RECOVERY LIKELY IN 2021 AS TENANTS WAIT AND SEE

Landlords and tenants recalibrate amid market uncertainties due to pandemic and lockdown

Joey Roi Bondoc
Senior Manager | Research | Philippines
+63 2 8858 9057
Joey.Bondoc@colliers.com

Dom Fredrick Andaya
Director | Office Services | Philippines
+63 917 831 6725
Dom.Andaya@colliers.com

Insights & Recommendations

We continue to see less office take up as occupants shelve leasing plans. Colliers sees a substantial drop in POGO* deals but we expect tenants that cater to essential needs such as healthcare leading take-up starting H2 2020.

Limited manpower and anti-pandemic measures continue to slow construction. We see limited new office supply helping limit the rise in vacancy and decline in rents.

Colliers recommends developers proactively engage existing tenants and be creative in structuring deals for those who continue to look for new office space due to expansions, relocations, and consolidations. We recommend both landlords and tenants to actively push for approval of more PEZA** spaces.

		Q2 2020	Full Year 2020	2020-24 Annual Average
Demand	> Over the next 12 months, we see occupants providing essential services leading office absorption while some outsourcing firms might opt for plug-and-play offices for their immediate space requirements.	▼ -46,200 square m	▼ 385,700 square m	▼ 668,700 square m
Supply	> Manpower shortages and strict construction guidelines are likely to further delay building completions. With subdued pre-leasing, we are seeing towers in early planning stages being put on hold or delayed.	▲ 57,500 square m	▼ 532,600 square m	▼ 721,400 square m

		QOQ/ End Q2	YOY/ End 2020	Annual Average Growth 2019–24 End 2024
Rent	> Subdued leasing, as well as early lease terminations, have created a supply and demand imbalance. Colliers is projecting average lease rates to drop by 17% in 2020, before a slow recovery to start in Q1 2021.	-6.0% ▼ PHP968	-17.0% ▼ PHP850	-0.0% ▼ PHP1,002
Vacancy	> Colliers sees vacancy rising in 2020 due to weak demand and a cautious market. However, we are slightly revising our forecast as office construction delays should help keep vacancy rates in check.	+0.8pp ▲ 4.9%	+1.0pp ▲ 5.3%	+0.1pp ▲ 5.0%

Source: Colliers International. Note: USD1 to PHP50 as of the end of Q2 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 ***Also known as Central Business Districts (CBD). †Traditional (includes companies in various sectors such as legal, engineering and construction, government agencies and flexible workspace operators), POGO, and outsourcing firms.

Colliers INTERNATIONAL

RECOMMENDATIONS

Be more accommodating to non-POGO occupants

In our view, landlords should be more accommodating to non-POGO occupants, especially with our projected slow take-up from Chinese offshore gaming firms in 2020. Colliers believes that landlords should offer extended fit-out periods and handover dates for new leases affected by the government-imposed lockdown. Landlords should also consider offering payment term concessions for tenants.

Take advantage of a partial shift to a tenant's market

Colliers believes that companies needing space this year should take advantage of their bargaining power and the propensity of landlords to be more accommodating with new leases. Pre-pandemic and lockdown, the Metro Manila office market tended to be landlord-favourable due to low vacancy rates and diversified tenancy. In our opinion, outsourcing firms and services firms that are continuing to expand during the pandemic, such as those from technology, telecommunications, and health information management industries, should take a moment to assess their space requirements and take advantage of the current rental correction.

Diverse, non-core options for tenants

Colliers encourages landlords to expand their options by offering available office space in non-core locations where rental rates are about 20-30% cheaper compared to major business districts. In H1 2020, Quezon City, for instance, has become an attractive option for cost-conscious traditional firms. In our opinion, fringe locations are likely to become more attractive for outsourcing as traditional firms scout for cheaper options in the market. Tenants with immediate requirements who planned to implement a split-office strategy can also consider available plug-and-play or fitted spaces.

More PEZA space to prop up outsourcing expansion

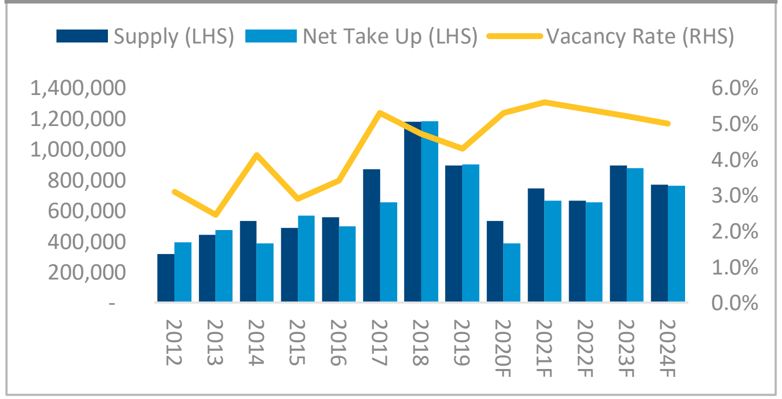
Colliers believes that the government should continue approving PEZA space across Metro Manila to entice more incentive-seeking outsourcing companies to occupy space. In H1 2020, Colliers recorded about 44,400 square metres (477,700 square feet) of PEZA space take-up. We see more aggressive absorption in the next 12 to 24 months as tenants take advantage of available space in the market. From 2021 to 2024, we only project about 1.12 million square metres (12.0 million square feet) of new PEZA supply in Metro Manila. Meanwhile, companies that are planning to expand their footprint outside of the capital region should consider areas with substantial PEZA space available. These include Pampanga, Cebu, Iloilo, and Davao.

SUPPLY BACK TO PRE-POGO LEVEL

As we mentioned in our Q1 2020 report, the lockdown's impact on new office supply will likely be felt starting Q2 2020 with only one building – Exquadra in Ortigas Center – being completed in the period. Factors including manpower shortage, physical and other anti-COVID measures implemented in construction sites, slow pre-commitment of some buildings, and developers' cost-cutting measures are all likely to cause delays in office completion in 2020. Buildings that were already in advanced phases of construction as of Q1 2020 are now delayed by at least two quarters from their original delivery dates.

Colliers is further reducing our new supply forecast for 2020 – from 784,700 square metres (8.4 million square feet) to only about 532,600 square metres (5.7 million square feet). This revised figure is only 50% of our initial estimate of 1.07 million square metres (11.5 million square feet) in 2020. It is also the slowest completion dating back to Q3 2015, prior to the entry of POGOs.

Metro Manila office forecast (square m)



Source: Colliers International

Colliers attributes the delayed completion to slower pre-leasing from both POGOs and outsourcing firms. While some outsourcing firms are still taking up space as they maximize the available PEZA space in Metro Manila, the reduced take-up is much more pronounced in the POGO segment due to the pandemic and travel restrictions. Note that developers previously ramped up office delivery due to strong pre-leasing from POGOs. Some developers in the Bay Area expedited completions to capture the offshore gaming demand.

Those that are still in the early planning stages may be put on hold or delayed altogether as numerous developers have announced significant reductions in capital expenditure.

VACANCY TO RISE IN 2020

Colliers recorded a 4.9% vacancy in Q2 2020, the highest vacancy recorded since Q3 2019. In our view, this is a result of slower leasing from all segments and a rise in vacated spaces. We only recorded about 261,100 square metres (2.8 million square feet) in transactions in H1 2020, which is 64% lower compared to the 730,000 square metres (7.9 million square feet) posted in the same period in 2019. From 228,100 square metres (2.5 million square feet) of transactions in Q1 2020, a mere 33,000 square metres (355,100 square feet) was added in Q2 2020. Among the firms that took up space were Mundipharma and flexible workspace operators Work.Able and Compass.

In the next 12 to 24 months, Colliers sees higher-value KPO[1] firms absorbing most of the available PEZA space in Metro Manila. With only about 139,100 square metres (1.5 million square feet) of available PEZA space in the capital region from 2020 to 2022, we expect more aggressive take-up of new space to spill over to the Bay Area, Ortigas CBD, Alabang and Makati CBD during this period.

Another trend we are likely to see for the remainder of 2020 is greater take-up in fringe, non-core locations such as Quezon City, by traditional occupants. Major outsourcing occupiers are likely to expand into non-core locations to minimize costs, given uncertainties in the market. Some firms with immediate requirements are likely to occupy plug-and-play or fitted offices.

Our new supply projections have fallen to about 532,600 square metres (5.7 million square feet) and we expect this to hold down vacancy rates in Metro Manila. We now see Metro Manila vacancy increasing to only 5.3% in 2020, compared to our initial estimate of 5.5% reported in Q1 2020.

[1]Knowledge Process Outsourcing

RENTS TO PICK UP PACE IN 2021

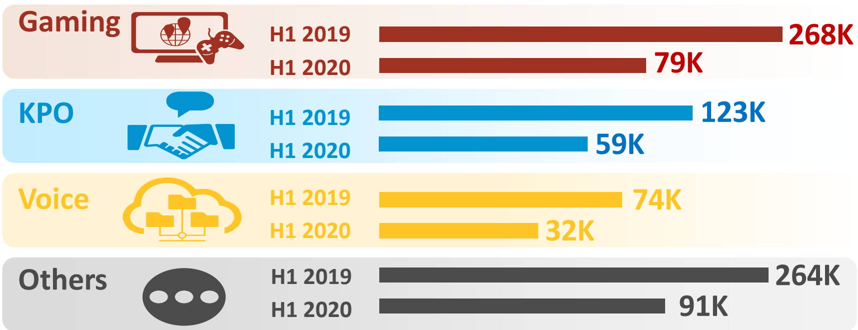
Landlords have expressed a willingness to be more flexible in accommodating new leases in order to boost the occupancy in their buildings. With a general slowdown in leasing activity all over Metro Manila following reduced space demand from POGO, outsourcing and traditional firms, coupled with willingness 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.

We see further correction in submarkets where there is large upcoming supply and where new space mainly targets POGO firms. The vacant space is likely to be offered to non-POGO tenants at a 20-30% discount.

Data from the Philippine Statistics Authority (PSA) showed that the Philippine economy contracted by 0.2% in Q1 2020, ending 84 consecutive quarters of growth. The Philippine central bank, along with other government agencies and foreign credit rating firms, is projecting the country's economy to contract by 1.0 to 4.5% in 2020. The last time the Philippine economy contracted, in 1998, office lease rates dropped by 16%.

However, an upside is that the central bank is projecting some form of economic recovery starting in Q4 2020. This should also be supported by the expansion of outsourcing firms to comply with the government's social distancing protocols. This should support growth in office leasing in the next six to 18 months and should result in a 2% growth in rents starting 2021.

Metro Manila office transactions:



Source: Colliers International

Primary Authors:

Joey Roi Bondoc
Senior Manager | Research | Philippines
+63 2 8858 9057
Joey.Bondoc@colliers.com

Dom Fredrick Andaya
Director | Office Services | Philippines
+63 917 831 6725
Dom.Andaya@colliers.com

Contributors:

Donica Cuenca
Research Analyst | Research | Philippines
+63 2 8858 9068
Donica.Cuenca@colliers.com

Martin Aguila
Research Analyst | Research | Philippines
+63 2 8863 4116
Martin.Aguila@colliers.com

For further information, please contact:

David A. Young
Chief Operating Officer | Philippines
+63 2 8858 9009
David.A.Young@colliers.com

Richard Raymundo
Managing Director | Philippines
+63 2 8858 9028
Richard.Raymundo@colliers.com