market insight

OCTOBER 2013

MANUFACTURING RENAISSANCE:
Philippine Economy Witnesses the Rebirth of the Industrial Property Sector

After several quarters of robust growth, the Philippine economy and its managers are bracing for more as the focus turns to investment in human capital to ensure employment, infrastructure development and the pursuit of new catalysts of sustained economic expansion. The recovery of the agriculture, fisheries & agro-industries, semiconductor & electronics, public & private construction, tourism, wholesale & retail trade and the real estate sector have all been the current drivers of growth and, given the current trajectory, may continue to push the economy upwards in the next few quarters.

In 2012, the 6.8% economic growth was mainly propelled by the service sector which grew 7.6% compared to the manufacturing sector's growth of only 5.4%. It is a remarkably different story in the first half of 2013 where the manufacturing sector has expanded by 9.9% compared to the same period in 2013 which only saw a 5.1% increase. This is also vis-à-vis the 7.1% growth of the service sector in the first half of 2013 which has been the perennial leading economic sector in the last few years.

Quietly, as the other real estate sectors such as office and residential hogged the market limelight in the last few years, the industrial sector has crawled out of its pit as the inventory of industrial parks slowly dwindled. Foreign companies flocked to the Philippines to avoid risks in other markets and to take advantage of what the Philippines has now to offer.

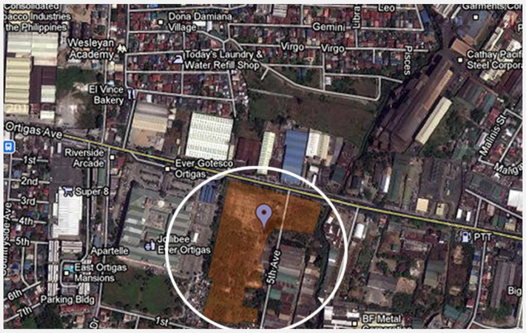
This is the indication of an economy ready to take-off. An economy spearheaded by the manufacturing sector which has the largest potential of alleviating unemployment and therefore attaining inclusive growth. As a consumer-based economy with close to 95 million relatively young people, the manufacturing sector is expected to benefit from a stronger domestic market.

NO SIGNS OF SLOWING DOWN

The real estate industry, in general, continues to be buoyed by the liquid banking system, a relatively young labor market with purchasing power, consumer & business optimism and the notion of an improving governance. Despite the issues currently afflicting the Philippine political landscape, businesses continue to flourish and may seem to be shielded from the noise. However, in the long run, the investment climate is very much dependent on the predictability of the political system. It is therefore important that outcome of the current Priority Development Assistance Fund (PDAF) investigation is a totally new system of spending taxpayers money for the welfare of the Filipino people. This will lead to a renewed confidence towards the government and a perception of strength for the economy. Ultimately, this positive environment will directly support the growth of the local real estate industry.

The office space market remains to be very active as business processing & outsourcing firms continue to scout for areas for expansion. About 90% of the current demand comes from these types of firms as they eat up 300,000 sqm to 400,000 sqm of leasable office space annually. In Fort Bonifacio alone (i.e. Bonifacio Global City and McKinley Hill),there are about 610,900 sqm of gross leasable office space in the market and at least another 730,000 sqm are in the pipeline in the next three to four years. This is while the entire office space market in major central business districts in Metro Manila registered a vacancy rate of only about 2.5% in the second quarter of 2013.

FEATURED PROPERTY



FOR SALE: ORTIGAS EXT. PROPERTY
Location: Pasig-Ortigas Extension
Type: Commercial Vacant Lot
Lot Area: Approximately 34,161sqm.
Asking Price: PHP34,000/sqm. Plus EVAT

INDUSTRIAL LOT W/ IMPROVEMENT
Location: Trece Martirez, Cavite
Lot Area: 5,000 sqm
Floor Area:
-1,800 sqm Main Factory Building
-225 sqm Office/Administrayion Building
-220 sqm Machine Shop Building
Asking Price: PHP20,000,000

In the retail space market front, almost 400,000 sqm of additional mall space were introduced this year with new malls such as the SM Aura and mall expansion projects such as those in SM Megamall and Glorietta. A domino effect leading to this expansion occurred as the spending power and increasing consumer base attracted old and new retailers to scramble to secure space to capture a piece of the action. With this explosion come newer brands, both local and international, widening the potentials of developing land for more retail space. Proof of this is that even developers have either tied-up or developed their own retail brands. The Ayala group introduced Family Mart, a Japanese convenience store brand, in partnership with the Rustans Group. The Villar group developed its AllHome and AllDay appliance and convenience stores. Both developers have ventured into the neighborhood mall business with projects such as the District in Cavite & Bacolod City and the Vista Malls such as the one in San Fernando, Pampanga.

Another sign of a very active real estate market is the entry of new boutique developers. This is particularly true in the residential market. This profitable real estate segment attracted new developers despite the presence of larger more established players. Data Land, for instance, launched its Silk Residences this year. Diamond Hiland will launch its luxury residential project at Nivel Hills Cebu.

Notwithstanding the security risks and select armed conflicts in some parts of Mindanao, its fundamentals has positioned key cities such as Davao, Cagayan de Oro, General Santos and Butuan City as new expansion areas for real estate development. For instance, Call Center companies are now moving to expand in this area given its large pool of qualified labor creating new demand for office space, convenience retail, hotel accommodation as well as accessible and affordable residential developments.

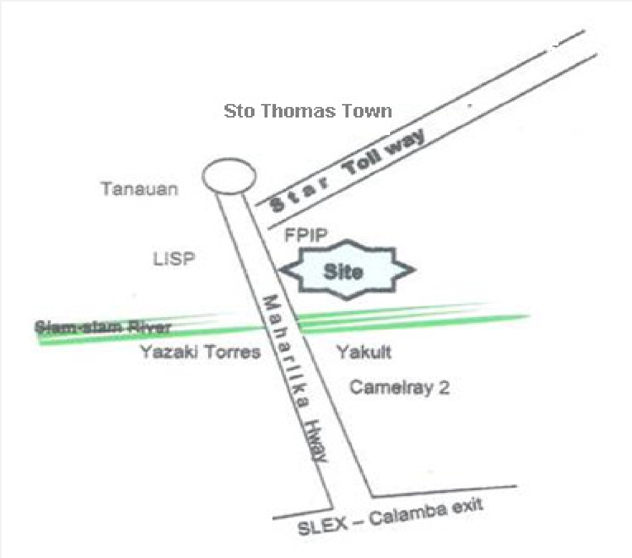
AMIDST THIS BACKDROP

The industrial property sector is not without a share of this action, especially in the last three years. At the start of the previous decade, a lot of industrial park developers and operators experienced troubles as their inventories have become stagnant and even sold-out projects suffered as the exodus of foreign locators and manufacturers left some of the parks and estates ill-maintained and disregarded. Some suffered difficulties with respect to debt payments and other financial woes. For the longest time, this sector has been described as a perennial laggard relative to the other segments.

At the turn of the decade, renewed confidence in the government, among others, had sparked interest in the country eventually leading to the upgrade of its credit ratings. Sovereign risk has been reduced and sparked the green light for fresh foreign capital to pour in. In fact, approved investments by the Board of Investment (BOI) and the Philippine Economic Zone Authority (PEZA) in the first half of 2013 grew by more than 30% year on year. Of which, almost 20% of PEZA approvals are in the manufacturing sector amounting to about PhP16.6 billion. In terms of foreign investments alone, a massive 139% increase in approved investments was registered in the BOI and PEZA in the first half of 2013 year on year.

Interests from foreign manufacturers continue especially from the United States, Japan and certain European countries. For example, Grupo Leche Pascua, a dairy company from Spain, plans on investing in the country after it has successfully launched its products locally. Sonion Philippines, Inc. a Danish electronics firm has built its11,500-sqm plant in Batangas. Moreover, in the Clark Freeport Zone, Ingasco, Inc., is developing a US$40 million air separation plant and Japanese aircraft parts manufacturer, Jamco, is investing PhP172 million. Yokohama Tires and Shimano had also expanded their operations in the country. Fujifilm Optics Philippines Inc. has also recently opened its new factory in Carmelray Industrial Park. These firms only represent the tip of the iceberg as several others have approached PEZA and BOI and are now in their preliminary due diligence stages.

All of this interest, although primarily induced by the inherent characteristics of the domestic economy, was also prompted by certain external factors have also contributed to this surge. The susceptibility of Thailand to calamities may have given reason for locators to rethink their investments. Despite the now stabilizing economies of China and Singapore, remnants of its recent slowdown may still haunt their local markets and the momentum is still with the Philippines. The escalating territorial tensions between Taiwan, China and Japan opened up opportunities for the country to be the recipient of a possible diversion of investments. The lingering tensions in the Korean peninsula impelled its manufacturing industry to explore new areas of expansion within the region. And as other western countries recover from their own economic slumps, access to relatively cheap labor and other offerings to save on operational costs will be the country's selling points.



INDUSTRIAL VACANT LOT – STO TOMAS, BATANGAS
Location: Along National Hiway, Sta Anstacia, Sto Tomas, Batangas (Adjacent to First Philippine Industrial Park)

Lot Area: 7 Hectares PEZA Classified Ecozone
Description:
-Strategically located along the National Highway
-Located at km 52 in the midst of 5 Industrial Parks
-An ideal site for downline industries in support of the requirements of the Industrial locators
-Centrally located in the rapidly growing CALABARZON Area
-Approximately 1 hr. ride by car from Makati City

Call for Pricing

INDUSTRIAL BANDWAGON

Basic economic principles dictate that as long as there are marginal profits to be made in the specific market, it is natural tendency for output, therefore supply, to increase. This is as true in the industrial space market as in any other. With demand for industrial space seen to have surged and the cost of development relatively lower than those of the other real estate segments, there really are profits to be made. In fact, in the last few years, several multi-segment developers have already started to enter (or re-enter, for some) industrial park development.

For instance, AboitizLand wants to expand its footprint in the industrial park market. Recently, it has offered to acquire a majority stake in Lima Land from the Alcantara Group. Lima Land developed the 485-hectare Lima Land Technology Center in Malvar and Lipa City. With the current demand level for industrial space and about 50 hectares that can still be developed within Lima Land Technology Center, AboitizLand is keen on taking advantage of this opportunity.

Even some local governments want to benefit from the current market conditions. A case in point is the Municipality of Minglanilla in Cebu which has entered into a public-private partnership (PPP) with Ming-Mori Development Corporation to develop the Minglanilla Reclamation and Industrial Park development project.

Seeing the potential for returns, investors even flock to industrial developers. Early in 2013, Republic Glass subscribed for 57 million shares or about 9% of Science Park of the Philippines, Inc. (SPPI) for an estimated amount of PhP278 million. SPPI currently has more than 800 hectares of industrial parks developed and under development. These include the Light Industry & Science Park in Cabuyao& Calamba in Laguna and in Sto. Tomas, Batangas; the Cebu Light Industrial Park in Mactan; and the

Hermosa Ecozone Industrial Park in Bataan. Included also is its recently launched fourth Light Industry & Science Park in Malvar, Batangas (LISP 4).

Other developers who used to focus on the other real estate segments but are now considering joining the industrial foray are SM Land, Megaworld, Filinvest and Ayala Land, among others. All have very expansive land banks especially Ayala Land which may introduce its industrial products in Pampanga and Filinvest which has vast tracts of land in Batangas.

With the revival of the industrial segment, logistics as well as supply chain management companies had established more ground cover across the archipelago to raise the operating efficiency of companies expanding to these industrial parks.

IN A NUTSHELL

Even with a strong economic performance in the recent quarters and enticement brought about by investment rating upgrades, the Philippines still lags behind its Southeast Asian neighbors in attracting foreign direct investments (FDIs) which could either be a boon or a bane for the country. It should be considered a bane since this means that there is still a lot of space for the expansion; otherwise, it is boon if the country does nothing and continues to rely on mere perception without executing any concrete efforts to lure in investment. Furthermore, by 2015, full implementation of One ASEAN will open up the Philippine economy to more markets, unrestricted. Now more than ever, the Philippines have the opportunity to capture the global supply chains of ASEAN and China by doing business in the areas of manufacturing and agro-industrial business.

Aside from the economic aspect, the country must take advantage of the current political agitations and allow this PDAF controversy to jumpstart a massive cleanup of the government. It is imperative that this leads to an overhaul of how the government manages it resources as this provides predictability for foreign investors. If they could very much calculate the risk and returns of their investments given a stable set of economic policies minus the uncertainties provided by corruption and mismanagement, then the country should expect a considerable inflow of capital for further nation building.

Moreover, it is critical for the Philippines to foster its manufacturing sector in order to truly achieve economic development. It is very rare for a developed country to have jumped from a predominantly agricultural economy to a largely service economy. This scenario is a trap and may do more harm than good in the long run. The government, through its investment promotion agencies (IPAs), has a big part in achieving this goal. The PEZA, BOI and the other IPAs need to fully execute their mandates and truly act as the country's salesmen to the international business community.

On this note, the real estate industry, likewise, plays a major role as it provides a major factor of production, land and space. Learning from the experiences during the 1997 Asian Financial Crisis, real estate developers are now more resilient in the way they conduct their businesses. We continue to see the phenomena of pre-leasing for our office segment, pre-selling for our residential segment and high demand for retail and hospitality developments.

It is also expected that in a matter of a few months, a lot of industrial space inventory will be floated in the market. However, as sudden as it was launched, so will these be when they are absorbed by the market. Industrial park developers are currently looking at a three to four year window before they begin to reassess their positioning and to continue supporting the burgeoning Philippine industrial sector.

ABOUT PINNACLE

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.

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