Colliers Quarterly

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Colliers INTERNATIONAL
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Office beats odds

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The office sector began 2017 clouded by uncertainty amid a government in transition and concern about shifts in policies. However, the sector ended the year strong. While BPO demand declined, this was outweighed by the surge in Philippine Online Gaming Operators (POGOs) and the growth of traditional companies, bringing overall Metro Manila net take-up to 639,500 sq m (6.9 million sq ft) for 2017 -- a record level, outperforming earlier forecasts. Today, the sector is better-positioned than a year ago with the late 2017 surge in Philippine Economic Zone Authority (PEZA) building proclamations and a well-established government with clear economic policies. Relations with other countries such as the United States, Japan, and China have been proven relatively stable, which should keep investors interested. We see the growth in demand supported by the following: (a) POGOs growing throughout the term of the current administration; (b) traditional companies expanding with the growing economy; (c) Strong pre-leasing activity; and (d) improved demand from BPOs brought about by the faster pace of PEZA proclamations of buildings. We recommend that developers ensure timely completion of buildings so tenants may consider their projects. Alternative business districts, most of which are already due for upgrades, are of particular interest as rents are at a discount to primary CBDs. The upcoming supply in various locations offers opportunities for tenants looking to relocate or consolidate.

Forecast at a glance

Demand

Net take-up reached 639,500 sqm (6.9 million sq ft) in 2017.We expect this to increase by about 6% annually over the next three years supported by a strong economy and growth in employment.

Supply

Supply reached a record high 852,000 sqm (9.2 million sq ft) of office GLA. Between 2018 and 2020, Metro Manila should add at least 900,000 (9.7 million sq ft) each year, providing more options for tenants.

Vacancy rate

The strong demand has caused a slight decline in vacancy to 5.3% versus 3Q 2017. However, in view of the heavy upcoming supply, we expect vacancy to reach 7% by end 2018, and rising to 10% by 2020.

Rent

Rents in primary CBDs range between P800 per sqm (USD 1.4 per sq ft) to over P1,300 per sqm (USD 2.34 per sq ft). We expect rents to slightly plateau as vacancy increases. We estimate a 2% to 5% per annum increase in rents across CBDs over 2018-2020. Alternative locations present leasing opportunities with discounts to primary CBD rents.

Vacancy Rates in Metro Manila Submarkets

LOCATION	2Q 2017	3Q 2017
Makati CBD	1.2%	1.2%
Fort Bonifacio	5.6%	6.0%
Ortigas Center	1.0%	3.6%
Manila Bay Area	3.4%	2.0%

Source: Colliers International Philippines

Office Supply Forecast, GLA (sq m)

LOCATION	AS OF 2016	2017	2018F	2019F	2020F	TOTAL
Alabang	483,100	89,500	60,700	60,600	-	693,900
Fort Bonifacio	1,533,800	383,000	137,100	292,100	38,800	2,384,800
Makati CBD	3,199,000	28,400	37,200	79,500	54,100	3,398,200
Makati Fringe	229,400	25,300	73,300	14,300	120,700	463,000
Mandaluyong	304,900	80,600	68,500	84,000	-	538,000
Manila Bay Area	330,600	70,300	240,200	84,500	141,000	866,600
Ortigas Center	1,578,000	66,900	98,000	23,700	421,600	2,188,200
QC*	888,200	89,600	148,100	157,400	110,600	1,393,900
Others**	293,700	19,000	63,900	129,300	64,900	570,800
Total	8,840,700	852,600	927,000	925,400	951,700	12,497,400

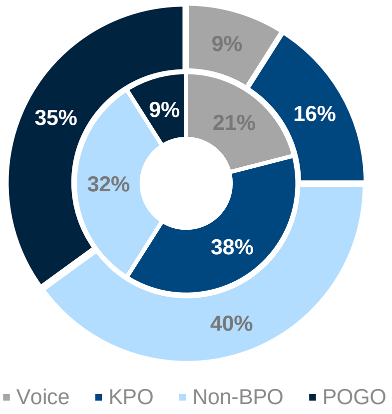
Source: Colliers International Philippines
*Includes Araneta Center, C-5 Corridor, Eastwood City, and North EDSA Triangle
**Manila and other fringe locations

POGOs surprise again

Overall net take-up reached 639,500 sqm (6.9 million sq ft) in 2017, a record level of Metro Manila. The volume of transactions for the year reached 870,000 sqm (9.4 million sq ft) of office GLA. Of this total, about 312,000 sqm (3.4 million sq ft) came from POGOs. Notably, more than half of POGO deals were closed in 4Q 2017 alone. The surge was also driven by a crackdown on offshore gambling entities in other countries which forced POGOs to look for viable alternative locations such as the Philippines. Recall that in 2016, total transactions from POGOs totalled a mere 80,000 sqm (861,000 sq ft). This latest development puts the Philippines as the potential premiere online gambling destination in Asia, strengthened by the country's improved relations with China since the Duterte administration took office.

The surge of POGOs was supported by an equally strong growth from traditional companies, including government entities, driving overall Metro Manila demand to exceed earlier 2017 expectations. Entities such as logistics companies, construction firms, online shopping firms were key growth areas. All these more than made up for the decline in BPO demand throughout the year. The overall 2017 breakdown of transactions by tenant type was as follows: About 35% each from POGOs and traditional companies, 25% from BPOs, and 5% from government agencies (also considered traditional/non-BPO).

Breakdown of Office Transactions 2016 (Inner Circle) vs 2017 (Outer Circle)



Source: Colliers International Philippines Research
*Government entities are included in Non-BPOs

Record high supply kicks in

Total completions during the last quarter of 2017 reached 269,000 (2.9 million sq ft) sqm of office GLA, pushing full year completions to 852,000 sqm (9.2 million sq ft), also the highest annual supply historically for Metro Manila.

Note that the average in the last three years was merely 540,000 sqm (5.8 million sq ft), making 2017 supply 57% higher than the average. This is an interesting development in a sector that has been plagued by numerous delays in recent years. Consequently, stock in Metro Manila now stands at 9.7 million sqm (10.4 million sq ft).

Looking ahead to 2018 and beyond, planned projects of developers still total over 900,000 sqm (9.7 million sq ft) annually until 2020. Among the submarkets, Manila Bay Area and Fort Bonifacio have the advantage in the short to medium term given the respectable size of new projects, and the largely concentrated nature of developments in these locations. Notable upcoming buildings in Fort Bonifacio include Daiichi's The Finance Center, Alveo's High Street South Corporate Plaza 2, and Megaworld's World Commerce Plaza.

In the long run, Ortigas has the potential to re-emerge as a key business district given the planned buildings due for completion in 2020. Approximately 44% of total supply for the same year will come from Ortigas CBD. Key developments include SM Keppel Land Tower by BDO-Keppel, SM Mega Tower by SM Prime, Glas Tower by Asya, and Double Dragon's Jollibee Plaza.

Completed Buildings, 4Q 2017

BUILDING	LOCATION	GLA, sqm
30th Corporate Center	Ortigas Center	45,500
68 Kalayaan Building	Quezon City	5,300
Arthaland Tower	Fort Bonifacio	29,800
Circuit Makati Corporate Center 2	Makati	25,300
High Street South Corporate Plaza Tower 1	Fort Bonifacio	38,200
IBP Tower	Ortigas	21,400
L&Y Plaza	Pasig City	13,800
Meridian Park Tower 1	Manila Bay Area	33,900
One Bonifacio High Street (PSE Tower)	Fort Bonifacio	29,000
Rockwell Sheridan Tower 2 (South)	Mandaluyong	22,200
The Sky Suites Tower	Quezon City	4,900
Total		269,300

Source: Colliers International Philippines Research

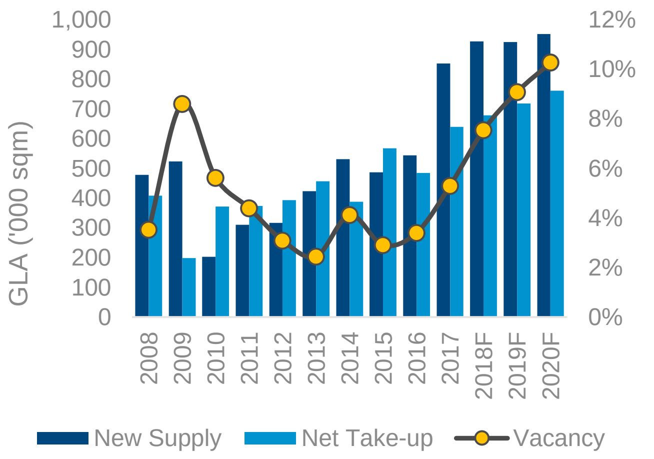
Vacancy respectable but rising

Given the strong demand recorded in the fourth quarter of 2017, Metro Manila office vacancy declined to 5.3% from 5.6% at the end of 3Q 2017, reflecting a reversal of the general trend in the prior three quarters. YoY however, this shows about a two-percentage point increase due to the heavy supply that was completed throughout the year.

With annual supply between 2018 and 2020 still projected to breach 900,000 sqm (9.7 million sq ft), we expect vacancy to rise to the 7% to 10% range, assuming an optimistic consistent 6% increase in net take-up. In the Philippine context, Colliers believes that a vacancy between 5% to 9% is respectable -- on the one hand, it provides tenants with enough office space options to choose from, and on the other, it provides landlords the opportunity to compete with counterparts based on cost, location, and building quality. Notably, this is the first time in the last seven years that the market has a vacancy above 5%, signalling a shift from a landlord-driven market.

Translating these vacancy rates to absolute office space sizes, with total office stock reaching 12.5 million sqm (134.5 million sq ft) by 2020, this could mean over 1.2 million sqm (129.2 million sq ft) of available office space by then. Such a scenario will further intensifies competition among developers. Given the increase in vacancy, Colliers believes this will ensure continuous upgrades in developments in a more competitive market.

Vacancy and Demand Forecast



Source: Colliers International Philippines Research

Alternative locations present opportunity

As mentioned earlier, the recent rise in vacancy has made the market more competitive for developers. Rents understandably, being a major point of differentiation. While asking rents continue to increase, transaction rates have reached discounts of five percent to as high as twenty percent of the headline rate, particularly for anchor tenants.

In terms of location, Makati and Fort Bonifacio still command the highest asking rents among submarkets, being the country's primary business districts. Rents in these locations range between PHP800 (USD 1.4 per sq ft) per sqm to well over PHP1,300 per sqm (USD 2.34 per sq ft). Meanwhile, Manila Bay Area is seeing the fastest growth in rents given the strong demand in the location and the new road networks that have helped improve the accessibility to and from this emerging business district.

Colliers believes that alternative locations present an opportunity for tenants as rents in these locations are more competitive, offering a discount of about 30% to primary CBDs. Furthermore, some of these alternative locations are due for upgrades. With new supply coming in Ortigas CBD, as well as portions of Quezon City and Alabang, particularly in township developments, tenants may want to consider these locations as sites for their office space requirements.

Comparative Office Rental Rates in Metro Manila (PHP / sq m / month)

LOCATION	4Q 2017	% CHANGE (QoQ)
Makati CBD	1,300 - 1,750	1.8%
Fort Bonifacio	900 - 1,500	2.4%
Ortigas Center	500 - 900	0.9%
Manila Bay Area	675 - 875	3.2%
QC*	550 - 950	1.5%
Alabang	650 - 750	1.0%

Source: Colliers International Philippines Research
*Eastwood

Off to a good start

Colliers believes the market is better-positioned than it was a year ago. The market performance in Q4 2017 has provided indications of a potentially stronger year ahead. We expect at least 6% growth in net take-up, consistent with the employee growth of finance, insurance, banking, real estate and other professional activities.

Among other things, we note the following key indicators and drivers for 2018:

1. Continuous POGO demand due to the country's strengthening relations with China;

2. Expanding traditional companies driven by a strong economy;

3. Strong pre-leasing levels of buildings due this year;

4. Improved pace of PEZA proclamations of buildings which may signal better demand contribution from BPOs

As noted earlier, POGOs have driven demand throughout 2017. While the sector was clouded with concerns early on, it appears that demand from POGOs will remain a key market driver rather than a one-time boost since inquiries picked up again in 4Q 2017. Requirements of 20,000 sqm to 30,000 sqm per site were once again noted. Thus, we expect POGO demand to continue throughout the term of the current administration given the stronger government ties with China.

Traditional companies have also been a major driver of demand. This segment has been largely forgotten in the past years as focus has shifted to BPOs. However, lately, the newer buildings offered in the market have considered traditional companies more. We see sustained demand from construction companies, logistics, and start-up companies, among others. Alongside, we also expect growth in flexible workspaces with the potential entry of international co-working operators.

The volume of transactions all year has translated to an equally vibrant pre-leasing market. Buildings due for completion in 2018 estimated at approximately 927,000 sqm (10 million sq ft) are now 37% pre-committed. Contrast this situation to the prior two years where pre-leasing levels at the beginning of the year were about 30% only with significantly fewer projects in the annual pipeline.

The pace of PEZA proclamations of buildings has significantly improved as well, particularly for those located in Metro Manila. Some of the buildings which obtained PEZA approvals include Rockwell Business Center Sheridan, Inoza Tower, Vertis North Towers, and The Finance Center. Furthermore, it must be highlighted that PEZA continues to grant PEZA status to IT Parks with the approval of Vertis North IT Park as an ecozone. Colliers believes this may signal better contribution from BPOs this year. We may not see great levels of take-up from this BPOs similar to prior years, this sector will remain as a major contributor of demand. We estimate that for 2018 alone, at least 450,000 sqm (4.8 million sq ft) PEZA-proclaimed office space will be available.

Lastly, Colliers recognizes that there may be risks ahead with the passage of the Tax Reform for Acceleration and Inclusion (TRAIN) Law Package One which impacts operations of regional headquarters, and the upcoming TRAIN Law Package Two, which may affect incentives of BPOs. Still, we are optimistic that the current more diversified tenancy mix seen and the potential benefits of a growing economy on the back of the government's Build, Build, Build program will allow the market to overcome the risks.

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