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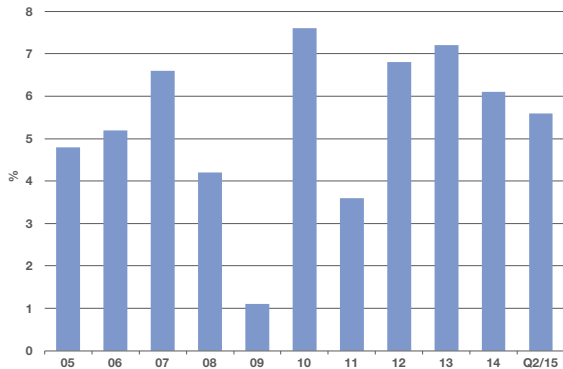
Savills World Research  
Philippines

# Asian Cities Report **Manila Office**

2H 2015

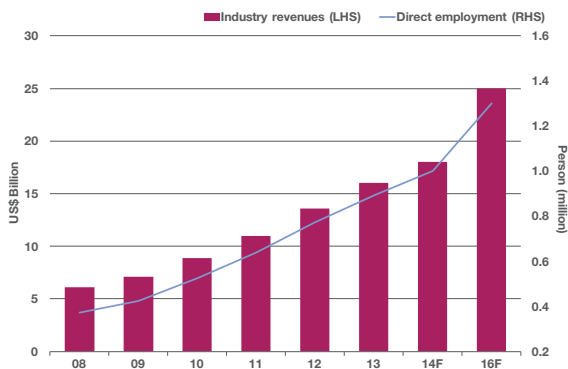


GRAPH 1  
GDP growth, 2005–Q2/2015



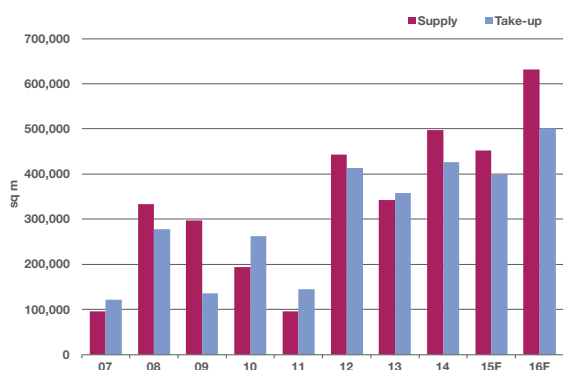
Source: National Statistics Coordination Board (NSCB)

GRAPH 2  
IT-BPO industry revenues and employment, 2008–2016F



Source: The Information Technology-Business Processing Association of the Philippines (IBPAP)

GRAPH 3  
Grade A office supply and take-up, 2007–2016F



Source: KMC MAG Group Research & Consultancy

## Economic overview

With rather uncertain news coming from the region, the Philippines is arguably one of the region’s bright spots. The economy grew by 5.6% in the second quarter of 2015, however, even this figure represented a deceleration from the 6.1% seen in 2014. Despite the slight slowdown, the Philippines is still one of the fastest growing economies in the Asia-Pacific region with a very positive outlook.

Much of the current favorable environment is due to strong underlying private consumption, accounting for almost 70% of the economy and growing at 6.2% YoY (in Q2/2015), which contributes significantly to economic growth. Fueled by the steadily growing overseas Filipino workers’ (OFW) remittances (around 10.0% of GDP), it has created a growth model which is highly domestically-driven, making it less vulnerable to outside shocks. Together with the booming outsourcing industry, it also sustains a rather large services sector (almost 60% of GDP), making the industrial sector less dominant.

The economy currently has relatively low levels of foreign investment and a low dependency on commodity prices which should limit the potential for capital outflows and maintain a less volatile currency compared to its regional counterparts, thus further dampening any external shocks. Furthermore, domestic liquidity has been well managed by the country’s central bank. With inflation staying below the target of 2.0% to 4.0% at 1.9% YTD, there is still some room for lower monetary policy rates which could further boost the economy. However, the additional support is more likely to come from fiscal stimulus as the current administration has pledged more infrastructure projects to increase government spending. In the first semester, public expenditure has increased at a slower-than-expected pace due to low budget execution, but several government agencies have guaranteed to improve their implementation towards the year end.

Overall, the growth is expected to accelerate in 2015 from last year.

Major financial institutions, however, are more conservative than the government’s 7% to 8% GDP forecast. The Asian Development Bank (ADB) forecasts the Philippines to grow by 6.4% in 2015, while the International Monetary Fund (IMF) has also upgraded the country’s 2015 growth projection to 6.7% from 6.6%. The World Bank, on the other hand, pegs growth at 6.5%, much higher than the expected global growth rate of 3.0% and a forecast for developing economies of 4.8% in 2015.

## Office market overview

Manila’s office market is witnessing a rapid expansion at the moment. With the lack of developable land in Makati CBD, the other submarkets are gaining a lot of traction. The main focus remains on Bonifacio Global City (BGC), but increasing interest has been observed in emerging submarkets, especially in Quezon City and Bay Area which are posting strong figures.

This rapid expansion is a result of the strongly performing occupier market which is driven by the IT business process outsourcing (IT-BPO) industry. The IT-BPO sector boosted annual take-up to 430,000 sq m in 2014, and is expected to reach 400,000 sq m this year with no signs of slowing down.

While the robust take-up has sustained the rapid growth of rents, the current growth rate of 5.4% YoY in Q2/2015 has slightly slowed from the 7% to 10% range seen in the past few years. Reasons for this can be found in supply factors which signal healthy market dynamics. The rather large pipeline has helped to restrain rental expectations and improved the occupiers’ position in rental negotiations. Since a significant share of leasing transactions is still focused on pre-leasing, this has resulted in relatively good terms for tenants with the luxury of time.

## New supply

In particular, a rapid expansion can be observed on the supply side. The market is expected to add around 2 million sq m of new office space until 2018 to the current stock of 3.7 million sq m. Except for BGC,

which will account for half of the new supply, new development is widely scattered among the main business districts of Metro Manila. This is a result of the increasing pressure on real estate to facilitate all the businesses which the traditional CBDs cannot handle anymore. Also, due to the fact that the outsourcing industry is somewhat price sensitive, tenants in search of cheaper occupancy costs are now more open to locate in secondary business districts, allowing them to emerge rapidly.

Meanwhile in Makati CBD, the redevelopment of Ayala Triangle and the City Gate Complex will add some new stock, especially of the traditional and headquarters-type office space. However, this supply will hit the market likely after 2018, forcing companies looking for prime space to revert to BGC.

Despite the strong demand, the large pipeline is expected to maintain a downward pressure on rental growth and slightly increase vacancies, especially in 2016 when the supply is expected to peak with 630,000 sq m to be introduced in the marketplace. Most of the supply pressure exists in BGC which accounts for 340,000 sq m of 2016's total additions, although around 47.0% of this is already pre-leased, encouraging developers to maintain the current construction activity.

### The investment market

As for the asset market, investment activity is mainly focused on developments and transaction volumes have been dominated by land deals with one to two office acquisitions pushing through a year. The year's largest office deal was the sale of Tower 6789 at a price close to PHP7.0 billion. While there has been fairly steady interest in investment properties in Manila, the interminable obstacle of available assets continues to stop investors from executing deals, especially those from overseas. This, together with positive future expectations, has kept prime yields on a downward trajectory, now ranging at 7.5% to 8.5%. Looking ahead, only time can tell how long the yield compression will continue before the current landlords will become more active in

the marketplace and volumes start to rise.

Since transaction volumes are low on the asset markets, investors and property owners are seeking returns from investments in new constructions and redevelopments. In particular, due to the actions of the central bank to limit the credit exposure of local banks, opportunities in the project funding side have been seemingly increasing. As developers are keen to maintain the current level of production, they are now becoming more open to start talks with financiers for alternative sources of financing.

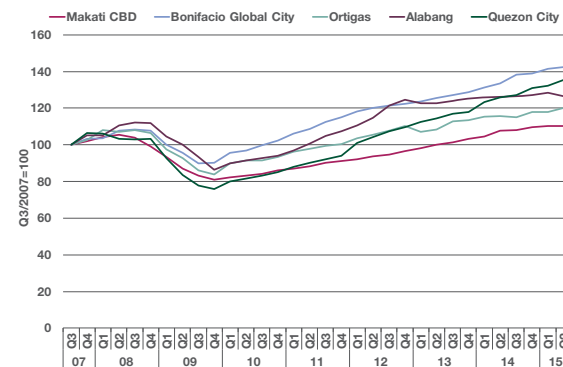
### Forecast

The strong economic performance, with growth projections at 6.0% to 7.0%, is expected to keep the real estate market buoyant across all sectors. Metro Manila construction activity will remain robust as major developers continue to expand their footprint. The key trend is the development of large-scale mixed use township projects which are rising all over Metro Manila. These projects are spreading the commercial focus away from the main CBDs as tenants are looking for more convenient options for their employees. Typically, these townships consist of several office and residential towers with a retail component, allowing them to be self-sustained communities.

In the office sector, the IT-BPO industry's presence in the Philippines is expected to remain strong and office demand should remain high, as global firms continue to seek reduced costs through the outsourcing of their services. With sustained demand, modest rental growth and a low vacancy rate, the significant office pipeline is expected to be absorbed and yields to remain attractive for core assets over the next few years.

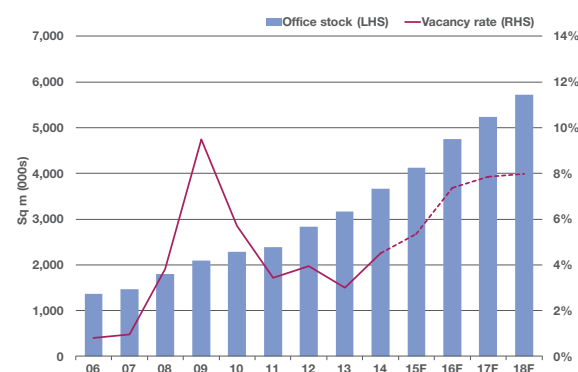
Some headwinds might be felt from the latest economic turbulence but given the strong fundamentals of the Philippine economy, the effect is not expected to be significant. All in all, we maintain our bullish outlook for Manila's office sector with rents and capital values forecast to grow by 5% to 7% over the next 12 months. ■

GRAPH 4 **Grade A office rental indices, Q3/2007–Q2/2015**



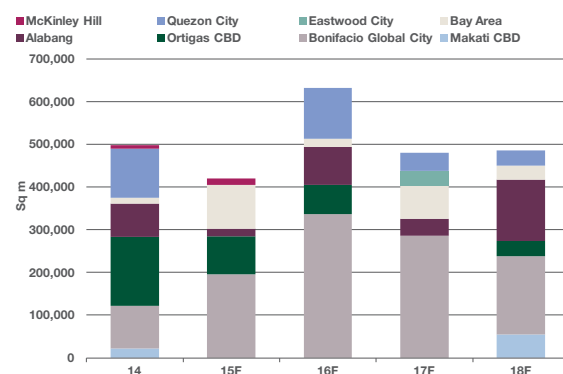
Source: KMC MAG Group Research & Consultancy

GRAPH 5 **Grade A office stock and vacancy rate, 2006–2018F**



Source: KMC MAG Group Research & Consultancy

GRAPH 6 **Future Grade A office supply, 2014–2018F**



Source: KMC MAG Group Research & Consultancy



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