Savills World Research
Philippines

Asian Cities Report
Manila Office

1H 2017

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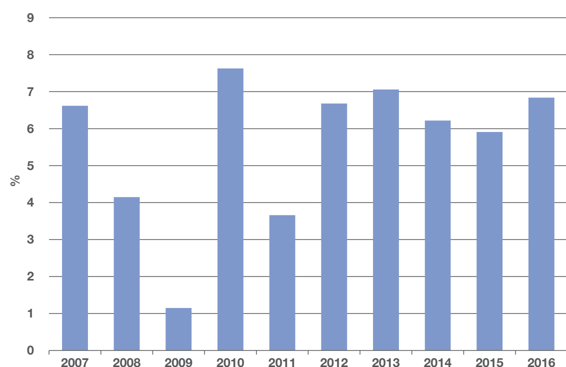
GRAPH 1

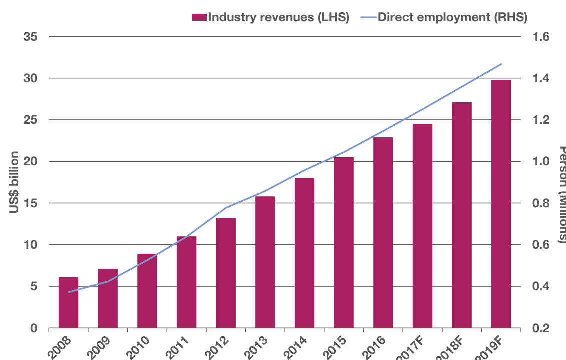
GDP growth, 2007–2016



Source: National Statistics Coordination Board (NSCB)

GRAPH 2

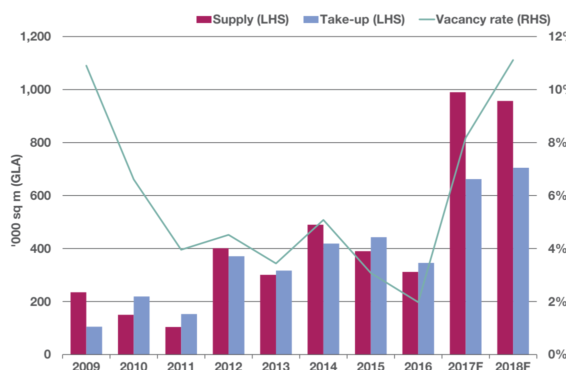
IT-BPO industry revenues and employment, 2008–2019F



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

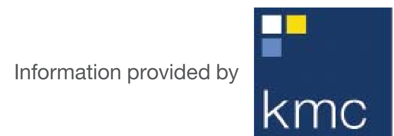
The Manila office market has recorded impressive growth in the past few years driven by the increasing demand for space from the expanding O&O sector. The growing outsourcing operations in the capital led to net take-up outpacing new supply in 2016 which pushed vacancy rate down to 2% by the end of the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

Information provided by



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

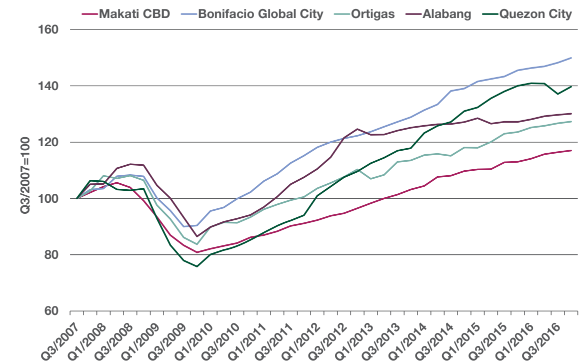
The robust economic story of the Philippines is expected to continue this year with GDP estimates still within 6% to 7%. However, there are risks of downgrades from credit agencies which have already raised worries of the unpredictability of the current government's policies. In addition, the forecast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

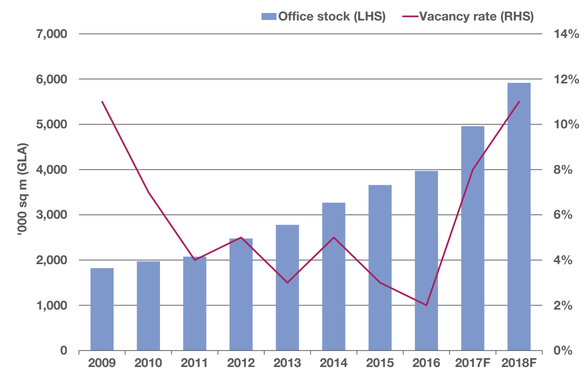
Grade A office rental indices, Q3/2007–Q4/2016



Source: KMC Savills Research

GRAPH 5

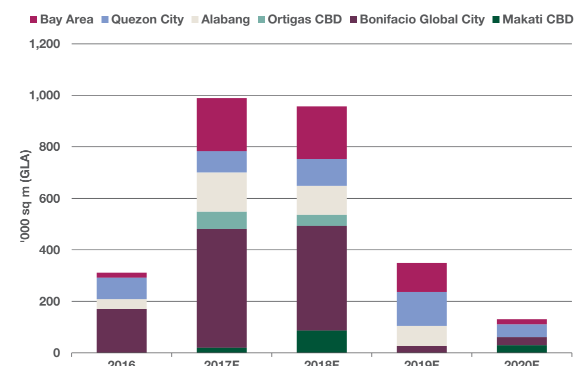
Grade A office stock and vacancy rate, 2009–2018F



Source: KMC Savills Research

GRAPH 6

Future Grade A office supply, 2016–2020F



Source: KMC Savills Research

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