OUTSOURCING BOUNCES BACK

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Summary & Recommendations

The Metro Manila office market is on track to posting record-high supply and net take up for 2018. Outsourcing firms continue to expand and account for the largest share of transactions.

Colliers encourages developers to provide flexible office floor cuts, implement creative leasing schemes, and offer non-Philippine Economic Zone Authority (PEZA) proclaimed buildings to offshore gaming firms.

Meanwhile, tenants that need to occupy space in the next 12 to 24 months should start pre-leasing and locking in rates in Ortigas Center, while Knowledge Process Outsourcing (KPO) and multinational corporations should consider office space in Fort Bonifacio that will likely be vacated from 4Q2018 to 2019.

		Q3 2018	Full Year 2018	2018–2021E Annual Average
Demand	> Colliers projects net take-up of 344,000 sq m (3.7mn sq ft) in 4Q 2018. This should raise net absorption in 2018 to 1.15mn sq m (12.4mn sq ft). We see annual net take-up of 800,000 sq m (8.6mn sq ft) from 2019 to 2021.	148,000 sq m	1.15mn sq m	800,000 sq m
Supply	> We project the completion of 310,000 sq m (3.37mn sq ft) of leasable space in 4Q 2018, bringing 2018 new supply to 1.18mn sq m (11.9mn sq ft). From 2019 to 2021, Colliers expects the completion of 2.66mn sq m (28.6mn sq ft) of new leasable space or 890,000 sq m (9.6mn sq ft) annually.	144,000 sq m	1.18mn sq m	890,000 sq m

		End Q3/QOQ	End 2018/YOY	End 2021/ Annual Average Growth 2018–21
Rent	> From 2019 to 2021, Colliers expects average rents across Metro Manila to rise by 9% annually on average. We see Ortigas Center and the Bay Area recording the fastest acceleration in rents during the period.	2.6% PHP928	9.2% PHP942	9% PHP1,220
Vacancy	> Colliers is projecting Metro Manila office vacancy to reach 5% by end 2018. From 2019 to 2021, we expect a year-end vacancy of between 5.3% and 5.9%, in line with our earlier projections.	-0.1pp 4.8%	-0.3pp 5.0%	0.3pp 5.9%

Source: Colliers International
Note: USD1 to PHP54 as of end-Q3. 1 sq m = 10.76 sq ft

RECOMMENDATIONS

In light of the current market, Colliers recommends:

Providing flexibility in terms of office floor cuts

Colliers encourages developers to be flexible with their projects and provide more room for tenants' future requirements as tenants initially acquire smaller office space cuts and expand as their operations grow. In the first three quarters of 2018, outsourcing and non-BPO tenants occupied spaces ranging from 100 to 500 sq m (1,080 sq ft to 5,380 sq ft). Non-BPOs, particularly, occupied an average of 700 sq m (7,530 sq ft) during the period.

More creative leasing schemes

Colliers believes that developers should be more creative with their lease models and provide perks especially to high-value tenants. Developers, for instance, should consider providing free exclusive lounge access to their tenants' C-level executives. We also encourage developers to provide a limited time concession rate for long-term, high-profile occupants. These MNCs and private equity firms should improve the tenant mix and branding positioning of developers – factors that could play a role in raising capital values in case the developer decides to sell parts of its tower in the future.

Strike while the iron is hot

Several towers applying for PEZA approval are still experiencing delays. Being a PEZA-proclaimed building enables developers to grant tax and non-tax incentives to PEZA-accredited tenants. Given the delay in PEZA proclamation and the relentless expansion of offshore gaming companies, Colliers encourages developers to be more accommodating to these firms looking for additional office space in the country's capital.

Lock in rates and available space in Ortigas Center

From 2019 to 2021, Colliers sees the completion of new office towers in Ortigas Center pushing lease rates up by about 10% from current levels. Hence, we encourage firms to start pre-committing to office space and locking in rates in new buildings planned to come online during the period.

KPOs and MNCs to look at Fort Bonifacio options

KPOs and multinational companies including private equity firms with immediate office space requirements should consider office space in Fort Bonifacio that is being be vacated from 4Q 2018 to 2019. We expect a number of large tenants to transfer to newer buildings in Fort Bonifacio from 2019 to 2021.

OFFICE SECTOR ON TRACK, TAKE-UP POSTS MORE THAN DOUBLE GROWTH IN 2017

Overall demand remains strong as Colliers has already recorded 810,000 sq metres (8.72 million sq ft) of net take-up for the first three quarters of 2018. This is more than double the 370,000 sq metres (3.98 million sq ft) posted in the same period in 2017. Given the current market conditions and sustained pre-leasing, Colliers projects a net take up of 344,000 sq metres (3.70 million sq ft) in 4Q2018 which should bring 2018 net absorption to 1.15 million sq metres (12.4 million sq ft). This is higher than our earlier projection of 1.06 million sq m (11.4 million sq ft). The 2018 figure will likely be the highest net take up in Metro Manila's history.

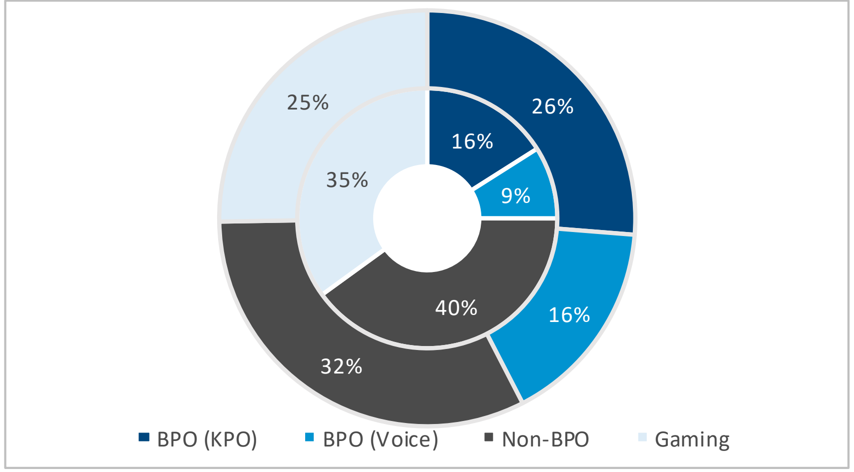
Strong pre-leasing activities indicate that robust demand will probably be carried over to 2019. Colliers estimates that 22% of office space projected to be completed over the next 12 months has been pre-committed.

OUTSOURCING DEMAND DOMINATES

For the first three quarters of 2018, demand from both KPO and BPO (voice) companies accounted for the largest share of total transactions, accounting for a combined 42% or nearly 480,000 sq metres (5.17 million sq ft).

The major deals closed during the first three quarters of 2018 involved Paypal, SMS Global Solutions, Alliance IT, Alorica, Accenture, Teledirect, SPi CRM, Infor, and Google. We have noted sustained inquiries from new and existing outsourcing companies. Hence, we see outsourcing demand dominating other sectors over the next 12 to 18 months.

Breakdown of Office Transactions 2017 (Inner Circle) vs YTD 2018 (Outer Circle)



Source: Colliers International Philippines

OFFSHORE GAMING TAKE-UP CONTINUES...

Offshore gaming firms continue to occupy space in the country's capital, with 280,000 sq metres (3.01 million sq ft) of transactions recorded during the first three quarters of the year. This represents 25% of all deals in Metro Manila. A combined two-thirds of the transactions were closed in Alabang, the Bay Area, and Makati CBD. We see these locations becoming key hubs for offshore gaming operations over the next 12 months although we project other submarkets such as Quezon City and Ortigas fringe attracting offshore gaming companies in the next one to two years.

... AS NON-BPO TAKE UP SUSTAINS PACE

Demand from non-outsourcing firms remains strong, accounting for nearly a third of total transactions. Among the companies that occupied space during the period are those providing engineering, pharmaceutical, advertising, online lending, construction, and insurance services. These include Kobayashi Pharmaceutical, Petrochem, Wells Fargo, LBC, National Tobacco Administration, Cashalo, and Daikin. The demand from non-outsourcing firms should partly be driven by a stable Philippine economy which the Development Budget Coordination Committee (DBCC), composed of the country's economic managers which head the departments of Finance, Trade, Budget and Management, and Socioeconomic planning, is forecasting economic growth of 6.5% to 6.9% this year and 7% to 8% per year from 2019 to 2022.

BUILDING COMPLETIONS ON SCHEDULE

In 3Q2018, Fort Bonifacio accounted for 65% of new office supply in Metro Manila following the completion of 10 West Campus (35,700 sq metres or 384,300 sq ft) and the Finance Center (56,900 sq metres or 612,500 sq ft). Meanwhile, Manila Bay covered 14% of the new supply with the delivery of Filinvest Pasay Cyberzone Tower 4 (D). Luz Building added 5,100 sq metres (53,800 sq ft) to Makati CBD stock while a planned 13,000 sq metres (139,900 sq ft) was completed in the fringes of Ortigas Center with the completion of G Business Hub and Global Link.

For the first three quarters of 2018 nearly 800,000 sq metres (8.61 million sq ft) of new leasable space has been completed. Colliers is projecting the delivery of an estimated 380,000 sq metres (4.09 million sq ft) in 4Q2018, bringing 2018 total to 1.18 million sq metres (12.7 million sq ft). This is 14% higher than Manila's stock in 2017.

EXPANDING SUPPLY OUTSIDE CBDS

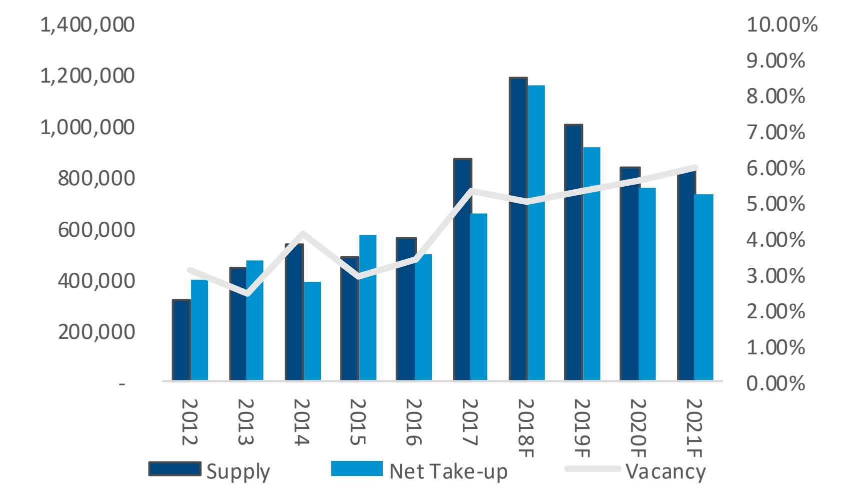
Due to a lack of developable land and surging land prices in major business hubs such as Makati CBD, office space development has been more pronounced in the fringe locations.

In 3Q 2018, office space completion along the fringes of Makati and Ortigas has grown by 45% and 28%, respectively, compared to the same period in 2017. The strong demand coupled with a dearth of developable land is benefitting the Bay Area, with the reclaimed CBD posting the fastest increase in supply as of 3Q 2018, at 80% YoY.

HEALTHY PIPELINE

From 2019 to 2021, Colliers estimates the completion of about 2.66 million sq metres (28.6 million sq ft) of new leasable space or 890,000 annually. Ortigas Center is scheduled to account for 24% of the new stock due to be completed during the period followed by Fort Bonifacio (17%), Manila Bay (16%), Quezon City (15%) and Makati CBD (10%).

Metro Manila Office Vacancy Forecast (sq m)



Source: Colliers International Philippines

METRO MANILA VACANCY AT BELOW-5%

Overall office vacancy across Metro Manila was stable at 4.8% in 3Q2018 from 4.9% in 2Q2018. We recorded a slight increase in Fort Bonifacio and Bay Area vacancies due to the delivery of new buildings while vacancy in other sub-markets such as Ortigas Center and Fringe and Alabang declined.

Colliers is projecting Metro Manila office vacancy to reach 5% by end 2018 as we see demand moving in step with supply. Despite the projected record high completion of 1.18 million sq m (11.9 million sq ft) in 2018, we estimate demand to reach 1.15 million sq m (12.4 million sq ft), another historical high. Hence, we do not see a substantial change in vacancy by the end of 2018.

Overall, we project supply to reach 890,000 sq metres (9.6 million sq ft) per annum from 2019 to 2021 but we see this being matched by a yearly net take up of 800,000 sq metres (8.72 million sq ft) resulting in a year-end vacancy rate 5.3% to 5.9% during the period, still in line with our earlier projections.

RENTS CONTINUE TO RISE

Prime and Grade A office space in the Makati CBD and Fort Bonifacio continue to command the most expensive lease rates, ranging from PHP900 (USD16.67) per sq m to PHP1,750 (USD32.4) per sq m as of 3Q2018. The rates are about 13% to 19% higher YOY. From 2019 to 2021, Colliers projects average rents across Metro Manila to rise by about 9% per annum on average as we project a tight market during the period.

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