firms due mainly to expansion of e-commerce platforms Lazada and Zalora in Cebu.

The conglomerate San Miguel Corporation (SMC) is also developing an industrial estate in Cebu. We see this supporting Cebu's growth as an agro-industrial hub in the Visayas-Mindanao area.

Colliers encourages industrial locators in the Visayas group of islands to consider Cebu given the island's proximity to both local and foreign markets. We believe that Cebu remains one of the most feasible industrial locations outside of Manila due to its strategic location and skilled manpower.

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