Savills World Research
Philippines

Asian Cities Report
Manila Investment

1H 2016

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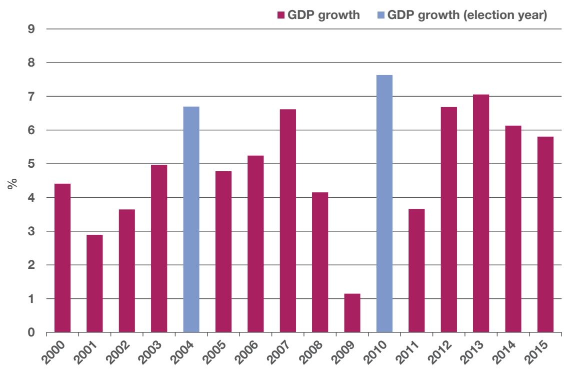
GRAPH 1

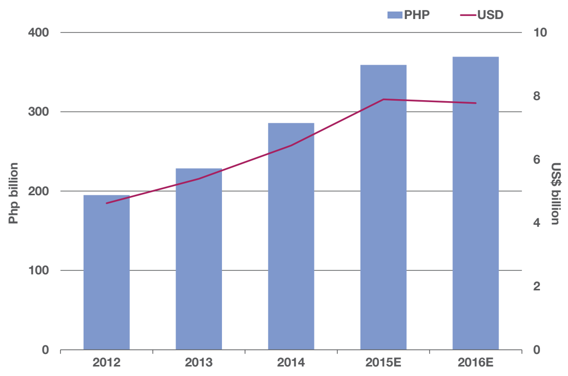
GDP growth, 2000–2015



Source: National Statistics Coordination Board (NSCB)

GRAPH 2

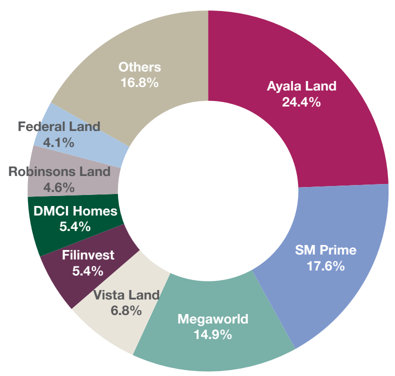
Estimated capital expenditure plans of listed developers, 2012–2016E



Source: KMC MAG Group

GRAPH 3

CAPEX by developers, 2016E



Source: KMC MAG Group

Economic overview

2016 will be a very important year for the Philippines on the political front as the country is set to take a new direction with the selection of its new president in May. The strong underlying fundamentals i.e. its advantageous demographics, healthy public finance, strong private consumption, growing outsourcing and offshoring (O&O) industry, and the steady inflow of Overseas Filipino Workers' remittances will likely maintain the current positive outlook, but the change in the nation's leadership is seen to bring in new approaches to tapping this economic potential.

Much of the recent years' economic growth and stability is attributable to the current administration. Under the six-year term of the outgoing president Aquino, the Philippines' GDP growth has averaged 5.9% but more importantly, the country has taken a big leap in terms of fiscal consolidation and reforms to fight corruption. As a highlight, the country gained its first investment grade rating in 2013 which has dictated the current growth path by providing a favorable investment environment and positioning the country as one of the fastest growing economies in the Asia-Pacific region.

Despite the effectiveness of the current administration, certain areas of the economy have been left unimproved, thereby requiring action from the new administration. Government spending and capital formation have been severely lacking over the years and unless these areas start to make headway, the inclusivity and sustainability of t he growth will eventually be put in jeopardy. The weak level of infrastructure in particular is now causing a rather unproductive manufacturing industry, leaving growth entirely dependent on service sector performance, which now accounts for 57.0% of GDP. Moving forward, a greater diversification of the economy would support and provide further stability, allowing the country to maintain its high-trajectory growth story.

Overall, growth is expected to accelerate in 2016 from last year. In the short term, the election spending is likely to support GDP growth but to sustain this in the long term, the structural challenges need to be addressed. Major financial institutions forecast that the Philippines' GDP will grow by 6.3% to 6.5% in the next couple of years which is much higher than the expected global growth of 2.9% and the forecast for developing economies of 4.8% in 2016.

Investment market overview

Real estate continues to benefit from the current upturn of the Philippine economy, contributing around 17.0% to GDP output. In particular, the country's O&O industry has been the major driver of real estate demand as Manila currently ranks the second best outsourcing destination in the world. A majority of the demand from the O&O industry is directed towards office space but has a spillover effect on the residential and retail sectors as well.

As an answer to the increased occupier demand, local developers remain extremely aggressive and are injecting large amounts of liquidity with record-breaking investment agendas. Capital expenditure programs are expected to reach the PHP370 billion (US$7.8 billion) level in 2016, an increase of 2.9% compared to PHP360 billion (US$7.9 billion) in 2015. Whilst a majority of this capital is covering ongoing projects and new launches, investment sales have certainly picked-up as well in recent years as evidenced by the increasing transaction volumes. KMC MAG Group has recorded approximately PHP96.8 billion or US$2.1 billion worth of property related transactions in 2015 in the Philippines. This is an increase of more than 20% over the PHP79.9 billion or US$1.8 billion recorded in the previous year. During the same period, 34 transactions were closed, an increase of 13% from the previous year's 30.

Despite the significant investor demand in Philippine property however, the everlasting obstacle of a structural shortage of suitable investment product is discouraging investors, especially those from overseas. Thus, the transaction volume remains relatively low and deals are predominantly concentrated around development sites and executed by local developers. The local developer purchaser category remained the most active in the investment market for

Information provided by KMC MAG Group

2015, purchasing 65.6% of the total volume or PHP63.5 billion (US$1.4 billion) worth of transactions.

Another trend seen in 2015 was the high number of property company M&A deals. Among the most notable arrangements in 2015 were Vista Land's consolidation with Starmalls, GT Capital's stake in ProFriends and the acquisition of Prime Orion by Ayala Land.

As for direct real estate investments, the largest transactions were the sale of nearly 46 hectares of reclaimed land in the Cebu South Road Properties and the acquisition of Tower 6789 in Makati CBD. Other than these, the ticket sizes stayed below PHP2.0 billion, and were mainly located in the Metro Manila area.

As foreign ownership rules continue to limit the participation of overseas buyers, foreign involvement is mainly in the form of joint venture partnerships or debt funding. Last year, the notable foreign investments included the US$150 million debt facility by ADM Capital and Baring Private Equity for the funding of five office buildings in Clark and the joint venture partnership of Mitsubishi and local developer Century Properties for Forbes Media Tower, a 95,000 sq m mixed-use project in Makati City.

Offices remain the most wanted asset class

Needless to say, driven by O&O industry demand, the office sector remains the most sought after asset class – a fact highlighted by firm property yields. Manila is currently home to the majority of the world's largest outsourcing companies and multinational firms which has translated to a significant increase in office demand in recent years. In 2015, the office market's net take-up equaled to some 443,000 sq m and given the growth projections of the O&O sector, net take-up is expected reach 450,000 to 500,000 sq m in 2016 as the markets will see more supply. The CBD vacancy is currently recording a vacancy rate of 3.0% – the lowest level recorded since the GFC.

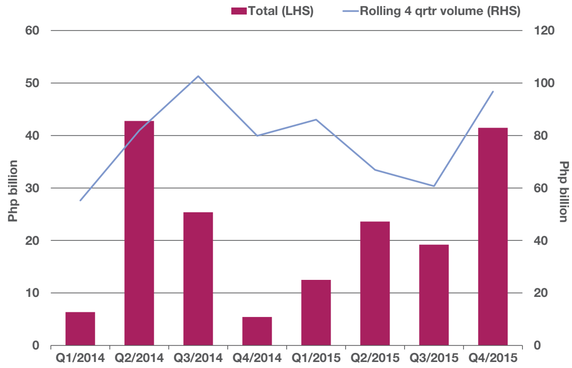
In terms of asset performance, Manila offices are returning exceptionally high rental yields, a trend outperforming most of the markets in the region, and demonstrating the highest yield spread when compared to other cities in the region. The current market risk premium is at a healthy 4.5% with market yields for Grade A offices estimated at 8.1%.

However, as it seems that the current landlord market has resulted in a lack of willing sellers of office properties, office sales represent only 13.0% of the total volume. At the moment, there are a couple of interesting assets offered for sale which will likely increase the volumes this year. However, in order for the market to grow substantially, a number of large and high-quality assets need to be put on the market.

Looking ahead, we see that the continued strong interest in prime assets will lead to a downward pressure on yields as the risk premium over the rental yield is now at a very high level even though risk to real estate has not yet increased to support it. The current high liquidity of the financial system with low interest rates and new rounds of quantitative easing from Europe and Japan can also bring an added boost, as it is likely to trickle-down to Manila. This being said, we believe that the current growth of capital values could reach 5.0-7.5% in 2016 and yields will continue to compress.

GRAPH 4

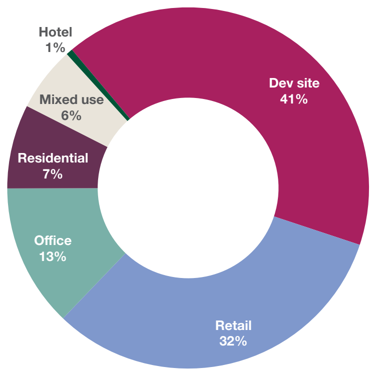
Transaction volumes, Q1/2014–Q4/2015



Source: KMC MAG Group

GRAPH 5

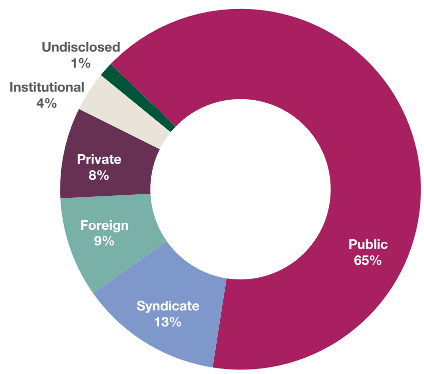
Transaction volumes by property type, 2015



Source: KMC MAG Group

GRAPH 6

Transaction volumes by buyer profile, 2015



Source: KMC MAG Group

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