COLLIERS QUARTERLY

OFFICE | MANILA | RESEARCH | Q3 2020 | 29 OCTOBER 2020

RATIONALIZING THE OFFICE: STRATEGIES FOR LANDLORDS AND OCCUPANTS DURING THE PANDEMIC

Traditional offices remain key accelerators of collaboration and corporate culture as firms rationalize space requirements

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Insights & Recommendations

We continue to see a challenging market. POGOs* have been vacating space while some traditional† and outsourcing firms have either closed shop or are rationalizing their footprint with remote working in the short- to medium term.

Due to the lockdown-induced construction delays, we see 2020 supply dropping by 64% compared to our initial forecast. .

We recommend that landlords: aggressively offer vacated PEZA space to outsourcing tenants and demonstrate the value a traditional office brings to promoting corporate culture and collaboration.

Firms should focus on a longer-term adoption of remote working and hub-and-spoke model to complement their traditional headquarters office set-up.

		Q3 2020	Full Year 2020	2020-24 Annual Average
Demand	> Net absorption turned negative for the second straight quarter as tenants, especially POGOs, return space. We project anemic take-up for the remainder of 2020 and this is likely to persist through H1 2021.	-191,300 sq meter	-121,900 sq meter	582,700 sq meter
Supply	> New office completion in 2020 is likely to drop by 64% compared to our initial estimates. Sluggish pre-leasing and cost-containment measures also compel developers to put projects on hold.	77,700 sq meter	385,000 sq meter	646,800 sq meter

		QOQ/ End Q3	YOY/ End 2020	Annual Average Growth 2019–24 End 2024
Rent	> Existing tenants have been shelving expansion plans and rationalizing office requirements, compelling landlords to lower rates. Hence, Colliers retains its projection of a 17% drop in rents in 2020, before a 2% rise in 2021.	-6.2% PHP907	-17.0% PHP850	-0.0% PHP1,002
Vacancy	> Colliers is revising upward its vacancy forecast. POGOs have been vacating spaces while BPOs have been rationalizing office footprints. Our projected 8.3% vacancy in 2020 is the highest since the GFC†† in 2009.	+2.2pp 7.1%	+4.0pp 8.3%	+0.1pp 5.5%

Source: Colliers International. Note: USD1 to PHP48 as of the end of Q3 2020. 1 square m = 10.76 square ft. *Also known as Philippine Offshore Gaming Operators (POGOs), primarily offshore gaming firms from China. **Also known as Philippine Economic Zone Authority. †Traditional (includes companies in various sectors such as legal, engineering and construction, government agencies and flexible workspace operators), POGO, and outsourcing firms. ††Global Financial Crisis.

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RECOMMENDATIONS

Offer POGO-vacated PEZA space to occupants with immediate requirements

A substantial size of PEZA-proclaimed space has been vacated by offshore gaming firms which are now available for lease to other tenants. As of Q3 2020, these vacated spaces totaled 54,000 sq metres (581,000 sq feet). Some of these spaces were handed over in fully-fitted condition and about 74% are located in the Bay Area, Alabang, Quezon City and Ortigas.

Be mindful of tenants' leasing strategies amid pandemic

Tenants continue to take a wait-and-see stance and look for opportunities to reduce cost and align their lease strategies with long-term business plans while being mindful of the uncertainties in the business environment. Colliers believes that landlords should focus lease negotiations on strategies that support tenants and are responsive to their needs. We see tenants exploring short-term (e.g. six month) lease renewals during this period of uncertainty, complementing traditional offices with remote work models. Meanwhile, the few companies that are still expanding are likely to secure long-term leases and are taking advantage of opportunity to negotiate cheaper rates.

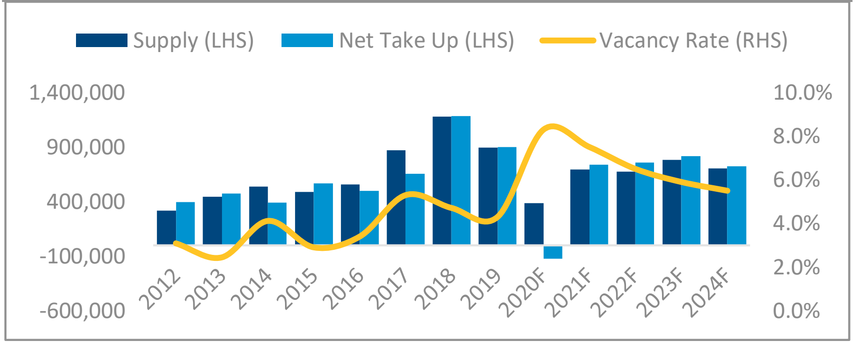
Alternative leasing schemes and expansion sites

While most leasing is momentarily paused, some occupiers are still actively looking for office space, especially those that plan to implement alternative schemes such as a hub-and-spoke model. Colliers encourages landlords to expand their options by offering available office space in non-core locations where tenants can avail themselves of rents about 30% to 50% 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 headquarter location for a more dispersed occupancy strategy.

Aim to achieve stable occupancy and highlight the office's value

Colliers encourages landlords to secure quality tenants especially outsourcing firms that cater to thriving industries such as telecommunications, health information management, and e-commerce. Landlords should also prioritize achieving stable occupancies in their buildings. To achieve this, they should continue highlighting traditional office's crucial role for collaboration and promotion of corporate culture.

Metro Manila office forecast (square m)



Source: Colliers International

PANDEMIC-INDUCED DELAYS

In Q3 2020, Colliers recorded the completion of about 77,700 sq metres (836,100 sq feet) of new supply. Ortigas CBD accounted for 70% of new supply following the completion of Jollibee Tower. Other new office buildings completed during the period were the Prestige Bay Mall in the Bay Area, Sta. Lucia Business Center in Ortigas Fringe and One Oculus Center in Makati fringe. These projects should further intensify competition among landlords in Metro Manila fringe areas.

Due to the lockdown-induced construction delays, Colliers sees new supply in 2020 reaching only 385,000 sq metres (4.1 million sq feet). The easing of lockdown across Metro Manila in mid-August hardly helped buoy construction. The figure represents a 64% decline from our forecast of 1.07 million sq metres (11.5 million sq feet) at the start of 2020. Colliers believes that office buildings that are 50% completed as of H2 2020 are likely to be delayed by about six to 12 months while towers that are less than 50% completed are likely to be delayed by 12 months or longer. We are also likely to see delays in new completion from 2021 to 2024.

[1] Santos, T. [Work permit applications dip 49% as many POGOs shut down](#).

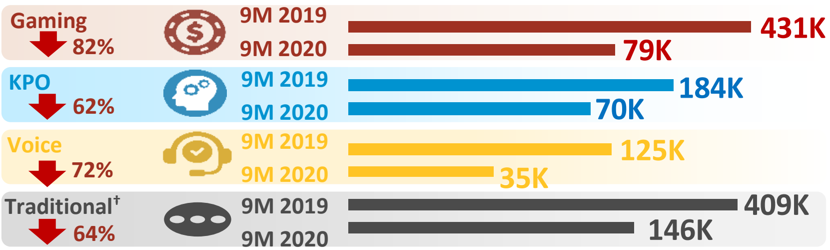
Colliers is seeing developers quickly adjusting to market trends, reminiscent of how they responded during the Global Financial Crisis (GFC). In 2010, supply plunged to about 203,000 sq metres (2.2 million sq feet) from 478,000 sq metres (5.1 million sq feet) in 2008 and 541,800 sq metres (5.8 million sq feet) in 2009.

VACANCY TO DOUBLE IN 2020

Leasing activity continued its downward trend with net take-up turning negative in Q3 2020, or −191,300 sq metres (−2.1 million sq feet). In the first nine months of 2020 we recorded a net take-up of −113,000 sq metres (−1.2 million sq feet), from about 605,600 sq metres (6.5 million sq feet) absorbed in the same period in 2019.

Among the traditional companies that secured space in Q3 2020 were Raemulan Lands Inc., TCL Philippines, BDO Unibank, PAGIBIG as well as others from the financial and insurance, construction and engineering, and telecommunications sectors. These firms took up space in Ortigas CBD, Alabang and Quezon City. Colliers also saw a number of outsourcing firms occupying between 2,000 to 4,000 sq metres (21,500 to 43,000 sq feet) each in Quezon City, Fort Bonifacio, Ortigas Center and Makati CBD.

Metro Manila office transactions:



Source: Colliers International

Vacated office spaces outstripped absorbed offices during the period. The bulk of the returned space in Q3 2020 was in Quezon City, Ortigas CBD and Makati CBD, covering 71% of office space returned to the market. The offshore gaming firms returned a total of 154,000 sq metres (1.7 million sq feet) as of Q3 2020.

Q2 2020 was the first time that we recorded a negative take-up since Q2 2009 or during the Global Financial Crisis (GFC).

Aside from POGOs, Colliers has also observed that traditional and outsourcing occupants contributed to a vacancy increase in the first nine months of 2020. In our view, this is mainly due to traditional firms closing shop due to the pandemic and outsourcing firms rationalizing office requirements as they have started implementing work from home (WFH) schemes. The muted business outlook for the next 12 months, as shown by the central bank's latest survey[2] also does not bode well for the office leasing market.

In our opinion, several tenants are waiting until the pandemic and lockdown issues are settled before they re-engage the market. Hence, Colliers sees a continued slowdown in demand for the remainder of 2020. We now project a net take-up of about − 121,900 sq metres (− 1.3 million sq feet) in 2020. This indicates that the size of office to be vacated this year will likely more than outstrip occupied space. This is a huge turnaround from 899,200 sq metres (9.7 million sq feet) of net take-up in 2019.

SLOW RENTAL RECOVERY

Colliers has observed that landlords have become more flexible in accommodating tenants' requests to lower lease rates. In Q3 2020, selected buildings in Ortigas Center, Makati CBD, and Fort Bonifacio were willing to provide discounts ranging from 6% to 25%. This is higher than the 5% to 15% range we reported in Q2 2020.

Colliers retains its forecast of a 17% average drop in lease rates in 2020. This may even go higher as we may see a further correction in submarkets where there is significant space vacated by POGOs, including the Bay Area, Quezon City, and Makati CBD. Rates are likely to tread a slow path to recovery, which should start with a 2% rise in H2 2021.

Colliers believes that office leasing recovery will primarily hinge on recovery of general business sentiment which should entice local businesses to re-open; and recovery of global economies that outsource services from the Philippines. In our opinion, key segments such as telecommunications, medical coding, health information management, and e-commerce should help lift leasing and hence, rental growth recovery in H2 2021.

[2]Noble, L. *Consumer confidence plummets to record low*.

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