HOW LANDLORDS & TENANTS SHOULD REPOSITION POST-PANDEMIC

Opportunities for Metro Manila office stakeholders as market recovers post-COVID19

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Insights & Recommendations

Colliers sees higher office vacancy in 2020 due to a slowdown in leasing activities following the adverse impacts of the pandemic and lockdown in Luzon. Economic analysts[1] and the head of the Philippine central bank are expecting a recovery in 2021 and this should support expansion of business activities and leasing deals.

Colliers recommends that landlords highlight their property management capabilities; proactively attract non-POGOs* and work with existing and potential tenants in providing flexible lease terms.

Meanwhile, tenants should adopt modern technology and a flex and core strategy; revisit business continuity plans; and revisit CBD** buildings that may now offer more flexible terms.

		Q1 2020	Full Year 2020	2020-22 Annual Average
Demand	> Less inspection activity should result in lower take-up in H1 2020. Assuming market sentiment improves in H2 2020, Colliers sees demand from traditional† and outsourcing tenants recovering sharply in 2021.	116,100 sq m	594,000 sq m	852,700 sq m
Supply	> Work stoppage due to the lockdown is likely to push back completions by around one to two quarters. New supply will likely start rebounding in 2021, partly including the deferred completions in 2020.	93,500 sq m	784,700 sq m	896,100 sq m

		QOQ/ End Q1	YOY/ End 2020	Annual Average Growth 2019–22/ End 2022
Rent	> With the rise in vacancy, Colliers sees the office market shifting to a tenants' market. With greater leeway for rent negotiation and concessions, we see rent declining in 2020 before recovering in 2021.	+0.5% PHP1,029	-17.0% PHP850	-3.3% PHP910
Vacancy	> Colliers sees vacancy rising in 2020 due to sluggish leasing all over Metro Manila. The rise is likely to be tempered by less supply this year but vacancy is likely to drop in 2021 due to a sharp rise in demand.	-0.2pp 4.1%	+1.2pp 5.5%	+0.0pp 4.4%

Source: Colliers International. Note: USD1 to PHP51 as of the end of Q1 2020. 1 sq m = 10.76 sq ft. *Also known as Philippine Offshore Gaming Operators (POGOs), primarily offshore gaming firms from China. **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. [1]*Padin, M. Government to boost infrastructure spending to cushion COVID impact*.

RECOMMENDATIONS

Work with existing tenants to provide flexible lease terms

With work stoppage in traditional offices and partial operations in most outsourcing companies, Colliers encourages landlords to provide short-term relief measures to occupiers such as deferment of rent covering the enhanced community quarantine (ECQ) period. This is particularly important for micro, small, and medium enterprises (MSMEs) that have been hit the hardest.

Maximize wellness features and property management capabilities

Colliers believes that landlords should maximize wellness features of their buildings and prioritize wellness certifications such as Leadership in Energy and Environmental Design (LEED) and WELL building standards. LEED buildings will likely account for 30% of new office supply from 2020 to 2022. Landlords should also be more discerning with design considerations (e.g. proper air circulation, more office space for employees, and glass ratio for natural sunlight) and strengthen property management capabilities including sanitation (e.g. implementation of measures to avoid transmission) and emergency preparedness.

Adopt new technology and consider flex-and-core strategy

The government's directive to implement alternative work schemes such as work-from-home should encourage occupiers to accelerate the adoption of modern technology. In our opinion, firms should effectively communicate cloud computing strategies to their employees to minimize disruption from the abrupt switch to remote working. Tenants should also consider implementing a flex-and-core strategy or a mix of traditional and flexible workspaces. Colliers believes that remote work provides an opportunity for tenants to re-examine office space demand.

Push for relaxation of government policies

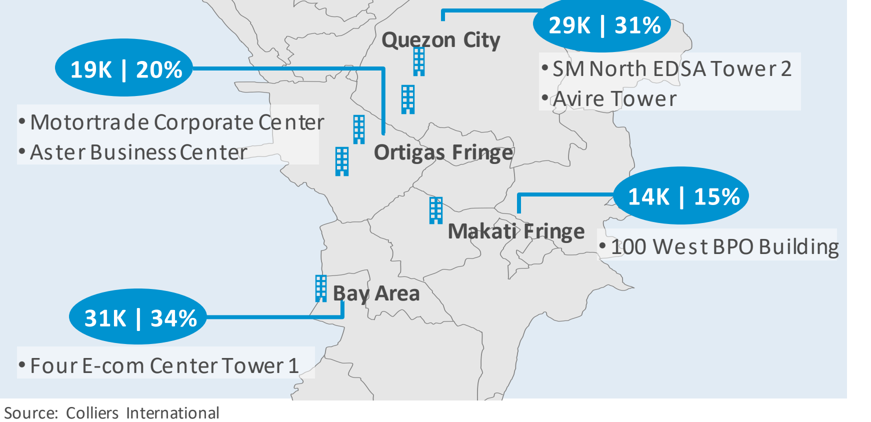
With the slower demand, stakeholders should push for policy concession from national and local governments. Stakeholders should now push for the lifting of moratorium on economic zone approval in Metro Manila to entice more outsourcing locators; urge Congress to delay passage of proposed bills that intend to reduce incentives granted to ecozone locators; and heed recommendations pushed for by industry groups such as the Information Technology and Business Process Association of the Philippines (IBPAP) including the adoption of split operations for BPOs. In our opinion, POGO stakeholders should also encourage certain city governments to allow the entry of new POGO firms into their respective localities.

SUPPLY TO REBOUND IN 2021

In Q1 2020, Metro Manila's office supply increased by only about 93,500 sq metres (1 million sq feet), bringing total office supply in the capital region to about 12.0 million sq metres (129 million sq feet). This is the lowest office completion recorded since Q3 2015. The full impact of the ECQ on supply will likely be felt in Q2 2020.

Colliers believes that the work stoppage due to the ECQ and supply chain disruption of construction materials are likely to affect office completions in 2020. From our initial forecast of about 1 million sq metres (10.8 million sq feet), we now project new supply to reach 784,700 sq metres (8.4 million sq feet). With completion being pushed back by about three to six months, Colliers now estimates annual new completion from 2020 to 2022 to reach 896,100 sq metres (9.6 million sq feet) from our original forecast of about 977,800 sq metres (10.5 million sq feet).

Q1 2020 new supply and % of total new supply



Source: Colliers International

VACANCY TO RISE IN 2020, UP FOR RECOVERY IN 2021

Colliers saw vacancy declining to 4.1% in Q1 2020 from 4.3% recorded in Q4 2019. This is partly due to a lower supply recorded in Q1 2020, about 93,200 sq metres (1 million sq feet) against a net take-up of 116,100 sq metres (1.2 millon sq feet). In our opinion, we are likely to see the full effect of the ECQ and the pandemic for the remainder of 2020. The pace of construction after the ECQ will also likely depend on how developers observe social distancing in construction sites.

In Q1 2020, office space transactions, which cover pre-leased spaces, reached 241,000 sq metres (2.6 million sq feet), down 24% from 316,200 sq metres (3.4 million sq feet) recorded in Q1 2019. A mix of traditional, flexible workspace operators and outsourcing tenants took up space during the period, including Sykes, Grab Philippines, Bank of Singapore and Accenture. Transactions from outsourcing companies were quite stable QOQ at 90,300 sq metres (971,600 sq feet) from 99,100 sq metres (1.1 million sq feet) in Q4 2019.

Outsourcing deals pre-COVID were encouraging, with demand from this sector picking up starting Q3 2019. However, given the ECQ and the global pandemic, Colliers sees tenants delaying decisions on fresh leasing by between one and two quarters.

For the remainder of 2020, Colliers expects fewer deals from traditional and non-BPO tenants as they are likely to adopt a wait-and-see stance. In 2019, Colliers noted that this segment has been growing on the back of a sustained macroeconomic growth (average annual growth of 6.3% from 2010 to 2019).

But with credit rating firms and multilateral agencies forecasting a slower 2020 Philippine GDP growth (between −0.6% and 4% from the initial 6% to 7%), Colliers projects slower expansion from these companies in 2020. Most firms are also adopting cash preservation measures due to economic uncertainty.

In our opinion, if the virus peaks in H1 2020 and market conditions start to improve in H2 2020, we are likely to see a recovery from both outsourcing and traditional segments in 2021. The rebound in demand should also offset a sluggish take-up from POGOs in 2020.

Among the business districts likely to record recovery in 2021 are Quezon City, Fort Bonifacio and Ortigas Center. A mix of outsourcing and traditional occupants have pre-leased office space in these business districts.

Once the deployment of POGO employees normalizes and travel bans are lifted, Colliers sees greater office space absorption in Alabang and Quezon City. Colliers sees muted leasing in the Bay Area in the next 12 months due to a pause in POGO transactions.

GEARING UP FOR A REBOUND

From the bitter experience of the Asian Financial Crisis (AFC) in the late 1990s, Philippine developers have learned the necessity to turn off the supply tap – and quickly. This was demonstrated after the Global Financial Crisis (GFC) in 2010, where supply dropped 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.

If take-up in 2020 only achieves 50% of our original forecast of about 900,000 sq metres (13 million sq feet), we expect vacancy will rise to 6% in 2020, up from the 4.3% in 2019.

Meanwhile, with our projected rebound in market conditions in 2021, followed by a pick up in office completion and a 33% increase in net take-up, Colliers sees vacancy declining to 5.0% in 2021. Even with a less diversified office market in 2010, the Metro Manila office sector turned around quickly post-GFC, posting a 5.6% vacancy in 2010 from 8.6% in 2009, the highest recorded since the global economic meltdown.

RENTS TO DROP BEFORE PICKING UP PACE IN 2021

Colliers has been recording a two-tiered rental structure since the entry of POGOs in Q4 2016. Traditional and outsourcing occupants are paying a discount (25%) compared to POGO tenants. As landlords are unlikely to attract POGO tenants due to the travel ban, we expect rents in selected business districts to adjust downward. Factoring in softer demand from all sectors, in 2020 Colliers sees a 17% YOY contraction in office lease rates across Metro Manila, faster than the 14% contraction we recorded in 2009 during the Global Financial Crisis. With our projected recovery in 2021, lease rates should rise at about 2%. Colliers sees a faster recovery in 2022.

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