



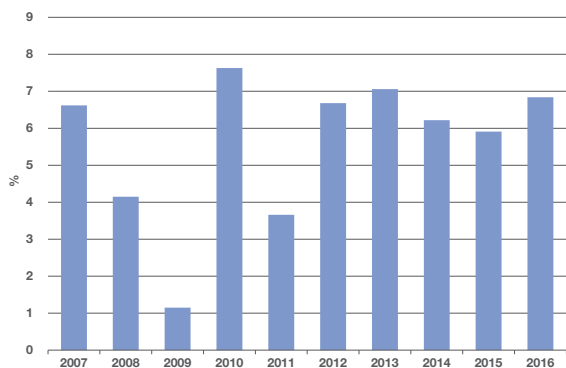
Savills World Research
Philippines

Asian Cities Report **Manila Office**

1H 2017

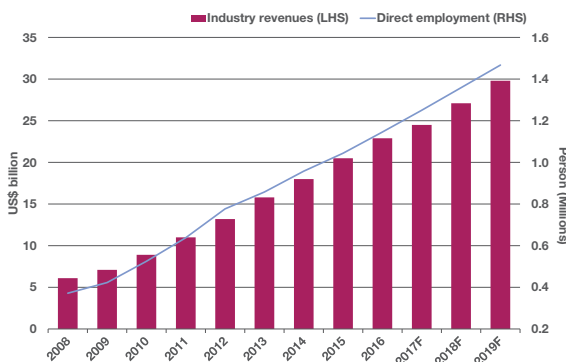


GRAPH 1
GDP growth, 2007–2016



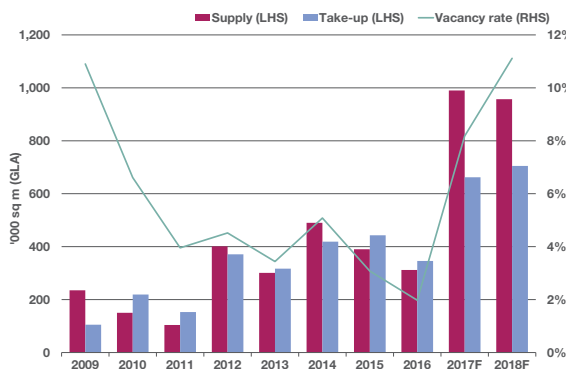
Source: National Statistics Coordination Board (NSCB)

GRAPH 2
IT-BPO industry revenues and employment, 2008–2019F



Source: IT and Business Process Association of the Philippines (IBPAP)

GRAPH 3
Grade A office supply and take-up, 2009–2018F



Source: KMC Savills Research

Economic overview

The Philippines has been resilient despite the changing political tide and slow global growth. In 2016, the economy grew within government expectations at 6.8% placing it ahead of Asia’s fast growing economies such as China and Vietnam. Private consumption continues to largely contribute to economic growth which is still being fuelled by remittances from Overseas Filipino Workers (OFW) and the expanding outsourcing and offshoring (O&O) sector.

Surprisingly, investment expanded by 20.8% last year and further increased its share in the predominantly consumption-driven economy. Investments have been a bottleneck for the economy for several years and finally both the private and public sectors have started to execute investment plans, helping to create a resilient and sustainable long-term growth trajectory. In addition, the current administration has planned to increase infrastructure spending to 5.4% of GDP in 2017 to support this growth. We expect that while remittances will fuel growth moving forward, government spending and investments will start to account for a larger share of the economy and possibly start the structural shift to a more industrial based economy.

On the other hand, the starting fiscal stimulus is expected to accelerate inflation while the rising global oil prices coupled with the depreciating peso will also create pressure. However, average inflation in 2016 was only at 1.8% and below the central bank’s target rate of 3.0%. Thus, the Bangko Sentral ng Pilipinas (BSP) may still have some headroom to keep interest rates low in order to support growth. Even with the US Fed raising interest rates this year, the BSP may not mirror the interest rate movements exactly as we do not expect similar capital outflows experienced late last year.

Furthermore, the shifting political landscape locally and internationally has increased uncertainty in the economy. Trump’s rhetoric on protecting the US economy from global trade may affect the local O&O sector as he tries to keep jobs in the US. Although Duterte has begun shifting his foreign policy stance

towards China, his unpredictability domestically has met with a mixed reception from foreign investors. Despite these challenges, foreign direct investments (FDI) surged to US\$ 7.9 billion in 2016 – hitting a new all-time high. Although FDI levels still pale in comparison to regional neighbours, we believe that improvements in public spending and capital formation growth should enhance foreign investor appetite moving forward. Overall, we still see Philippine economic growth to continue strongly as the indicators are all positive.

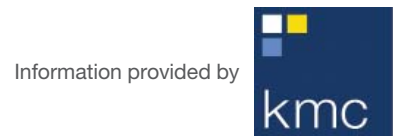
Office market overview

The Manila office market has recorded impressive growth in the past few years driven by the increasing demand for space from the expanding O&O sector. The growing outsourcing operations in the capital led to net take-up outpacing new supply in 2016 which pushed vacancy rate down to 2% by the end of the year.

Furthermore, rental growth was stable at 3.5% YoY at the end of 2016 despite declining vacancies. Rents are still expected to experience positive growth due to sustained demand, but the estimated new supply of close to two million sq m over the coming two years is expected to weigh heavily on rents as it increases occupiers’ bargaining power. Despite this, the pipeline is likely to remain substantial as local developers are still keen to expand their recurring income base with offices.

Political uncertainty has also raised concerns that the growth in the O&O sector will likely be impeded. However, we remain optimistic as the country continues to be the best destination for voice-related services due to the presence of a well-educated workforce with excellent English proficiency and competitive wage rates.

According to the IT and Business Process Association of the Philippines (IBPAP), the sector is estimated to grow to US\$ 38.9 billion in revenues by 2022. The IBPAP also acknowledges that the country is planning to move up the value chain towards the mid and high-skilled services market which will drive the bulk of revenue growth in the coming years. On the flip side, employment from the sector may slow down as these services will utilize less



full-time employees (FTE) compared to the established voice services. Nevertheless, the outsourcing sector is still estimated to employ on average 100,000 additional FTEs per year until 2022.

New supply

The construction delays in 2016 have led to a noticeable rise in the anticipated new supply in the 2017 pipeline. BGC will account for close to half of all new additions this year with 461,400 sq m while the Bay Area will come in second with 206,700 sq m. Although new supply for 2017 in these submarkets is relatively large compared to previous periods, we have still witnessed high levels of leasing activity. Furthermore, a number of buildings in both districts have already been partially preleased and there are encouraging signs that the robust occupier demand is intact.

Although BGC has become an established office market that can rival the Makati CBD, the Bay Area is quickly transforming into a dominant submarket as well. We estimate that by the end of 2020, the Bay Area will have 869,300 sq m of Grade A office stock, overtaking the Ortigas Center as the third largest office district in the country.

Investment market

In the asset market, investment activity was not as busy compared to 2015 due to the lack of big ticket acquisitions. Additionally, the landscape was dominated by several land deals with just two office transactions recorded during 2016.

Both office transactions were concentrated in the country's two main CBDs with the largest transaction coming from the sale of the AccraLaw Tower. The recently repositioned and refurbished Grade A office building located in BGC is believed to have delivered an above-average market return after transferring ownership for a consideration of around US\$ 75 million – representing a cap rate of 5.4%. The extremely low cap rate is explained by the significant investor demand the asset achieved, from both domestic and overseas sources, before ending up being bought by a local investor. The other notable transaction was Enterprise Center where ING Real Estate sold their partial interest to

Shang Properties and A. Soriano Corporation. The deal was estimated at US\$ 48.9 million.

We expect a turnaround in transaction volumes this year as Manila maintains its status as an appealing investment destination. According to the ULI Emerging Trends in Real Estate report, Manila ranked third in the region as an investment prospect for offices. However, in order for volumes to increase substantially, there needs to be one or two big portfolio or large scale transactions. We have already noticed increased interest from Chinese developers for big ticket projects in the country which may boost the transaction activity moving forward.

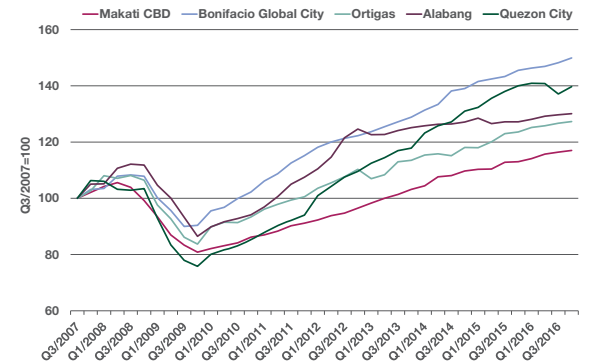
Forecast

The robust economic story of the Philippines is expected to continue this year with GDP estimates still within 6% to 7%. However, there are risks of downgrades from credit agencies which have already raised worries of the unpredictability of the current government's policies. In addition, the forecast budget deficit may further add to this likelihood despite the added government stimulus.

Increases in the US Fed's interest rates could have consequences, causing a rise in the bond market and an increase in the cap rates for real estate. On the other hand, this could also result in the peso's further depreciation which may result in more affordable rents and labour costs for the O&O sector.

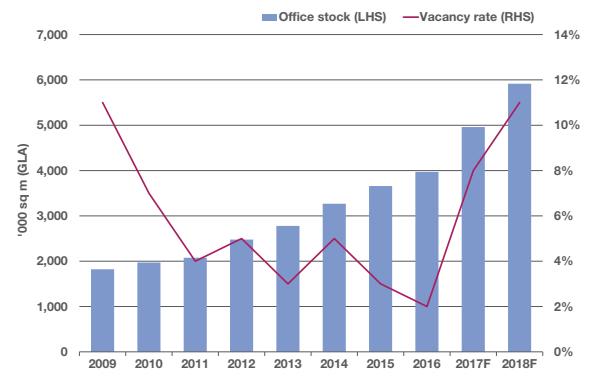
In the coming quarters, the unprecedented new supply in Manila will likely test the O&O sector's appetite for office space. However, with the projected FTE growth, we should still see strong occupier demand from the industry. Furthermore, the sustained economic growth together with government's infrastructure thrust should continue to support the overall real estate sector. ■

GRAPH 4 Grade A office rental indices, Q3/2007–Q4/2016



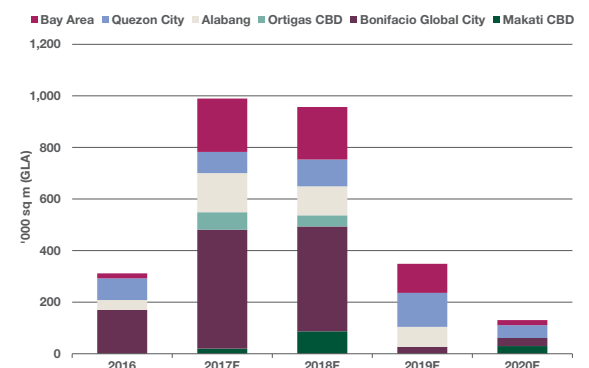
Source: KMC Savills Research

GRAPH 5 Grade A office stock and vacancy rate, 2009–2018F



Source: KMC Savills Research

GRAPH 6 Future Grade A office supply, 2016–2020F



Source: KMC Savills Research

ASIA PACIFIC HEADQUARTERS

23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4400 Fax: (852) 2868 4386



HONG KONG SAR

Savills (Hong Kong) Limited

23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4534 Fax: (852) 2869 6738
Contact: Raymond Lee E-mail: rlee@savills.com.hk
EA Co. Licence: C-002450

Savills Valuation and Professional Services Limited

8/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2801 6100 Fax: (852) 2501 5810
Contact: Charles Chan E-mail: ccchan@savills.com.hk
EA Co. Licence: C-023750

Savills Property Management Holdings Limited

8/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2534 1628 Fax: (852) 2508 1883
Contact: Johnnie Chan E-mail: jckchan@savills.com.hk
EA Co. Licence: C-002955

Savills Guardian (Holdings) Limited

7/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2512 1838 Fax: (852) 2887 3698
Contact: Peter Ho E-mail: peterho@savillsguardian.com.hk
EA Co. Licence: C-004089

MACAU SAR

Savills - Macau

Savills (Macau) Limited
Suite 1309-10, 13/F Macau Landmark, 555 Avenida da Amizade, Macau
Tel: (853) 8506 6288 Fax: (853) 2878 1805
Contact: Franco Liu E-mail: fliu@savills.com.mo

CHINA

Savills - Shanghai

25/F Two ICC, 288 South Shaanxi Road, Shanghai 200031, PRC
Tel: (86) 21 6391 6688 Fax: (86) 21 6391 6699
Contact: Albert Lau E-mail: Albert.Lau@savills.com.cn

Savills - Beijing

2101 East Tower, Twin Towers, B-12 Jianguomenwai Avenue, Chaoyang District
Beijing 100022, China
Tel: (86) 10 5925 2288 Fax: (86) 10 5925 2299
Contact: Billy Chau E-mail: Billy.Chau@savills.com.cn

Savills - Guangzhou

Room 906, R & F Centre, 10 Hua Xia Road, Zhu Jiang New Town
Guangzhou, 510623, China
Tel: (86) 3892 7168 Fax: (86) 3892 7030
Contact: Woody Lam E-mail: Woody.Lam@savills.com.cn

Savills - Shenzhen

Unit A, 5/F, Anlian Plaza, 4018 Jintian Road, Futian District, Shenzhen 518026, China
Tel: (86) 755 8828 5707 Fax: (86) 755 8828 5676
Contact: Woody Lam E-mail: Woody.Lam@savills.com.cn
Offices in Chengdu, Chongqing, Dalian, Hangzhou, Nanjing, Qingdao, Shenyang, Tianjin, Xiamen, Xi'an, Zhuhai

ASIA

Savills - Indonesia

PT Savills Consultants Indonesia
Panin Tower – Senayan City
16th Floor, Unit C
Jl. Asia Afrika Lot. 19
Jakarta 10270, Indonesia
Tel: +62 (21) 293 293 80 Fax: +62 (21) 293 293 81
Contact: Jeffrey Hong Email: jeffrey.hong@savills.co.id

Savills - Japan

Savills Japan Co., Ltd
15/F Yurakucho ITOCiA
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: (81) 03 6777-5150 Fax: (81) 3-6777-5105
Contact: Christian Mancini E-mail: cmancini@savills.co.jp

Savills - Korea

Savills Korea
13/F Seoul Finance Center, 84 Taepyungro-1-ga
Chung-gu, Seoul, Korea 100-768
Tel: (82) 2 2124 4201 Fax: (82) 2 2124 4188
Contact: K.D. Jeon E-mail: kdjeon@savills.co.kr

Savills - Malaysia

Savills (Malaysia) Sdn Bhd
Level 9, Menara Milenium, Jalan Damanlela, Bukit Damansara
50490 Kuala Lumpur, Malaysia
Tel: +603 2092 5955
Contact: Christopher Boyd Email: chris.boyd@savills.com.my

Savills - Philippines

KMC MAG Group
8/F Floor Sun Life Centre, 5th Ave
Bonifacio Global City 1634, Philippines
Tel: (632) 403-5519
Contact: Michael McCullough Email: michael@kmcagggroup.com

Savills - Singapore

Savills (Singapore) Pte Ltd.
30 Cecil Street, #20-03 Prudential Tower, Singapore 049712
Tel: (65) 6836 6888 Fax: (65) 6836 2668
Contact: Chris Marriott E-mail: cjmarriott@savills.asia

Savills - Taiwan

Savills (Taiwan) Limited
21/F Cathay Landmark, No.68, Sec. 5, Zhongxiao E. Road
Xinyi District, Taipei City 110, Taiwan
Tel: (886) 2 8789 5828 Fax: (886) 2 8789 5929
Contact: Cynthia Chu E-mail: cchu@savills.com.tw
Office in Taichung

Savills - Thailand

Savills (Thailand) Limited
26/F Abdulrahim Place, 990 Rama IV Road
Silom, Bangrak, Bangkok 10500, Thailand
Tel: (66) 2 636 0300 Fax: (66) 2 636 0339
Contact: Robert Collins E-mail: rcollins@savills.co.th
Office in Pattaya

Savills - Vietnam

Savills Vietnam Ltd. Co.
18/F, Fideco Tower, 81-85 Ham Nghi Street
District 1, Ho Chi Minh City, Vietnam
Tel: (84) 8 3823 9205 Fax: (84) 8 3823 4571
Contact: Neil MacGregor E-mail: nmacgregor@savills.com.vn
Office in Hanoi

AUSTRALIA

Savills - Australia

Savills (Aust) Pty Ltd.
Level 25, 1 Farrer Place, Sydney, Australia NSW 2000
Tel: (61) 2 8215 8888 Fax: (61) 2 8215 8899
Contact: Paul Craig E-mail: pcraig@savills.com.au
Offices throughout Sydney, Parramatta, Canberra, Melbourne, Notting Hill, Adelaide, Perth, Brisbane, Gold Coast and Sunshine Coast.

NEW ZEALAND

Savills - New Zealand

Level 8, 33 Shortland Street, Auckland NZ 1010
Tel: (64) 9 951 5911
Contact: Paddy Callesen E-mail: pcallesen@savills.co.nz

NORTH AMERICA

Savills - New York

Savills Studley
399 Park Avenue, 11th Floor, New York, NY 10022
Tel: (1) 212 326 8610 Fax: (1) 212 326 1034
Contact: Mitchell Steir E-mail: msteir@savills-studley.com

UNITED KINGDOM / EUROPE / SOUTH AFRICA

Savills - Europe

33 Margaret Street, London W1G 0JD
Tel: (44) 207 499 8644 Fax: (44) 207 495 3773
Contact: Mark Ridley E-mail: mridley@savills.com
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