Asian Cities - 2H 2022

SPOTLIGHT

*Savills Research*

# Metro Manila Logistics

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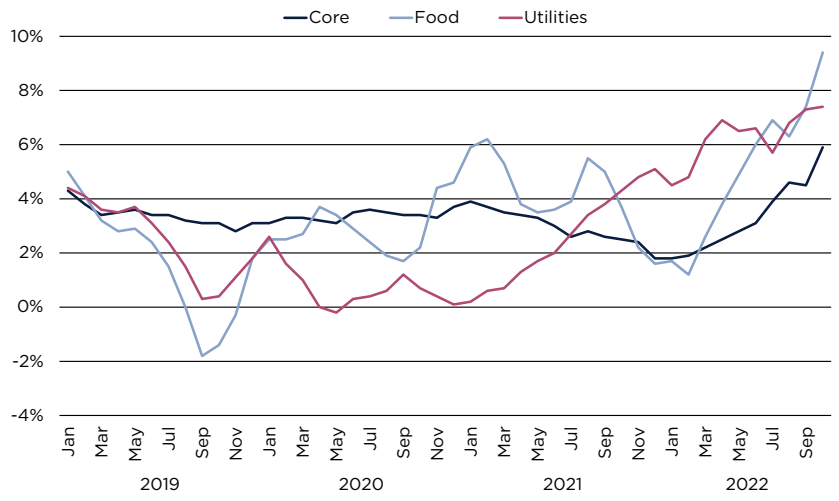
# Changing consumer behavior is dictating Metro Manila's logistics developments

## MACROECONOMY

As core inflation rose to 5.9% in October from 4.5% in September, the Philippine economy beat consensus forecasts after increasing by 7.6% in Q3/2022. Household consumption continued to support the economy after growing by 8.0% despite inflation eating into household incomes. The strong OFW remittance inflows and expanding IT-BPM sector are projected to maintain their respective growth trajectories amidst a slowing global economy. Cash remittances from abroad should further boost consumption as the Philippine peso remains weak against the dollar. Meanwhile, the local IT-BPM sector remains on an upward trajectory after the growth the industry experienced during the pandemic.

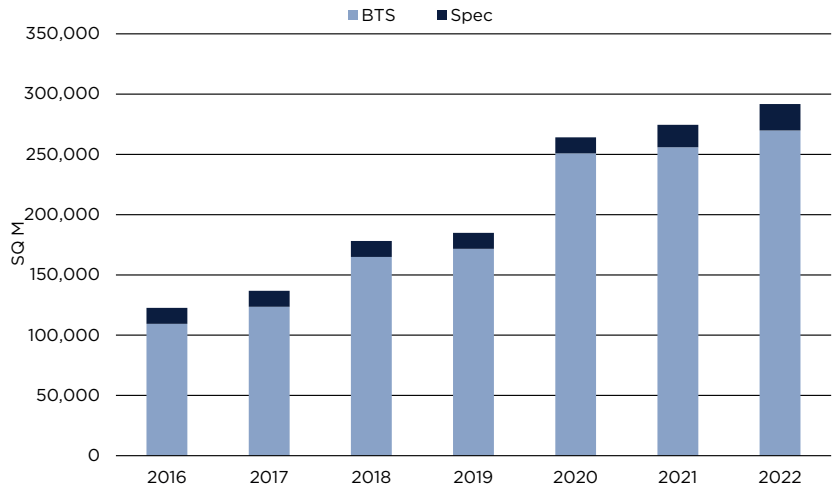
Despite the absence of a concrete economic plan, the Marcos administration is still optimistic that the country will hit its growth target of 6.5% to 8.0% this year.

**GRAPH 1: Core Inflation vs Food and Utilities, January 2019 to October 2022**




**Source** Philippine Statistics Authority

**GRAPH 2: Logistics Warehouse Stock, 2016 to 2022**




**Source** KMC Savills Research

A key headwind to this bullish outlook is the Bangko Sentral ng Pilipinas (BSP) hiking interest rates in tandem with the US Federal Reserve. Left to its own devices, the central bank is likely to favor controlling inflation and stabilizing the currency to ease import costs. These moves should hit domestic consumption in 2023 as we have not seen the effects of higher interest rates on the economy.

## STOCK AND SUPPLY

As household consumption grows, Metro Manila's logistics developments continue to multiply with e-commerce players squeezing the market. Parcel throughput for the top online platforms like Lazada and Shopee continues to grow and has increased demand for last-mile facilities in the capital. Just this year, Amazon announced free shipping and delivery to the Philippines which should further heighten demand for similar facilities.

Warehouse supply has doubled since 2017 from around 136,800 sq m and has expanded at an average of 16.4% YoY since then. Developers hold 38.5% of the market with Ayala Land (ALI), ISOC Land (ISOC) and Robinsons Land (RLC) leading the charge. On the other hand, logistics, couriers, and parcel delivery firms dominate the space owning close to half of all logistics warehouse stock. Lastly, the remainder of stock is held by individuals which is a significant amount given how large players control the market.

Of Metro Manila's 291,800 sq m of total stock, around 92.5% is build-to-suit (BTS). The remaining speculative (spec) buildings are predominantly by individual investors driven by the recent demand for warehouses. However, these new spec developments are still unoccupied which reflects a demand preference for space customized to the client's requirements.

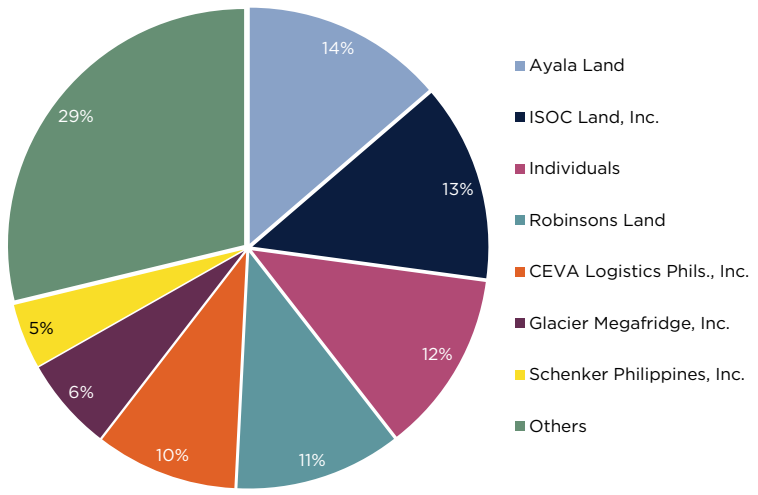
## DEMAND

In 2H/2022, the overall vacancy rate in Metro Manila stood at 4.3% or only around 12,700 sq m. Compared to the large markets of Laguna and Cavite, vacancies in metro have been very tight due to the high demand and the lack of available greenfield areas for any BTS development. Developers with land inventory have had more success in capturing and catering for this unique demand. Although BTS developments assure landlords of predictable occupancy levels, these deals take time to mature and may close at below-market rents.

Although e-commerce is a significant tenant of warehouse space, third-party logistics (3PL) and cold storage services corner 67.4% of total stock. The rise of cold storage facilities reflects the rapidly changing consumer behavior which prefers modern retail channels (i.e. grocery chains, convenience stores) over traditional ones (i.e. wet markets or palengkes). On the other hand, the dominance of 3PL companies may have complemented the increasing parcel throughput from e-commerce platforms, but it may also indicate the rising dependency of firms on outsourcing most of their logistical requirements.

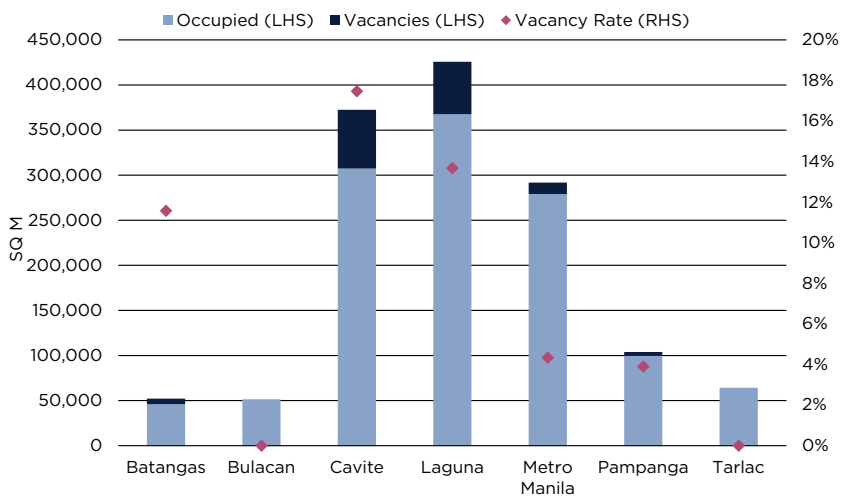
**The average rent in Metro Manila is within the range of PHP200 to PHP300 per sq m per month and still comparable to rental rates outside the capital.**

**GRAPH 3: Developer Market Share, 2H/2022**




**Source** KMC Savills Research

**GRAPH 4: Stock and Vacancy by Market, 2H/2022**




**Source** KMC Savills Research

Interestingly, much of the occupied stock is strategically concentrated in the metro's southern cities of Parañaque and Taguig. These are also adjacent and accessible to major expressways – Cavite Expressway (CAVITEX), South Luzon Expressway (SLEX) and the Metro Manila Skyway System (Skyway) which connect SLEX to the North Luzon Expressway (NLEX). We believe this clustering of warehouses gravitates towards the larger logistics cluster and industrial zones in the Laguna and Cavite markets.

## RENTS

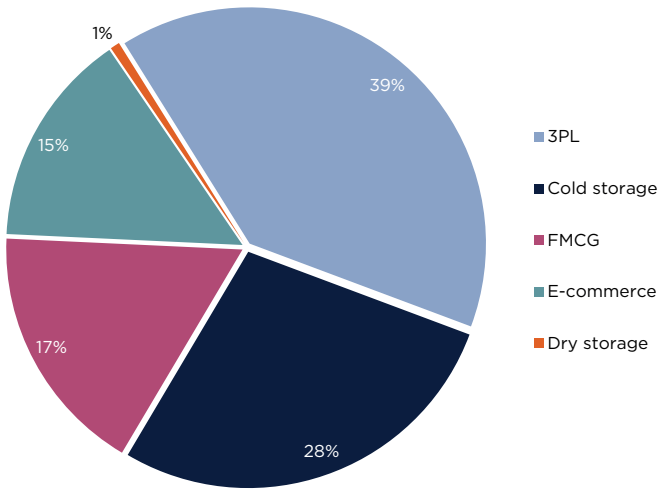
The average rent in Metro Manila is within the range of PHP200 to PHP300 per sq m / month and still comparable to rental rates outside the capital. Although the upper net rental rate stands at PHP450 per sq m / month, BTS contracts have weighed down the market average. In addition, the lower net rental rates have been isolated to spec units which have been difficult to lease out.

We may expect the tight market to put pressure on rents and see double-digit escalation rates, but the predominance of BTS stock should only cap rental growth in the future. As long as spec units do not satisfy the requirements of the market, we should see the average rent under pressure from BTS contracts. In addition, we may expect developers and investors to focus away from greenfield developments and to brownfield prospects to cater to rising demand. As such, redevelopment and refitting capex costs are a better predictor of future rental rates.

## OUTLOOK

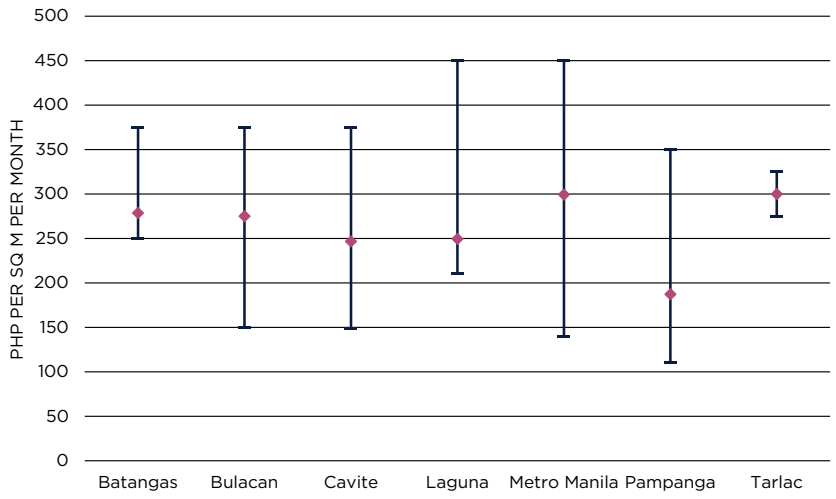
Growth of logistics real estate in Metro Manila hinges on household spending. Inflation remains the largest downside risk as higher commodity prices eat into household incomes and the subsequent

**GRAPH 5: Metro Manila Warehouse Tenant Mix, 2H/2022**




**Source** KMC Savills Research

**GRAPH 6: Rental Bands by Market, 2H/2022**




**Source** KMC Savills Research

interest rate hikes discourage future spending. Currently, domestic consumption is still supported by OFW remittances and low unemployment. In addition, Q4/2022 has historically been a strong period for consumption due to the holiday spending boosted by remittances.

The entire logistics real estate sector is still in its infancy, and we can observe this through the composition of warehouse supply. The prevalence of BTS units indicates the inexperience of landlords when it comes to appreciating the rise of e-commerce and 3PL occupiers. Consumer habits are also changing the supply network which has given rise to cold storage supply chains. Moving forward, we may see a larger number of spec units in the pipeline as landlords become accustomed to this new environment. Traditional real estate developers (i.e. ALI, ISOC and RLC) may not be as dependent on BTS contracts in the future.

Lastly, the office building glut may also prompt developers to reassess their landbanks on the fringes of Metro Manila's major CBDs and residential enclaves. The lack of available greenfield sites and unaffordable land values have always been a key constraint for logistics facilities. Interim redevelopment opportunities for old industrial districts may be feasible on 10 to 15-year investment horizons. This should give landlords and developers opportunity to fight potential headwinds and ample time to recover when the office and residential sectors struggle.

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