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Rising Vacancy Presents Opportunity

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Vacancies in malls across Metro Manila have continued to rise. Colliers recommends that developers use this situation as an opportunity to improve tenant mix and attract new types of retailer. We believe that the proposed liberalisation of entry of foreign retailers is a step in the right direction as more foreign brands can now enter the food and beverage (F&B) and home furnishing categories which are dominated by local players. Mall operators and retailers should adopt the click-to-brick strategy and start complementing their physical stores with the effective use of online selling and social media platforms. Retailers should consider tapping transportation apps such as Uber and Grab for their deliveries given the worsening traffic in Metro Manila, exacerbated by holiday-induced spending. We believe that more Filipinos will be encouraged to transact online if operators and retailers tighten the security of their online sites, expand the use of mobile wallets, and charge minimal or even waive delivery fees. To boost consumer traffic, we encourage malls to provide more lifestyle amenities and technology-driven customer experiences that generate a sense of destination.

Classification of Retail Formats

CLASSIFICATION	TOTAL GLA (sq m)
Super Regional	100,000 and above
Regional	50,000 to 99,999
District Center	25,000 to 49,999
Neighborhood	Below 25,000

Source: Colliers International Philippines Research

Forecast at a glance

Demand

From 2018 to 2020, Colliers sees food and beverage (F&B) and fast fashion businesses occupying a combined 50% to 60% of new retail space in Metro Manila.

Supply

Colliers projects about 30,000 sq m (322,920 sq ft) of leasable space being completed for the remainder of the year. For 2018 to 2020, we see Metro Manila's retail stock expanding by about 800,000 sq m (8.6 million sq ft), or by more than 250,000 sq m (2.7 million sq ft) annually.

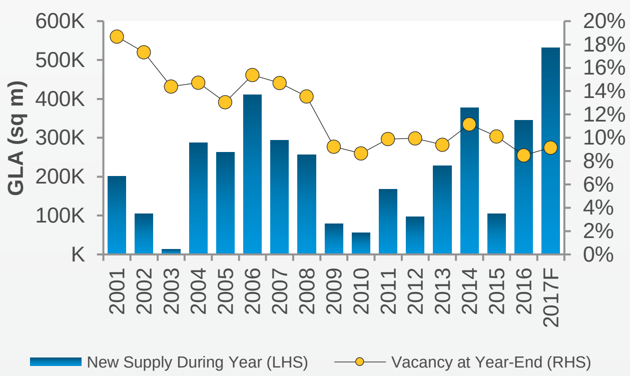
Vacancy

We see vacancies in regional and super-regional malls at around 4% to 9% annually over the next three years. The smaller neighbourhood and district centres will continue to encounter difficulty filling vacant spaces. We see overall vacancy rising to 9% to 10% annually from 2018 to 2020.

Rent

Given the rising vacancy rates and projected new completions, we see slower growth in lease rates over the next three years. We expect rents in Makati CBD and Ortigas Center to grow by only 1% and 2% annually from 2018 to 2020.

Metro Manila Retail Vacancy Forecast



Retail Supply Forecast, GLA (sq m)

CLASSIFICATION	1Q 2017	3Q 2017	%CHANGE (HoH)	3Q 2018F	%CHANGE (YoY)
Super Regional	3,354,900	3,354,900	-	3,554,900	-
Regional	1,321,500	1,427,500	8.02%	1,430,400	0.20%
District Center	1,299,600	1,339,600	3.08%	1,412,500	5.44%
Neighborhood	507,200	507,200	-	609,100	20.1%
Total	6,483,400	6,629,200	2.25%	7,006,900	5.70%

Source: Colliers International Philippines Research

Cashing in on holiday spending

Among the new retail developments that opened from April to September of this year was the 47,000 sq m (506,000 sq ft) Vertis North mall. This had a soft launch in June and will be 85% operational by 4Q 2017, in time for the start of holiday shopping. The mall primarily targets millennials and offers themed retail destinations such as Korea Town, Japan Town, and Urban Turf. The retail outlet will benefit from the construction of Metro Rail Transit (MRT)-7 and the LRT-MRT common station, which the government intends to complete by 2020 and 2019, respectively. The MRT-7 should connect Vertis North mall to a larger fraction of northern Quezon City and San Jose del Monte, a city in Bulacan and about 80 kilometers north of Manila with a population that is growing by 3.6% annually, almost double the national average. The mall complements other developments within the Vertis North estate of Ayala Land such as residential and office towers and a 438-room hotel, currently the largest under the Seda brand.

Newly-Completed Malls, 2Q 2017 to 3Q 2017

Mall	Developer	Location	Type
Vertis North	Ayala Land	Quezon City	District
Festival Mall Expansion	Filinvest Land	Alabang	Regional

Source: Colliers International Philippines Research

Over the past six months, the expansion of Festival Supermall in Alabang was also completed. The retail outlet now offers an additional 46,000 sq m (495,000 sq ft) of leasable space and a 60,000 sq m (646,000 sq ft) Landmark Department Store. The mall remains a key retail destination south of Metro Manila. Decathlon, the world's largest sports retailer, recently opened an outlet in Festival Supermall. This is Decathlon's first outlet in the Philippines.

We see two new Ayala malls opening from November to December 2017. These are Ayala Malls Cloverleaf in Balintawak, Ayala Malls Feliz in Cainta, Rizal, and Ayala Malls Marikina Heights in Marikina.

Two additional Ayala malls are also expected to be completed next year. These are One Bonifacio in Bonifacio Global City (BGC) and Southvale in Alabang.

Malls to be Completed by 4Q 2017

Mall	Developer	Location	Type
Cloverleaf	Ayala Land	Quezon City	District
Feliz	Ayala Land	Rizal	Regional
Marikina Heights	Ayala Land	Marikina	Neighborhood

Source: Colliers International Philippines Research

Other expected completions next year are Blue Wave Mall, Big Apple Mall, and the expansion of Robinsons Galleria, Podium, and Powerplant Mall. Not a single super-regional mall will open next year as most retail projects are composed of smaller formats developed within integrated communities.

Overall vacancy in Metro Manila rose from 7.3% in 1Q 2017 to 8.6% in 3Q 2017. The vacancy in super-regional malls, which account for about half of outlets in Metro Manila, was almost stable, rising from 3.7% to 3.9%. Regional malls' vacancy increased marginally from 8.2% to 8.4%. The vacancy of smaller outlets such as neighbourhood and district centres surged to 12% and 19%, respectively, effectively pushing the overall Metro Manila vacancy up.

We attribute the increase in vacancy to the continued closure of a number of US-based fashion shops as well as the persistent difficulty in filling retail space in smaller retail outlets. Some district and neighbourhood malls continue to record high vacancies despite being completed more than half a year ago.

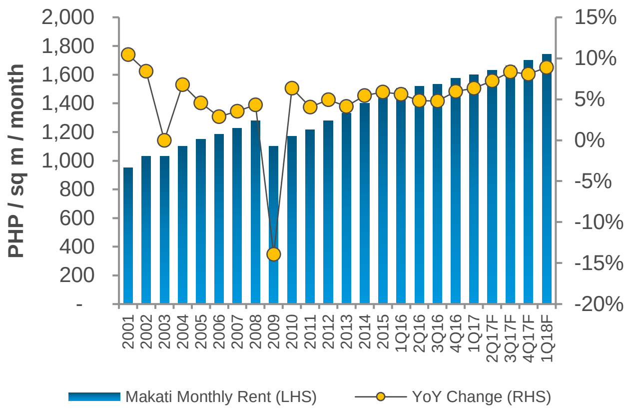
Colliers expects the overall vacancy in Metro Manila to rise to about 9% by the end of the year following the completion of close to 30,000 sq m (322,920 sq ft) of additional leasable space in 4Q 2017. From 2018 to 2020, we expect the delivery of more than 800,000 sq m (8.6 million sq ft) of new space. Among the expected completions over the next three years are SM Mall of Asia expansion, Arca South Mall in the former FTI property in Taguig, and Aseana Mall.

The three malls are projected to raise Metro Manila retail stock by 500,000 sq m (5.4 million sq ft), accounting for 8% of the current stock. Given the projected additional supply we see overall vacancy hovering between 9% to 10% annually from 2018 to 2020.

Rental rate growth slows

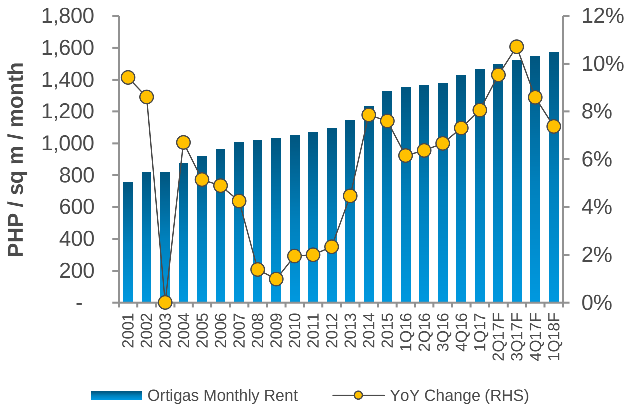
Growth of retail lease rates slowed down following the increase in vacancies across Metro Manila. Ayala Center rental rates averaged PHP1,580 (USD31.6) per sq m a month in 1Q2017, up by a slower 1.4% HoH. Meanwhile, average lease rates in Ortigas Center reached PHP1,400 (USD28) per sq m a month, up by only 0.7% compared to 1Q2017 rates.

Makati Monthly Retail Rents



Source: Colliers International Philippines Research

Ortigas Monthly Retail Rents



Source: Colliers International Philippines Research

We still expect lease rates to increase over the next two to three years, albeit at a slower pace. Colliers sees rental rates in Ayala Center and Ortigas Center growing by only 1% and 2% annually from 2018 to 2020 given the substantial amount of leasable space that will be completed over the next three years.

Testy US retail setting persists

The most recent US retailer to file for bankruptcy is Toys 'R' Us. Despite this, the local franchisee has assured its customers that its 78 outlets will remain open. Toys 'R' Us Philippines is even rolling out five new stores annually over the next five years.

However, we see the precarious retail landscape in the United States as affecting the operations of US retailers' Philippine franchises in the long run. We see the US-based retailers' filing for bankruptcy as diminishing the ability of their Philippine operators to provide discounts and offer a wider array of inventory.

This early, Toys 'R' Us Philippines, and other local and foreign retailers, are attempting to protect their businesses against future challenges by utilising online selling platforms and opening new outlets in emerging retail hubs outside of Metro Manila

Bricks complement clicks

Unlike the United States and other Western economies where brick-and mortar businesses close 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. This is the reason why developers and retailers 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 should tap.

Despite the growing acceptance of online shopping in the country, only 3.5% of Filipino adults make purchases online according to World Bank Global Financial Index; only 2.2% use a credit card to make payments; while a mere 4.2% have mobile accounts. 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.

Operators and retailers should 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.

Operators trying to develop their online shops should consider giving priority to clothing and accessories as these are the most visited categories according to a Mastercard Online Shopping Survey.

Online supermarkets, which cater to working mothers and highly mobile millennial consumers, are the second-most visited segments.

We expect online shopping to thrive over the near to medium term given the private telecommunications firms' efforts to improve internet connectivity in the country and the government's rolling out of free internet in public places.

Vacancy to improve tenancy

Colliers also sees retail offerings in brick-and-mortar malls becoming more generic. In fact, two retail hubs in Makati CBD that are only about ten-minute walk apart are being anchored by the same fast fashion brand.

With increasingly generic retail offerings, we encourage operators to select retailers carefully and to improve tenant mix. We believe that developers should aim to achieve a more lifestyle-based tenant mix to survive in a highly competitive retail landscape. The rising vacancy rates should be used by developers as an opportunity to overhaul their retail offerings.

We also recommend that retailers complement their online businesses by firming up partnerships with logistics and warehousing firms. This will enable retailers to effectively carry out deliveries in far-flung areas and to complement their physical stores in the provinces.

With adequate online shopping and logistics services, mall operators are able to empower Filipinos working in Metro Manila and overseas to shop online and have their family members pick up their groceries in physical stores nearest to them.

Physical and online stores can also complement each other during holiday sales. The typically heavy traffic within Metro Manila is exacerbated by the holiday shopping rush, prompting some consumers to stay at home and purchase items online. Brick-and-mortar malls can maximise their partnership with e-commerce sites by offering their discounted items online.

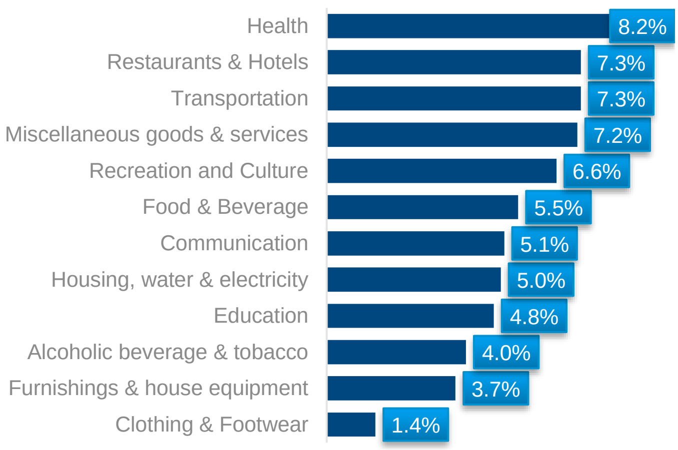
Sustained spending indicators support holiday spending

We expect stronger retail sales for the fourth quarter of the year as robust holiday shopping is supported by stable spending indicators.

The Philippine Statistics Authority (PSA) noted that household spending rose 5.9% in 2Q 2017, slower than the 7.5% growth recorded in the same period in 2016 primarily due to the absence of election-related spending and the slight rise in inflation (3.1% in 2Q 2017 from 1.5% a year ago). Among the major contributors to household spending's growth in 2Q 2017 were restaurants and hotels (+11.4%), education (+8.7%), and food and non-alcoholic beverages (+6%). Clothing and footwear recovered slightly (+1.1%) owing to a low base (-2.1%) in 2Q 2016.

From 2009 to 2016, consumer spending in the country was primarily driven by health and restaurants and hotels, growing by an average of 8.2% and 7.3%, respectively. Recreation and culture (+6.6%) and F&B (+5.5%) were also key drivers. Clothing and footwear grew by only 1.4% per annum during the period, indicating a slowdown in Filipinos' spending for apparel.

CAGR of Consumer Spending (2009-2016)



Source: Philippine Statistics Authority

Other indicators point to strong household spending for the rest of the year with the Philippine central bank projecting Overseas Filipino Workers (OFW) remittances to rise by at least 4% this year to an estimated USD31 billion and annual inflation rate still expected to hover within the central bank's projection of 2-4%. OFW remittances for the first eight months reached USD20.7 billion, up 6.4% YoY. Inflation peaked at 3.1% during the period, higher than the 1.5% posted last year but still within the central bank's projection for the year.

Per capita GDP, a proxy for individual income, grew by 5% in 2Q 2017. Per capita incomes have been growing by 4.6% annually since 2010.

Lower income taxes, greater purchasing power

The first package of the proposed tax reform programme covers the reduction of income tax rates and this should raise Filipinos' per capita incomes and purchasing power. According to the Finance Department, households earning a combined monthly income of PHP13,000 to PHP40,000 (USD255 to USD784) will raise their disposable incomes by PHP1,100 to PHP3,500 (USD21.6 to USD68.6) per month. The bill passed by the Senate also exempts employees earning less than PHP150,000 (USD2,940) a year from paying taxes. The new tax rates are expected to be enacted by the start of next year. The higher take home pay should raise households' purchasing power, resulting in the expansion of Metro Manila's consumer base.

More foreign retailers through liberalized trade

The government has said it will reduce the minimum paid up capital required for foreign retailers to open shop in the country to USD200,000 from USD2.5 million. This will take effect once the government releases the next Foreign Investment Negative List (FINL) by the end of the year. The FINL specifies the investment areas restricted to foreigners.

The government's move should enable the entry of more foreign retailers especially those into F&B and home furnishing as these are the two segments still dominated by local players.

The F&B mix in Metro Manilla should become more interesting especially after the entry of foreign brands such as Denny's Diner, Paradise Dynasty, Wolfgang's Steakhouse, Harry's, Pink's Hotdogs, and Olivia & Co. Sarabeth's, a popular bakery from New York is reportedly opening a branch in the country's capital while Wolfgang's is said to be keen on opening two additional outlets.

Local and Foreign Retail Mix

Item	Local	Foreign
Apparel	49%	51%
Shoes	33%	67%
Bags and Luggage	57%	43%
Sporting Goods	45%	55%
Jewellery, Watches, and Accessories	75%	25%
Health and Beauty	51%	49%
Home Furnishing	92%	8%
Food and Beverage	67%	33%

Source: Colliers International Philippines

Meanwhile, the Board of Investments (BoI) has approved the application of global home furnishing giant IKEA to enter the Philippine market. The firm will be competing against foreign retailers such as Pottery Barn, West Elm, Crate and Barrel, and H & M Home as well as homegrown brands such as SM's Our Home and Vista Mall's AllHome.

We see a sustained demand for home furnishing given the increasing acceptance of condominium living in Metro Manila and other major urban hubs across the country. The demand will also be driven by the growing appetite for worker housing facilities in business districts across Metro Manila.

We encourage foreign retailers planning to enter the Philippine retail market to zero in on the thriving F&B and home furnishing opportunities. Home furniture investors should focus on smaller residential cuts as about 70% of projects launched today are composed of studio and one-bedroom units.

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