MARKET INSIGHT – 3RD QUARTER

TO BUILD OR NOT TO BUILD

BY PINNACLE.PH

The real estate market has been blisteringly active in the past five years or so. Margins north of 30% were doable especially right after the Philippines was rated as "investment grade" by a number of international rating agencies. There are sufficient reasons that the market, together with the general economy, is backed by real demand, but real estate developers cannot wantonly build and expect brisk sales and returns. As usual, Pinnacle Real Estate Consulting Services, Inc. evaluates macroeconomic indicators that directly impact on the real estate as well as supply-and-demand dynamics to answer the question of to build or not to build.

Based on reports, Bangko Sentral ng Pilipinas (BSP) Deputy Governor Diwa Guinigundo stated that massive urban migration and strong consumer power generated by dollar-earners like the overseas Filipinos workers (OFWs) and the Business Process Outsourcing (BPO) companies support the bullish foundation. By 2017, revenues from BPOs will reach US$25 billion revenues and OFW remittances will reach US$28 billion, generating a total of US $53 billion. This dollar income will be chasing after consumer favorites like houses, cars, and appliances.

Added to this will be the relatively high 1.9% annual population growth rate characterized by a young, employable population sector (with, therefore, low dependency ratio). Essentially, the stability of the industry is underpinned by demand outstripping supply. At present, the residential housing backlog is five million units and independent foreign-based forecasters peg the same 5.0 million supply gap even up to the year 2030. The BSP Deputy Governor says it will take the construction of 2,600 residential units every day to catch up and erase the backlog. Some argue this may not necessarily be true for the office types currently centered in Makati, Ortigas and the Fort Bonifacio areas.

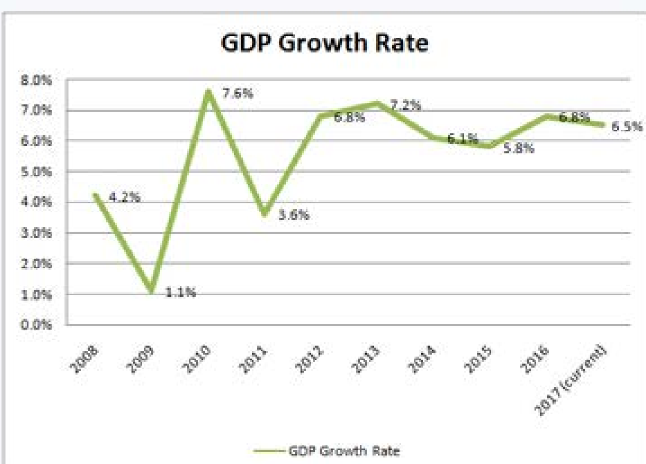
Sheer economic growth targeted at 6.5-7.5% GDP expansion from now until 2022 and the gradual reduction of poverty levels from 24% to 16% in 2022 would empower more people to afford some form of housing budget. Low-interest rate regime, which is a deliberate BSP policy, is also a prime factor that encourages people to go into house financing. The Philippines has had 74 consecutive quarters of positive GDP growth. Yet even with this impressive growth, prices of goods and services inflation rate has remained stable at 1.8% in 2016 edging to 3% in the near term.

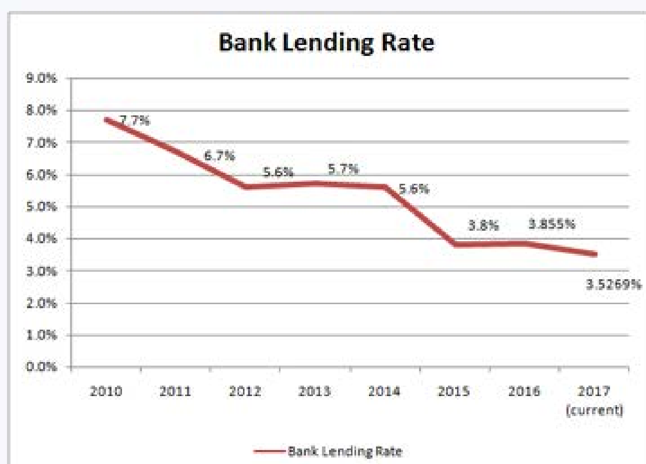
In previous [reports](), Pinnacle has cited the build build build (BBB) thrust of President Rodrigo Duterte's Administration. The Philippine economy will surely benefit from this major infrastructure spending, and would improve the efficiency of transportation and doing business since majority of these projects are rail development projects. It is imperative to consider the overall economic backdrop and hinge this on how real estate players react to paint the big picture of the property market.

MACROECONOMY

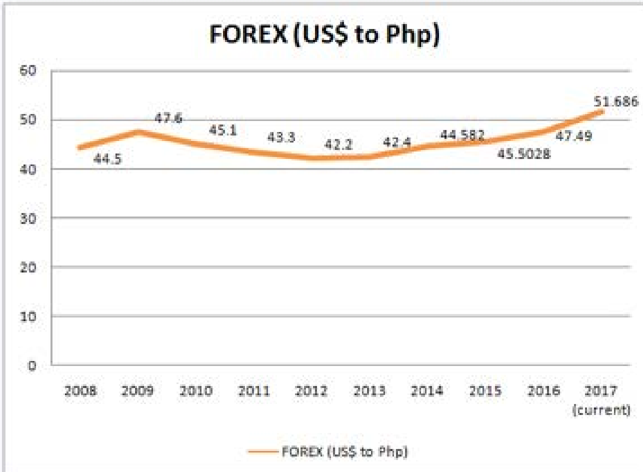
The country's gross domestic product (GDP) grew by 6.5% during the first half of the year, which is within National Economic and Development Authority (NEDA)'s projected annual growth between 6.5-7.5%. The GDP's growth is slightly lower than the 6.8% growth for the entire 2016, although Philippines is also second to China's growth of 6.8% among selected countries in Asia. For the same period, here are the GDP growth rates of some countries: Vietnam: 6.4%; Malaysia: 5.8%; India: 5.7%; Indonesia: 5.0%; South Korea: 4.1%; Thailand: 3.7%; Singapore: 2.9%; and Taiwan: 2.1%.

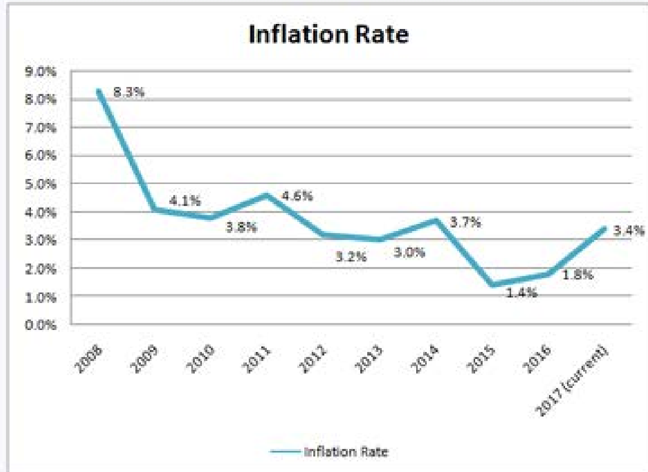
The Bangko Sentral ng Pilipinas (BSP) figures show that the net foreign direct investment (FDI) from January to July of this year reached US$ 3.904 billion, which is 16.52%% lower for the same period in 2016. At any rate, this is still at pace to breach the US$ 7 billion-mark that was done for the first time last year. This total does not include investments by the Business Process Outsourcing (BPO) companies.





Sources: GDP Growth Rate - Philippine Statistics Authority; Bank Lending Rate - Bangko Sentral ng Pilipinas





Sources: Inflation Rate - Philippine Statistics Authority; FOREX - Bangko Sentral ng Pilipinas

Based on latest BSP statistics, the average bank lending rate from October 9 to 13, 2017 slightly decreased to 3.4728% as compared to 3.855% towards the end of 2016. This is very attractive that can boost real estate acquisitions. The Philippine Peso to US Dollar exchange increased to Php 51.463 to a dollar as compared to Php 50.609 in July. This is a testament that the US economy has weathered its economic weakness in recent years. The weakening peso, however, is not necessarily a bad thing, since Filipino products, especially real properties, would be more attractive to dollar-earners, and probably to other foreign currency earners. Thus, Pinnacle Research is in the view that bank interest rates and foreign exchange are stable and manageable at present, and can still fuel spending on real estate.

Overseas Filipino remittances continue to grow. Total remittances from January to August 2017 reached the US$ 18.595 billion as compared to US$17.642 billion for the same period in 2016, or an increase of 5.4%. Dollar remittances are on track to eclipse US$ 26-billion performance last year, and perhaps breach the US$ 27 billion-mark this year.

The latest Philippine Statistics Authority (PSA) figure shows that inflation rate increased to 3.4% as compared to the annual average of 1.8% in 2016. This increase is within BSP's target inflation between 2% and 4%. One thing is clear, the government, businesses and consumers are now spending more, and this would in turn push further growth.

Based on Department of Tourism statistics, the total international arrivals for the first half 2017 reached 3.36 million from 2.98 million for the same period last year. There is a significant increase of 12.73% between the two periods, despite the negative publicity of the Marawi conflict. At this rate, the target of six million arrivals by end of the year appears imminent. More importantly, revenues generated from visitor receipts reached Php 146.33 million for the first half of the year, from Php 127.37 million for the same period last year, for an increase of 14.89%. This increase in spending bodes well for the country's tourism industry.

The latest unemployment rate released by PSA is at 5.6% as of July 2017, which is slightly better to the 5.8% unemployment rate in the April 2017 survey. Again, this is a strong testament that the yearly graduates are being absorbed by the labor market since the nominal average hovered around of 6% in the past five years.

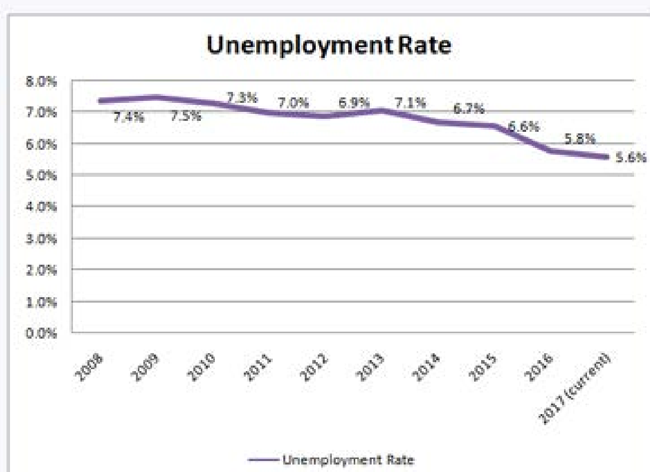
The Philippine economy has sustained its robust growth despite the negative impact of the Marawi conflict. It may be a blessing in disguise that the local conflict pales in comparison to the conflicts and violence in other parts of the world. Other concerns are the weakening Peso versus the dollar and inflation rate is slightly increasing. These two concerns, however, actually make Philippine products more affordable and attractive to foreign currencies, especially from overseas Filipinos and dollar-earning BPO industry. Overall, the upbeat macroeconomic indicators bode well for the real estate market in general.

THE TOUGH GETS GOING

Most if not all real estate developers have been cashing in from the robust Philippine economy and booming real estate market in the past years. In some sectors, like the mid-market residential condominium market in Metro Manila, competition has stiffened in recent quarters since all of the players want to have a market share in this segment. Margins and profits are still there to be made, but have been compressing due to sheer competition. On a separate front, the office market is slightly softening due to the protectionist Donald Trump administration thereby creating a little bit of uncertainty. Pinnacle Research is in the view that the property market will definitely expand and grow, but it is not for the feeble heart and underprepared.

As earlier reported, the Ayala Land Group will launch approximately Php 100 billion worth of projects this year, or an increase of 64% from 2016. While Ayala Group would rely on the strength of their sales team, they are now committing in the leasing market by adding another dimension in their portfolio. The Group is now investing Php 3 billion to build five dormitories on four sites in the Makati and Taguig business districts. These developments will comprise 1,500 units that can house as many as 6,000 people. The first dormitory will be ready next year, and has received interest from firms wanting to lease entire floors for their employees.

Based on reports, Ayala Corporation increased its net income by nine percent (9%) in the first half of the year to Php 15.1 billion, primarily driven by the solid contributions of its real estate and power generation businesses. Ayala Land sustained its growth trajectory in the first semester, recording Php 11.5 billion in net income on the continued expansion of its property development and commercial leasing businesses.



Source: Unemployment Rate - Philippine Statistics Authority

SNAPSHOTS

SECTOR	TREND	
OFFICE	↑	Office take-up is strong, slight softening of demand from BPOs. Traditional companies and government agencies may fill in the demand gap. Very high occupancy levels and stable rents.
RESIDENTIAL	↔	Housing backlog persists. Demand for residential products has been steady. Middle-market condominium is very competitive. Metro Manila fringe areas are now explored to serve the demand for the affordable and socialized segments.
RETAIL	↑	Small retailers are still queuing to enter in choice retail malls to get a share of the demand from consumers and shoppers especially with the "Ber" months. Further expansion by the big players; various retail platforms are tested, especially the convenience store setup.
HOTEL & GAMING	↔	International and local brands are introduced in the market to attract the increasing tourist arrivals. The redevelopment of Intercontinental Manila and Mandarin Hotel created opportunities to new five star hotels
INDUSTRIAL	↑	Sustained demand for industrial spaces; limited quality stock; stable rents.

The SM Development Corporation (SMDC) reaffirms its vision for the Philippines to be a nation of homeowners while celebrating its 10th year anniversary. Starting with the launch of Mezza Residences in 2006, SM Group has been selling 15,000 to 20,000 units a year, reaching 31 projects with more than 50,000 units delivered to residents.

The Group recently launched Green 2 Residences, its first high-rise condominium project in Dasmariñas, Cavite worth Php 3 billion. This part of the Group’s portfolio of “University Town” developments is aimed at college students and young professionals. The Group plans to sell 1,057 units at an average price of between Php 2.6 million and Php 4.5 million, and it is near De La Salle University Dasmariñas, De La Salle Health Sciences Institute and Emilio Aguinaldo College Cavite. The schools have a combined student population of 20,000.

Reports cite that SM Investments Corp. (SMIC), the holding firm of the businesses of the Sy family, has increased its income for the first half of the year by nine percent (9%) to Php 16.6 billion, from Php 15 billion for the same period last year. The property business contributed the most to SMIC’s consolidated net income at 42%, followed by banks with 36% and retail with 22 percent. In terms of property sales, reservation sales grew 22% from recently launched projects for the first half of 2017.

The Megaworld Group is reported to be the biggest lessor of office spaces and urban township developer. The Group recently launched its Php 30-billion 35.6-hectare township in San Fernando. In addition, Megaworld continues to ramp up its commercial portfolio with the opening of the Php 2-billion Southwoods Mall this year. The Southwoods Mall, located inside its integrated township Southwoods City in Biñan, Laguna and Carmona, Cavite, is the 14th mall of Megaworld, offering 58,000 square meters of retail, dining and entertainment facilities. The Group is targeting to operate 28 malls by 2020.

Photo courtesy of Megaworld

Robinsons Land Group has been growing its recurring income from malls, offices and hotels. The Group is now targeting to open its 271-room Dusit Thani Mactan Cebu Resort, a luxury resort property, by 2019. This is in addition to its Go Hotels; new malls in Cebu City, Tagum in Davao, General Trias in Cavite, and Jaro in Iloilo; and the mixed use development in Naga City, Bicol.

The housing unit of the DMCI Group is reported to hit its full-year target as of June. Total sales reached Php 26.2 billion as of end-June, which is higher than its target sales of Php 25.5 billion for entire 2017. This prompted the Chairman and President, Isidro A. Consunji, to push its unit further and hit a total annual sales of Php 40 billion. DMCI Group sold 6,206 units and 3,473 parking slots by end of June.

The top developers very well know their strengths and core competencies, and strive to maintain them. At the same time, they always find new ways on how to sustain their growths. The real estate market is expected to be more competitive in the coming quarters, but rest assured, all of the sectors rest on real demand, albeit somewhat softening. With a softening demand, the going would get tough, but the tough gets going.

OFFICE MARKET

The tepid demand from the Business Process Outsourcing (BPO) industry during the first three quarters of the year is a sign that BPO companies are seriously evaluating their positions given the protectionist policy of the Trump Administration. At the end of the day, even if the outsourcing would translate to additional taxes, if BPO companies would still save on cost, they will still outsource. The advantage of the Philippines is that it is always on top, if the not the first choice.

Pinnacle Research is projecting that the Metro Manila total stock of Grade A office buildings or better (handful of Prime Grade A buildings in Makati CBD) will reach over 9 million square meters by the end of 2017. Overall vacancy across the various business districts in Metro Manila would increase to approximately 5%, from 3%, since it will now take a while to absorb the approximately 500,000 sqm of new office spaces. It is important to note that most of the buildings

that were turned over were pre-leased, with limited office space available for lease. This additional in vacancy is not that bad, but it is a signal that planned new office buildings should really do their due diligence since most big players have been at pace with the growth of demand in recent years.
While the office market is still a landlord's market due to high occupancy, weighted average rents are quite stable. Rents in Makati Central Business District (CBD) are steady where Premium Grade A buildings have a weighted average of Php 1,400 per sqm per month, Grade A buildings have a weighted average rent of Php 950 per sqm per month, and for Grade B&C Buildings, the weighted average is Php 720 per sqm per month.

The weighted average rent in BGC is at par with Makati Grade A buildings at Php 950 per sqm per month. The average rent of Grade A office buildings in Ortigas, Alabang and Bay Area is estimated at Php 680 per sqm per month. Quezon City office rents have a slightly higher weighted average of Php 700 per sqm per month, owing to new and only few buildings.

Aerial perspective of San Fernando Township courtesy of Megaworld

RESIDENTIAL MARKET

According to the Bangko Sentral ng Pilipinas (BSP), Philippine residential property values slightly slipped from the first quarter prices to the second quarter rates. The Residential Real Estate Price Index (RREPI) decreased to 116.6 for secondary of 2017 from 116.7 in the first quarter of the year. The base period of the index, or the time when it was "100" is the first quarter of 2015. Based on this index, residential property prices grew by 16.6% since the first quarter of 2015. The slight decrease from the first quarter to the second quarter of 2017 means that prices are "plateauing" or perhaps even dipping.

Nonetheless, the big players are still building due to the huge housing backlog. As elaborated above, the big players get tough and optimize their corporate advantages, and they look for new demand in the market, like the dormitory housing.

Furthermore, a lot of real estate developers, including the small and medium size players are waiting for the implementing rules and regulation, as well as the price ceiling of the vertical socialized projects. This is intended to tame the housing backlog. In fact, Pag-IBIG Fund CEO Acmad Rizaldy P. Moti was quoted in a report that he sees a future wherein workers would be highly mobile so that “we may have to consider that people may prefer to rent than get housing units in fixed communities.” Apart from the traditional lending by Pag-IBIG Fund, Moti said the public housing sector could consider constructing condominiums and tenements to suit the highly mobile nature of some occupations, housing developers may also consider “offering them rent-to-own units.”

With this pronouncement from the head of Pag-IBIG Fund, together with the upbeat outlook of the big players, Pinnacle Research is in the view that residential development shall continue. It is doubly important then that proper market research and segmentation is done to avoid margin compression when faced with stiff competition for the same market share.

RETAIL MARKET

The SM Group has tightened its grip as the undisputed leader in the commercial retail sector. It targeted to have 65 big malls by the end of the year, and they will soon operate their 64th mall to serve the shoppers in Puerto Princesa and Palawan in general. Looking forward, SM Group intends to increase its malls to 75 by 2018. The Group also operates 48 supermarkets, 44 hypermarkets, 156 Savemore grocery stores, 39 Waltermart stores, 210 Alfamart convenience stores and 1,749 specialty stores.

On a separate note, the Cebu-based Metro Retail Stores Group Inc. (MRSGI) is celebrating its 35th anniversary. The "Metro" Group is now operating 52 stores and has been cited by research firm Euromonitor as the country’s fourth largest multi-format retail operator in terms of retail sales value in the Philippines, and the largest operator in Visayas.

In addition, there is a side story in the "retail" front. Reports cite that Goldilocks President Richard L. Yee confirmed that the company is currently in talks with the SM Group for the acquisition of a controlling stake in the company. This is no small news since Goldilocks opened its 400th store in 2013. If we are to look back at the retail sector, a similar occasion already occurred in 2005 when the cake and pastry restaurant chain, Red Ribbon Bakeshop, was completely acquired by Jollibee Foods Corp. These mergers and acquisitions are a testament to the further consolidation of the retail business.

Photo courtesy of Dusit Hotels and Resorts

HOTEL AND GAMING MARKET

According to reports, there are 24,000 hotel rooms in Metro Manila, presumably in the deluxe category, or the three-to-five star hotels in the current category. The estimated weighted occupancy is at 65-70 percent in Metro Manila. The Philippine Hotel Owners Association (PHOA) drew a comparison with Metro Bangkok that has a total of 44,000 hotel rooms. PHOA projected that Metro Manila will have a room gap of 69,185; Cebu-Mactan will have a gap of 14,931, while Boracay will have a gap of 17,775 rooms. Thus, PHOA is seeking incentives from the Government to compensate for the handicaps faced by the Philippine tourism

industry. The Tourism Act of 2009 offers incentives such as:
- Income Tax Holiday (ITH) for new enterprises in the Greenfield and Brownfield Tourism Zones for a period of six years from the start of business operations, which may be extended up to a maximum of another six years depending on the substantial expansion or upgrade to be undertaken by the enterprise prior to the expiration of its first six year ITH.
- Newly registered Tourism Economic Zone enterprises shall likewise be allowed to carry over as deduction from gross income for the next six consecutive years immediately following the year of the loss, their net operating losses for any taxable year immediately preceding the current taxable year which had not been previously offset as deduction from gross income.
- Five percent income tax on gross income in lieu of all other national and local taxes, license fees, imposts and assessments except real estate taxes and such fees as may be imposed by TIEZA after the ITH.
- Exemption from all taxes and customs duties on importation of capital investment and equipment.
- Tax deduction not to exceed 50% of the cost of environmental protection and cultural heritage preservation activities, sustainable livelihood programs for local communities and similar activities.

In addition to these existing tax incentives, it is reported that PHOA is asking the Government for the following additional incentives: retain Pioneer status for hotel projects, and grant Board of Investments (BOI) fiscal incentives for tourism developments throughout the country, lifting all investment restrictions in the accommodation sector.

At any rate, Pinnacle Research earlier reported that the top developers have been busy gearing up their local brands. The Robinsons Land Group has been expanding its Go Hotel operations to 16 hotels, and is looking to duplicate its successful Summit Hotel in its Robinsons Magnolia development. Ayala Land Group has rolled out six Seda Hotels. The Vista Land Group is building four hotels under the Mella Brand to add to its current operation of the Boracay Sands Hotel. The second tier Eurotower Group has ramped up its operations to nine Eurotel branches and 39 Sogo branches. The tourism target is still at six million arrivals this year, and recent statistics show that the industry is on track to reach this target.

INDUSTRIAL MARKET

The Philippine Economic Zone Authority (PEZA) website reports that these are the operating economic zones are: 73 Manufacturing Economic Zones, 243 Information Technology Parks/Centers, 21 Agro-Industrial Economic Zones, 19 Tourism Economic Zones, and two Medical Tourism Parks/Centers, or a total of 358 economic zones. In terms of economic zones being developed, here is the list: 29 Manufacturing Economic Zones, 104 Information Technology Parks/Centers, six Agro-Industrial Economic Zones, and six Tourism Economic Zones, or a total of 145 economic zones being developed. Pinnacle Research monitored a number of end-use industrial space demand, as well as demand for land consolidation to build industrial zone. Since industrial spaces are typically sprawling, average lease on land of selected zones ranges between Php 55-70 per sqm per month, while average lease of selected factory spaces ranges from Php 150

to Php 250 per sqm per month, depending on the level of fit out of the industrial spaces. These rates remain stable.

LOOK FOR THE DEMAND, BUILD THE SUPPLY

Public and private sources are unanimous in claiming that the growth of the various real estate sectors is backed by strong demand. The real estate developers have been aggressively serving the demand of the buyers and renters in the past years, making the competition tougher. As discussed, the big players have been innovating and blending their product offerings to maximize their coverage and optimize their margins. Pinnacle Research recommends to continue building supply for the demand that one has meticulously identified. Like most developing markets, there are gaps that may be filled in by the most diligent real estate players.

Pinnacle Real Estate Consulting Services, Inc. provides a full range of services to buyers, real estate lenders and investors. A team of experienced professionals is dedicated to enhancing the value of clients' investments throughout the Philippines.

Our Services

Asset Management (REAM)
- Asset Sales, Workout, and Repositioning
- Portfolio Management
- Legal Administration
- Investor Accounting and Reporting
- Project Management (Community Mortgage, Redevelopment)

Sales, Leasing and Marketing
- Investments and Corporate Sales
- Corporate Leasing
- Residential Sales and Leasing
- Leisure and Hospitality

Property Management
- Building Management
- Parking Management
- Facilities Management
- Caretaker Services
- Technical Services

Research and Consulting
- Market and Industry Research
- Highest and Best Use and Feasibility Studies
- Investment Due Diligence / Development and Site Planning

Property Appraisal
- Full and Desktop Valuation
- Property Inspections
- Portfolio Valuation
- BIR NAV Valuations
- Plant, Machinery and Intangibles Valuation

Property Services
- Title Services - Transfer, Document Retrieval, Annotation, COS, E-Filing
- Payment Services - Real Property Tax, Association Dues
- Special Property Services - Land Use Conversion, Title Replacement, Ejectment, DAR (VOS)

Loan Servicing
- Non Performing Loan Servicing (Special Servicing)
- Performing Loan Servicing (Primary Servicing)
- Securitization and Loan Pool Servicing (Master Servicing)
- Performing and Non Performing CTS Servicing

Contact Us

Makati Office:
Unit E-1 Garden Level, Corinthian Plaza Building, Paseo De Roxas cor Legaspi St., Makati City
Telephone: (02) 859-1000 Fax: (02) 859-1088 Email: sales@pinnacle.ph

Cebu Regional Office:
2F VCFI Bldg., Archbishop Reyes Ave. corner Molave St. Brgy. Camputhaw, Cebu City
Telephone: (032) 416-4010 Email: cebu@pinnacle.ph