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MARKET VISTA

Doing Business Together

Attracting Foreign Capital into the Housing Industry via Business Matching and Joint Ventures

by Pinnacle.PH

According to *Investopedia*, a joint venture is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This purpose can be a project, a new company, or a business activity. These business arrangements are used to take advantage of individual member-companies' expertise and resources, and in some cases to reduce risk of major capital investments.

Joint ventures have been a staple of the Philippine real estate market for many years. Bonifacio Global City is perhaps the best known joint venture project in the Philippines. Its developer, Fort Bonifacio Development Corp., is a joint venture between the Bases Conversion and Development Authority, Ayala Land Corp., and Evergreen Holdings of the Campos group. Other joint ventures in real estate include Cebu Property Holdings, Axis Residences in Mandaluyong (a joint venture between Robinsons Land and Federal Land), and the Grand Hyatt Residences Manila (a development of Federal Land and Japan's Orix Corp.).

But joint ventures in the low-cost and economic housing segments are something largely unexplored, save for a few initiatives in the last couple of years. This is unfortunate, as these segments are largely underserved. In this paper, Pinnacle Real Estate Consulting Inc. explores the potential of joint ventures in solving the country's ballooning housing backlog.

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The Philippines: Population and Trend

The Philippine population is estimated at 106 million as of second quarter of 2018, based on interpolated data from the Philippine Statistics Authority (PSA) as calculated by the Bangko Sentral ng Pilipinas (BSP). In 2020, the country's population is estimated to reach 110 million, and by 2045, it would reach as high as 142 million based on the 2010 Census-based Population Projections of the PSA. By this period, the Philippines would have already surpassed the populations of Russia and Japan. Although yearly growth rate is declining, the Philippines' population growth rate is at 1.6 percent as of 2016, which is still higher than Malaysia's 1.5 percent and Thailand's 0.5 percent.

The PSA also disclosed that the CALABARZON Region still has the largest population among all regions, followed by the National Capital Region (Metro Manila) and Central Luzon. Meanwhile, the country's top five most densely populated provinces are Rizal, Cavite, Laguna, Bulacan, and Pampanga (excluding Angeles City, Pampanga), in such order.

Current Housing Scenario

The National Economic and Development Authority (NEDA) spearheaded the preparation of the Medium-Term Philippine Development Plan (2017–2022), which published the latest housing shortage projections calculated by the Housing and Urban Development Coordinating Council (HUDCC).

According to data from HUDCC, as of December 31, 2016, the country's housing backlog is already at 2.0 million dwelling units, primarily affecting the socialized and economic housing segment. This number will

Housing Scenario

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80% of the increase is attributed to future and recurring housing needs related to allowance for inventory losses and increase in household population

Source: Latest projections made by the HUDCC. Visit http://pdp.neda.gov.ph/wp-content/uploads/2017/01/12-04-07-2017.pdf

then balloon to about 6.8 million shelters by 2022. Note that the latter figure is in gross total since it did not yet take into consideration the supply side.About 80 percent of the increase is mainly attributed to future and recurring housing needs related to allowance for inventory losses and increase in household population.

Meanwhile, statistics from the Housing and Land Use Regulatory Board (HLURB) show that the agency issued Licenses-To-Sell covering an approximately 238,000 housing units as a nationwide average for the last 5 years. The figures extend across all housing segments and other non-residential developments. It is important to note that only 101,000—equivalent to 42 percent of the 238,000 yearly average—are dwellings (i.e., house and lot or condominium units) targeted for socialized and economic housing segments where the big housing shortages are traced.

With the annual projected increase in population, the demand for housing supply has never been so evident. Housing production must then also be raised to keep up, or hopefully resolve, the persistent social problem of the country. There is an immense requirement of 346,000 house construction on a yearly basis resulting from the above figures.

Joint Ventures for Housing Supply

One of the common strategies in property development is through joint venture agreements where two or more entities pool in their resources to put up a project.Joint venture agreements typically has these main capital components: Financial Capital, Natural Capital, and Technological and Human Capital.

Joint venture participants who introduced capital to projects or developments can benefit (a) by setting limitation on one's liability or share risks, (b) by learning and capitalizing on the expertise of others, and (c) by exploiting the capital introduced by others.

Throughout the years, there have been joint-venture arrangements in the Philippines in the housing industry participated by both local and foreign players. Some of the recent and up-coming projects are:

a. In 2012, George Ty–owned Federal Land and Orix Corporation of Japan entered into a joint-venture agreement to develop a prime 1.5-hectare mixed-use estate in Bonifacio Global City (BGC). The two companies formed a joint-venture entity named Bonifacio Landmark Corp. for this project, which is located in the northeastern section of BGC.

b. In 2016, Taft Properties and Hongkong Land teamed up for the development of a 20-hectare waterfront micro-township project along the Mactan Channel in Mandaue City, Cebu, which they will call Mandani Bay.

c. In 2017, Century Properties Group was also reported to have reached an agreement with the Indonesian conglomerate Bakrie Group for the undertaking of multiple mixed-use developments in the country.

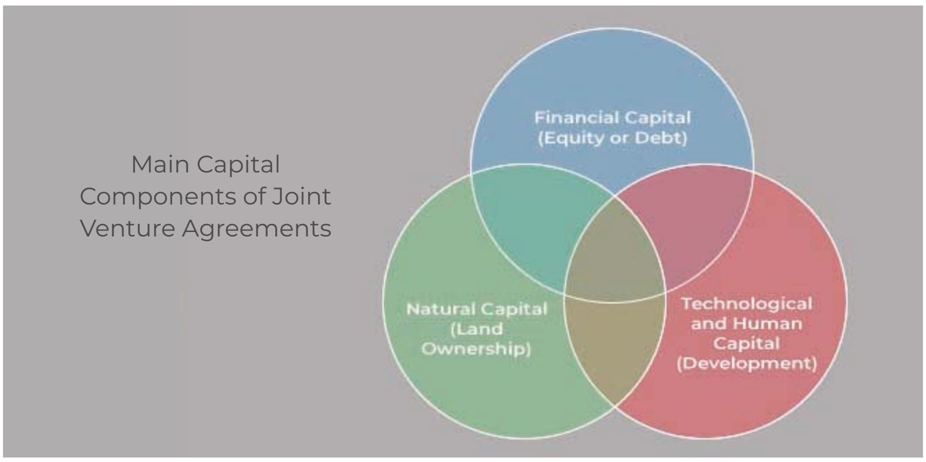
d. In 2017, it has been also reported that the Chinese government intends to undertake and finance 20,000 units of socialized housing in the Province of Cebu with the local government units (LGU) providing access to government-owned lots where the projects will be built.

e. In 2017, Japanese Hankyu Realty Co. Ltd. teamed up with P.A. Properties, a Laguna-based property developer, for the development of a 37-hectare mixed-use township project called Idesia in Dasmariñas, Cavite. The project's 11-hectare first phase broke ground in late 2017, and offers about 900 residential houses.

f. In 2017, another Japanese property firm, Mitsui Fudosan Co. Ltd., signed a joint venture agreement with Lopez-owned Rockwell Land Corp. The two companies will co-develop the residential component of the latter's The Arton project in Katipunan, Quezon City.

g. In 2017, Federal Land, Inc. inked a joint venture agreement with two Japanese firms Nomura Real Estate Development Co. Ltd. and Isetan Mitsukoshi Holdings Ltd. for the undertaking of their Sunshine Fort project in BGC, Taguig. This project is part of the larger Grand Central Park development of Federal Land.

h. In 2018, Mitsubishi Corporation collaborated with Century Properties Group to form a joint venture company they named PHirst Park Homes Inc. This company's objective is to create housing supply in the affordable segment in the next 5 years. PHirst Park Homes announced recently that it will roll out 33,000 housing units in 15 communities in CALABARZON and Central Luzon in the next five years.



In addition, Michael Mabutol, president and managing director of Pinnacle, mentioned during his presentation at the national convention of the Subdivision and Housing Developers Association (SHDA) that his firm helps Japanese investors partner with local players for their real estate ventures. According to Mr. Mabutol, these foreign players are looking into investing a minimum equity of US$5 million or US$10 million for a horizontal housing project or vertical condominium project, respectively, which demonstrates the attractiveness of the country's housing market to foreign players.

Attracting Capital to Housing Industry via Business Matching and Joint Ventures

Attracting joint venture capitalist to the housing industry can be achieved through several ways.

I. Sustaining Strong Macro-economic Fundamentals

Sustaining the country's robust macro-economic fundamentals is perhaps the most important and effective way to attract foreign capital into the housing market. A strong economy indirectly fuels demand by putting much-needed money to households, and a steady household cash flow can encourage stakeholders to put their capital to housing projects because of greater demand with lesser risk of defaults. Worth mentioning are selected macroeconomic fundamentals below showing a very strong economic outlook of the country.

Gross Domestic Product

The country's 2017 gross domestic product (GDP) at 6.7 percent is one of the strongest in the region, ranking third behind China (6.9 percent) and Vietnam (6.8 percent). Yearly economic growth has not gone below 6 percent over the last 5 years with a 6.6 percent average; better than Vietnam at 6.2 percent in this perspective. The country's GDP for 2018 Q1 is 6.6 percent (revised from 6.8 percent initially reported) but slowed down by 6.0 percent by 2018 Q2. Still, robust domestic consumption and government infrastructure spending will keep the country's economic growth promising for the coming years.

Foreign Direct Investments

In 2017, foreign direct investments (FDI) inflow is estimated at US$10.05 billion, which has been increasing at an average of 27 percent for the last 5 years. Investments in real estate activities at US$247.82 million ranked third among all placements for 2017, next to the manufacturing and power sectors. A total worth of US$121.32 million has already been poured into real estate activities for the period January to May for this year.

Overseas Filipino Remittances

A total of US$31.29 billion in personal and US$28.06 billion in cash remittance flowed into the country from overseas Filipinos in 2017. Remittance growth has been experienced at an average of 6.04 percent and 5.59 percent for personal and cash remittances in the last 5 years, respectively. For the first 5 months of 2018, personal remittance reached US$13.2 billion, while cash remittance reached US$11.8 billion. Figures show a year-on-year increase of 4.4 percent in personal and 4.2 percent in cash remittances, respectively.

II. Keeping the Real Estate Market up

Keeping a robust real estate market will incentivize participation of joint venture stakeholders, especially foreign players. Participants in joint venture housing development would certainly enjoy the current uptrend of the market as it can mean a healthy investment. A seller's market is usually desired by investors into house developments as it shows supply absorption of a targeted market.

Currently, capital values of properties, especially for prime condominium projects, have been increasing steadily due to the high demand. It has been observed that the relationship between the Philippines and China has even influenced the demand in the real estate market, and this is most apparent in the Bay City area in Pasay and Parañaque. Another sign of the country's desirable real estate market is the increasing rental rates but declining vacancy rates of residential condominium projects.

Data from the PSA reported about 15.7 million square meters of floor area of approved buildings permits in 2015. Fifty-two percent were attributed to single-detached houses, 20 percent is for townhouse constructions and the rest of the 28 percent is for residential condominiums.

In addition, demand for horizontal housing remains robust. The high demand in this segment has been existing for more than a decade, which has been unfortunately under-supplied. This points to a lot of upside for stakeholders who want to venture in this housing sector. Also, a strong demand across all housing sectors show a healthy real estate market that capitalists can take advantage in the coming years to come.

III. Improving Regulatory Framework

Improving the country's regulatory framework governing the housing business will draw more interests in the residential housing industry. A sustainable economic growth in the foreseeable future and a real estate market in the uptrend both give investors positive signs for their investments. However, there is a lot of room for improvement in terms of the business climate that may dampen capitalist interests if not addressed.

Increased Housing Budget

The overall 2018 budget of key shelter agencies significantly decreased by 63 percent compared to their 2017 budget. The National Housing Authority (NHA), the primary agency involved in socialized housing, took most of the burden. From Php12.6 billion in 2017, the agency's budget was slashed to Php3.2 billion in 2018. It should be noted that 79 percent of the NHA's 2018 budget goes to housing projects intended for the Armed Forces of the Philippines and the Philippine National Police, while the rest, or 21 percent, is allocated for various resettlement programs involving informal settler families. In general, budget appropriations should focus on housing developments and end-user financing.

Increased Socialized Housing CeilingCap

Currently, the price ceiling for socialized housing is set at Php450,000, which pales in comparison with the economic housing ceiling of Php1.7 million. Note that the last price ceiling cap increase is Php50,000 and Php450,000 for socialized and economic housing, respectively. The increase in ceiling may draw attention from stakeholders to partake in socialized housing projects where most of our current housing backlog originate.

Institutionalized Tax Holidays

National and local tax benefits are enshrined in Republic Act 7279 (Urban Development and Housing Act of 1992). Its main purpose is to draw participation of the private sector in housing projects and the reduction of housing costs. However, there were reported delays in securing tax rulings from the Bureau of Internal Revenue (BIR), which hampered production of mass-housing projects. Tax exemptions should be processed swiftly with minimal documentation requirement, i.e. vouched housing projects by key shelter agencies should suffice, subject to BIR audit.

Passage of Relevant Legislatures in Housing

There are several pending bills relevant to real estate and housing. Some of these are the bills for the formation of the Department of Human Settlements and Urban Development, the *National Land Use Act*, and the amended *Comprehensive and Integrated Shelter Finance Act*. These bills aim, among others, to rationalize the use and allocation of land for housing and other needs, create a single program and policy-making arm of the government for housing and urban development, and provide access to financial assistance for individual home-loan borrowers without access to government or private funding.

Strengthening of Local Housing Boards

The participation of local government units (LGUs) through their Local Housing Boards is an integral part of creating a sustainable housing industry. The Department of Interior and Local Government had initially created them for the monitoring of eviction and demolition activities involving informal settler families within their jurisdiction. However, they should also be equipped in developing sustainable communities for the same displaced informal settler families though planning and coordination with key shelter agencies of the national government.

Rationalized Creditable Withholding Tax

As it currently stands, the socialized housing ceiling cap is already at Php450,000. It must be noted that the graduated withholding tax rate was made when the socialized housing ceiling cap then is at Php150,000 only. Re-calibration of withholding tax rates may benefit housing segments, other than socialized housing, insofar as their capital outflows.

Passage of the TRABAHO Bill

There are fiscal incentives already outlined in RA 7279 but only benefits the socialized housing segment. The passage of TRABAHO Bill (Tax Reform for Attracting Better and High Quality Opportunities), which is directed at reducing corporate income taxes, will benefit stakeholders from the economic to open market housing segment. Based on proposals, the corporate income tax shall be lowered to 20 percent from a high of 30 percent. However, some sectors are against the bill due to the perceived reduction of fiscal incentives of PEZA- and BOI-registered entities.

Preparation and Continuous Review of Land Use Plans

The Local Government Code encourages the continuous formulation of Comprehensive Land Use Plans (CLUPs), while the Housing and Land Use Regulatory Board (HLURB) set a maximum land-use planning period of 9 years subject to review every 3 years. Based on the data of the latter, majority of LGUs have outdated CLUPs, while a great number of them have never had one. Land-use plan can identify suitable land for development and facilitate its acquisition for housing projects.

Overall Housing Policy and Process Review

While there is a pending bill for the Department of Human Settlements and Urban Development, the functions of the national and local agencies together with their cross-agency procedures should be defined and reviewed to identify gaps and streamline activities involved in housing projects. This would mean faster housing production due to reduced bureaucracy, which also means faster investment returns.

Improved Overall Business Environment

Based on a published study of the World Bank, the Philippines' overall score in terms of doing business for 2018 is 58.74 out of 100. Figure is even below the East Asia & Pacific average of 62.70, topped by Malaysia, Thailand, and Indonesia. To be more attractive to foreign investments, the ease of putting up a business should be well improved.

The paper was presented by Mr. Michael R. Mabutol, President and Managing Director of Pinnacle Real Estate Consulting Services, Inc., during the 27th Subdivision & Housing Developers Association (SHDA) National Developers Convention with a theme "The Roadmap To BALAI 2028" held on September 14, 2018, at Xavier Sports and Country Club, Cagayan De Oro City, Misamis Oriental.

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

Pinnacle's primary business lines are real estate asset management and brokerage, real estate closing and advisory services, and non-performing loan asset management among others.

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