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PROSPECT FOR ECONOMIC RECOVERY A BOON TO PHILIPPINE PROPERTY

Developers convert and repurpose assets amid the pandemic and global economic crunch

Insights & Recommendations

The Philippine economy continues to reel from the impact of the pandemic and lockdowns, officially entering into a recession.

Colliers believes that conversion and repurposing of assets are crucial amid the pandemic and global economic downturn.

Hotel operators should explore the viability of co-living and flexible workspace schemes.

Industrial developers should modernize existing warehouses and look at converting vacant mall spaces into micro-warehouses near business districts in Metro Manila. This should benefit property firms with industrial and retail arms.

Office landlords and occupiers should consider adopting the hub-and-spoke model to reduce cost and improve employees' work-life balance.

GDP REBOUND IN 2021 TO RANGE FROM 6-8%

The Philippine economy contracted by 16.5% YOY in Q2 2020, its worst performance since World War 2. Despite this, the government remains positive with the potential for recovery. The National Economic and Development Authority (NEDA) and the Bangko Sentral ng Pilipinas[1] (BSP) or central bank are projecting 6.5% to 7.5% growth in 2021 while the World Bank, Asian Development Bank (ADB), and credit rating firms Moody's and Fitch are looking at an economic recovery ranging from 6.2% to 7%.

OFW REMITTANCES TO BUOY DEMAND

Data from the Philippine central bank show that remittances sent in by Overseas Filipino Workers (OFW) in June rebounded by 7.7% MOM after three consecutive months of decline. This is likely to increase Filipino consumer confidence and resuscitate a retail sector reeling from the pandemic and strict anti-COVID social distancing measures. A recovery of global economies in 2021 should also result in a rebound of OFW remittances and we forecast a positive impact on residential demand across the Philippines.

PRIVATE CONSTRUCTION RESUMES

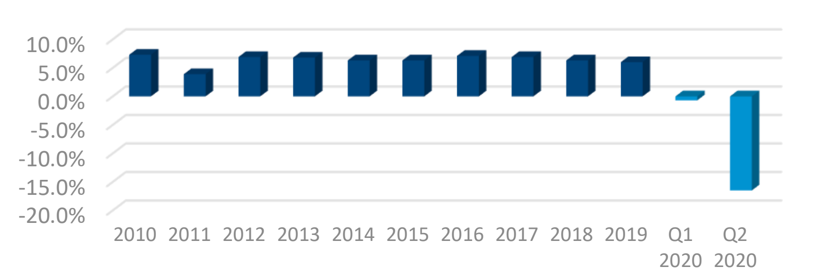
Colliers sees the relaxation of lockdown in key parts of Mega Manila (Metro Manila, Laguna, Cavite, Rizal, and Bulacan) buoying economic activity in the region that accounts for about 50% of the country's economy. The easing of lockdown should result in a revival of public and private construction which declined by 33.5% YOY in Q2 2020[2]. This has resulted in slower office and residential construction across the country. In Metro Manila, we see new office completion in 2020 dropping by 50% to only 532,600 sq metres (5.7 million sq feet) from our initial forecast of 1.07 million sq metres (11.5 million sq feet). Meanwhile, condominium completion is only likely to reach 6,270 units in 2020, down 57% from our previous forecast of 14,720 units.

ECONOMIC BILLS TO SUPPORT PROPERTY

Legislative measures likely to provide relief to the economy and property are pending in Congress and are likely to be implemented before the end of Q3 2020. These include the Corporate Recovery and Tax Incentives for Enterprises Act (CREATE) bill which should clarify ecozone locators' (including outsourcing firms) lingering concerns on tax and non-tax perks. Other important bills include the Senate version of the Bayanihan To Recover As One Act or Bayanihan 2 which sets aside PHP10 billion (USD200 million) for the ailing hospitality sector, and the small business-focused PHP1.3 trillion (USD26 billion) Accelerated Recovery and Investments Stimulus for the Economy (ARISE) Act which should benefit traditional office tenants.

[1]Business Mirror. (2020), *BSP still sees "vigorous rebound"*. [2]Philippine Statistics Authority. Note: 1 sq m = 10.76 sq ft. USD1 = PHP50 as of the end of Q2 2020. Traditional occupiers includes companies in various sectors such as legal, engineering and construction, government agencies and flexible workspace operators.

Historical Gross Domestic Product (GDP), 2010-Q2 2020



Source: Philippine Statistics Authority

Office: Landlords and occupiers explore hub-and-spoke model

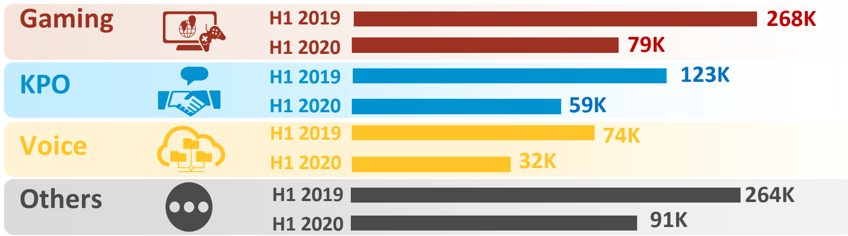
Colliers sees subdued leasing in 2020. Transactions in H1 2020 declined by 64% YOY. We recorded less transactions across all segments - offshore gaming, outsourcing, and traditional.

Colliers has observed that landlords have expressed willingness to be more flexible in accommodating new leases in order to boost the occupancy in their buildings. With a general slowdown in leasing activity all over Metro Manila following reduced space demand from POGOs, outsourcing and traditional firms, coupled with willingness among landlords to drop rents, Colliers retains its forecast of a 17% correction in lease rates in 2020. This is likely to be more apparent starting from Q4 2020.

Colliers encourages landlords to expand their options by offering available office space in non-core locations where tenants can avail themselves of rents about 20% to 30% cheaper than major business districts. This is important especially for companies planning to implement a hub-and-spoke model wherein occupiers reduce the reliance of a single headquarters location for a more dispersed occupancy strategy. This also enables firms to reduce real estate costs by shrinking headquarter location and occupying smaller hubs across Metro Manila. Typically, these would be in lower cost locations and would allow companies to access talent in alternative locations. Colliers believes that this arrangement improves work-life balance of employees and reduces living expenses.

Landlords seeing rising vacancies in their malls should explore the viability of converting these vacant spaces into flexible workspaces. This is crucial given that malls are near residential communities and this arrangement should significantly reduce employees' commuting time.

Metro Manila office transactions:



Source: Colliers International

Hotel: Innovative use under the new normal

The Philippine leisure sector continues to suffer from the sluggish impacts of the global pandemic and imposition of travel restrictions. In the first seven months of 2020 (7M), foreign arrivals reached 1.3 million, a 73% drop YOY. Colliers sees foreign arrivals dropping by more than 50% in 2020 due to the pandemic and travel bans.

Colliers projects hotel occupancy to reach only 30% in 2020 due to the substantial drop in foreign arrivals. This is significantly lower than the 72% posted in 2019. Occupancy will likely remain below 50% up to 2021 as local and foreign air travel continues to be disrupted.

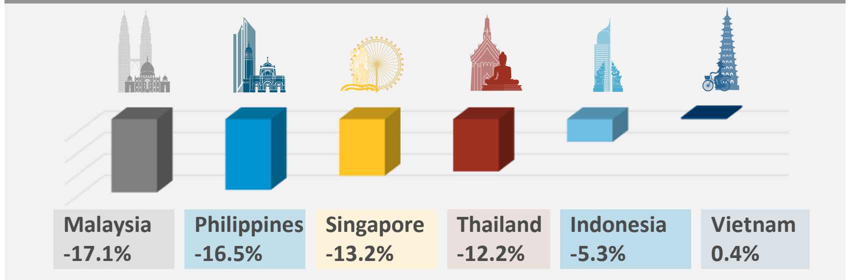
Colliers expects average daily rates (ADR) to drop by 30% in 2020 due to lower occupancy. We do not see a pickup in ADR over the next 18 to 24 months as the leisure sector continues to suffer from the global economic crunch and limited spending of local tourists.

Like other property markets, the hotel segment is likely to suffer from delayed completion of new projects as developers factor in a sluggish recovery. According to the International Air Travel Association (IATA), global air travel will only likely recover in 2024[3].

Data from the Philippine Statistics Authority (PSA) showed that spending for accommodation and food services fell by 68% while other services (arts, leisure, entertainment and personal services like wellness and grooming) dropped by 63%. This is likely due to Filipino households skimping on non-essential spending. Among the proposed measures to help ailing leisure establishments is the infusion of a PHP10 billion (USD200 million) of working capital loans for hotels and other related businesses.

[3]International Air Transport Association (2020). Recovery Delayed as International Travel Remains Locked Down.

Q2 2020 GDP Performance of Selected ASEAN



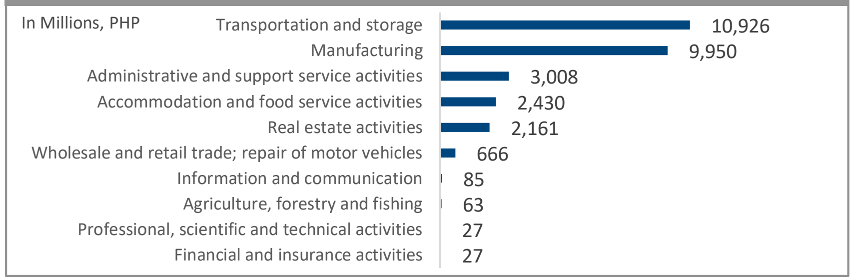
Source: Various news articles

Colliers encourages hotel operators and developers to highlight compliance with health protocols, innovate services using technology, and consider other leasing models and repurpose facilities into co-living facilities and flexible workspaces. These schemes, however, should comply with the government-mandated physical distancing measures.

Industrial: Bright spot amid the pandemic

Colliers believes that manufacturers of essential items such as food, medical, and other household products are likely to lead industrial space take-up in 2020 and 2021. This should offset a subdued absorption from electronics manufacturers due to the global economic slowdown.

Top 10 Foreign Investments in the Philippines According to Industry



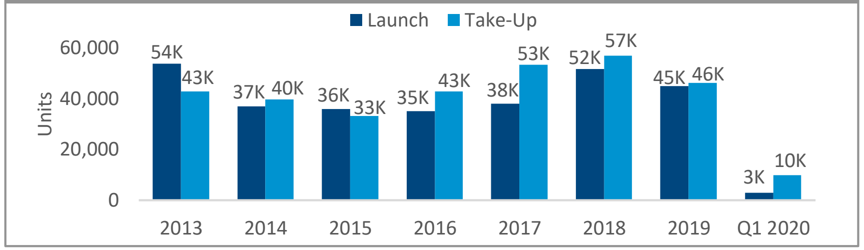
Source: Colliers International. Philippine Statistics Authority

Colliers recommends that developers modernize warehouses to capture the growing demand for e-commerce and firm up partnership with delivery firms to reach more consumers. Mall operators with vacant spaces should also explore converting or repurposing vacant retail spaces into warehouses. This should allow retailers to reach last-mile deliveries. (See also: Colliers' *Ready, Get Set, Go! 2019*)

Residential: Opportunistic buyers take advantage of low mortgage rates

The Metro Manila condominium market continues to reel from the impact of the pandemic and lockdowns. Colliers recorded secondary residential vacancy of 11.8% in Q2 2020. We believe that vacancy rates could reach the mid-teens by the end of 2020, which should be indicative of the pandemic and lockdown's deeper impact on the Metro Manila residential market.

Metro Manila Historical Pre-selling Launches and Take-up, Q1 2020



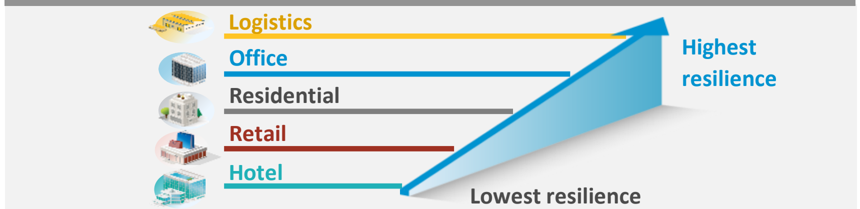
Source: Colliers International

As of Q1 2020, there were about 44,800 unsold condominium units across Metro Manila, from 47,600 units as of the end of 2019. These are a mix of pre-selling and RFO units.

In our opinion, the impact of the COVID-19 pandemic on the secondary residential market was not yet apparent in Q2 2020. However, the latest economic indicators (economic contraction, lower OFW remittances, record-high unemployment) point to a more precarious condominium market for the remainder of 2020.

Colliers encourages developers to continue extending attractive payment terms to potential clients to prop up demand for the remainder of 2020. In our opinion, this should support the prevailing low interest rates in the market which should anchor residential demand growth starting 2021.

Colliers opinion: Rebound potential of Philippine property segments



Source: Colliers International

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