Asian Cities Report – 1H 2019

REPORT

Savills Research

Manila Office

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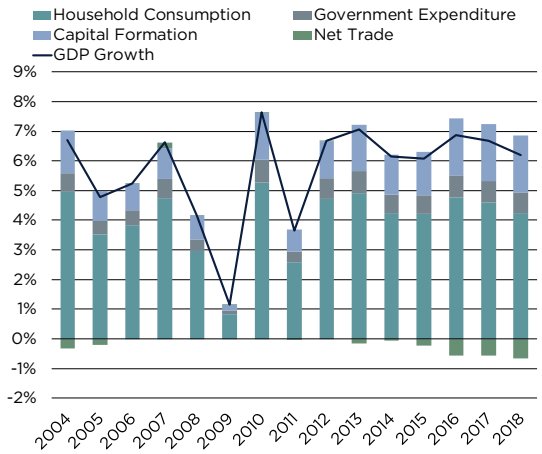
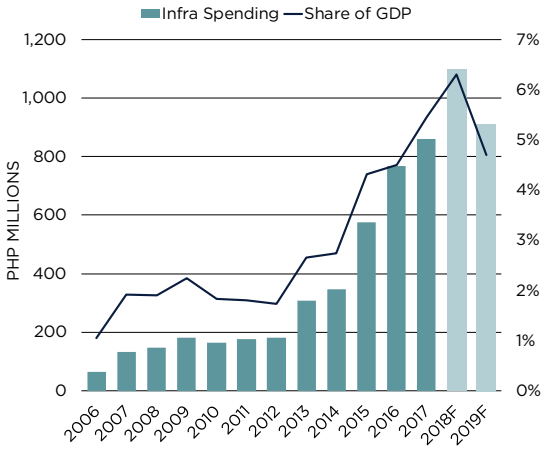
Infrastructure spending reached PHP803.6 billion in 2018, up 41.3% YoY

GRAPH 1: GDP Growth, 2004 to 2018



Source Savills Research & Consultancy

GRAPH 2: Share Of GDP And Infra Spending, 2006 to 2019F



Source Savills Research & Consultancy

ECONOMIC OVERVIEW

The Philippines continues to show strength after a challenging 2018. As inflationary pressures wane, the Bangko Sentral ng Pilipinas (BSP) now has a window to lower interest rates. Although GDP slowed down to 6.2% last year, the country remains one of the fastest-growing economies in Asia. Household consumption has consistently provided the largest boost to economic growth, however, we're seeing a growing contribution from government spending and investments as the structure of the economy shifts to investment-driven growth. Gross capital formation increased to 13.9% year-on-year (YoY) in 2018. With the country's 'Build, Build, Build' program well underway, investment could accelerate further in 2019 and contribute more to GDP growth.

The government aims to increase infrastructure outlay from 4.7% of GDP in 2019 to 7.0% in 2022. Infrastructure spending reached PHP803.6 billion in 2018, up 41.3% YoY, in line with the government's target and equivalent to 5.1% of GDP. Meanwhile, foreign direct investment registered a solid US$9.8 billion in 2018, albeit lower than 2017's figure. Economic managers believe that the slowdown stemmed from uncertainties about global economic conditions. However, the slump is seen as temporary since the Philippines is working on implementing reforms that should improve the overall investment environment. In 2018, foreign investors injected US$2.3 billion of fresh capital in to the economy, focusing mainly on manufacturing, real estate and financial activities.

We believe the economic growth story for the Philippines in 2019 is still on track, supported by both public and private investments. Election spending, steady Overseas Filipino Workers (OFW) remittance flows and a subdued outlook on oil prices could also boost the ongoing recovery in household consumption. We see a sound macroeconomic backdrop coupled with a healthy financial environment, which could lift the real estate sector's performance.

OFFICE MARKET OVERVIEW

A combination of sustained, healthy demand from the offshore and outsourcing (O&O) sector and the continued rise of the Philippine Offshore Gaming Operators (POGO) has been driving demand in Metro Manila's office market despite 746,900 sq m of new Grade A office launching in 2018. Net absorption improved to 701,100 sq m compared to 615,200 sq m recorded in 2017. This resulted in an overall vacancy rate of 4.8% of stock, slightly higher than the 4.5% vacancy rate recorded in the previous year.

Metro Manila rents increased by 5.0% YoY in Q4/2018. The tight conditions coupled with contract expirations prompted higher bids in Makati CBD while subsequently pushing up rents in the premier district. In addition, rents in Bonifacio Global City (BGC) are still on the uptrend as the strong demand from O&O companies raised rentals further during the quarter.

Half of the new supply in Q4/2018 came from Quezon City, where the vacancy rate rose to a ten-year high of 16.4% as occupier demand remained lackluster. The less than stellar figures dragged down Metro Manila's overall performance during the quarter. Quezon City has been underperforming since 2016, falling behind the other submarkets such as Alabang and the Bay Area, which have reversed course over the last several years. Notably, the latter is quickly transforming into a district that can rival established submarkets.

NEW SUPPLY

We are expecting record levels of new supply, which should reach 851,500 sq m of GLA. A majority of this new supply - 82.1% - is forecast to launch in BGC, Ortigas Center and the Bay Area. Completions in BGC will peak in 2019, and are expected to add 275,000 sq m to the submarket. The bulk of BGC supply will come from the opening of World Commerce Plaza, which will add 105,325 sq m of new office stock.

Meanwhile, with 206,000 sq m of new Grade A office stock coming online, Ortigas Center is trying to make a comeback. However, we anticipate market absorption to be a struggle in the CBD, and that will consequently raise total vacancy rates. On the other hand, we forecast a significant acceleration in rents as the new supply improves the quality of stock overall.

Optimism by the top-listed developers for the government's infrastructure plan encouraged record-high capital expenditure in 2018, which topped out at PHP434.9 billion. Developers are continuing to expand their office portfolios, with 4.3 million sq m of combined office space under construction and scheduled for completion by 2020.

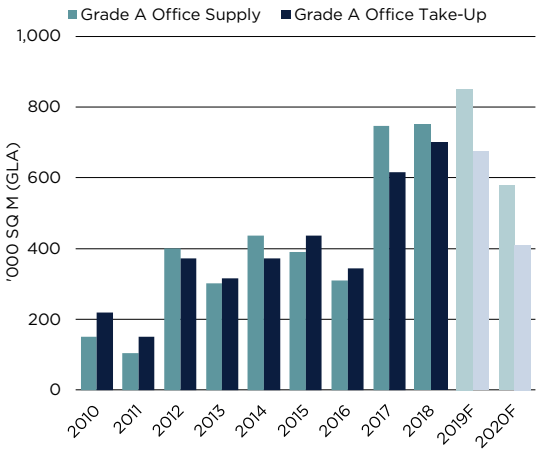
FORECAST

With the country's economic prospects remaining bright and the government committed to accelerating infrastructure development and improving the business climate, we believe overall confidence in the sector will persist in 2019.

Monetary policy is expected to continue to support the growing real estate sector. The latest inflation figure registered 3.0%, back within the government's target range of 2-4%. This gives room for the BSP to maintain low interest rates and support economic growth. In addition, the central bank is back to pursuing a cut in the reserve requirement ratio (RRR) after a hiatus last year due to accelerating inflation.

Headwinds to watch out for could come from the government's plan to rationalize incentives in the second tranche of tax reforms while a slowdown in Philippine Economic Zone Authority (PEZA) approvals could limit demand from O&O firms. We remain vigilant of the potential for rising construction costs in the medium term caused by the cement tariff. We are also mindful of possible construction delays due to skilled labor shortages, which would push back new revenue contributions from delayed projects.

GRAPH 3: Metro Manila CBD Grade A Office Supply And Take-up, 2010 to 2020F



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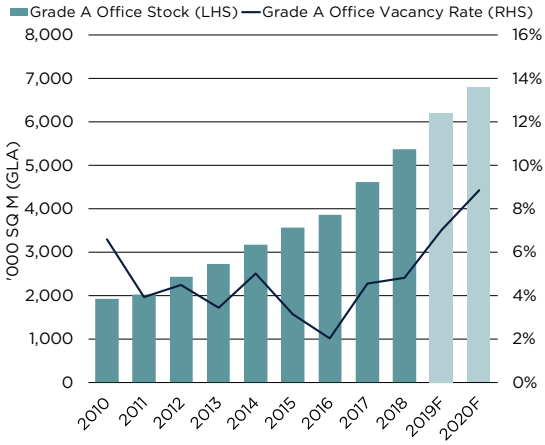
> "Top-listed developer's positive attitude towards the government's infrastructure plans encouraged record-high capital expenditure in 2018, which topped out at PHP434.9 billion."

GRAPH 4: Manila CBD Grade A Office Stock And Vacancy Rates, 2010 to 2020F



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Information provided by kmc

KMC MAG Group
11/F Sun Life Centre
5th Avenue corner Rizal Drive
Bonifacio Global City 1634
Philippines
+632 2 403 5519