PINNACLE

market insight

JUNE 2015

WEATHERING THE STORM

MACROECONOMY

The sunny days are starting to give way to wetter days. By the end of the third quarter, a handful of strong storms would have passed, given that approximately 20 typhoons visit the Philippine area of responsibility per year. By the second half of the year, another season would have set in; not the wet season coming from the dry, but rather the election season. Political candidates have started sprinkling the “tri-media”; and some have already fully utilized school graduations and town fiestas in recent months for visibility. Various surveys are coming out, not only from the major survey firms, but suddenly radio and talk shows feel compelled to conduct their own surveys on potential candidates.

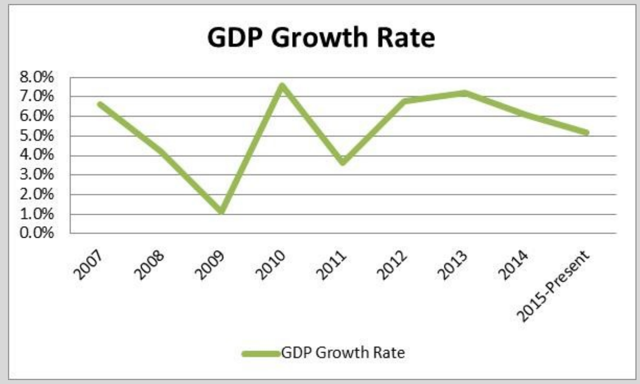
The political cycle impacts on the economic cycle. In turn, the economic cycle weighs heavily on the property cycle. While it is true that the real estate business activities have been contributing to the sustained economic growth in recent years, it is instructive to be aware of the political and economic forces in play.

Philippines’ gross domestic product (GDP) grew by 5.2% during the first quarter of the year based on the latest Philippine Statistics Authority (PSA) data. While this is lower than the 6.1% GDP annual growth in 2014, the first quarter of 2014 was also a relatively slow growth of 5.6% and finished with a strong growth of 6.9% by the fourth quarter. Underspending by the government is the easiest to blame since the government have the resources but has been viewed to be slow in deploying this capital. This may dramatically change given that there are a number of approved and ongoing infrastructure projects. It has been observed that spending during the “election season” is high and may even be inflationary. At any rate, from the private sector, the Services Sector is the main driver of growth for the quarter, which grew by 5.6% percent from 6.8% growth last year. Industry accelerated to 5.5% percent from 5.4 percent. The Agriculture sector grew by 1.6 % from 0.6 percent.

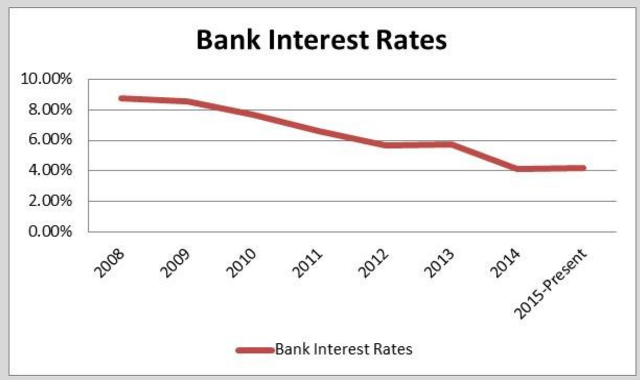
Based on Bangko Sentral ng Pilipinas (BSP) statistics, the average bank interest rate inched up to 4.18% as of May this year as compared to 3.82% as of February. The Philippine Peso to US Dollar exchange slipped to Php 45.103 in June from Php 44.69 in March. Dollar remittances from overseas Filipinos from January to March 2015 reached US$ 5.79B as compared to US$ 5.49B for the same period last year, or an increase of 5.46 percent.

According to PSA, inflation rate in May is 1.6% as compared to 3.7% by the end of 2014. The latest unemployment rate data is pegged at 6.6% as of January of this year, which is slightly lower than the 6.17% in July 2014.

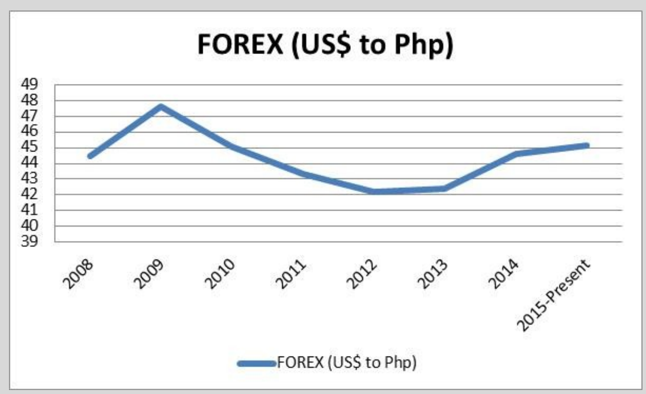
According to the Department of Tourism, the total Visitor Arrivals for the first quarter of the year reached 1,391,836 visitors, registering an increase of 6.26% over the last year's arrivals of 1,309,872 for the same period. Visitors from South Korea still cornered the top spot at 361,480 arrivals; second from the United States with 214,057 visitors; and third from Japan with 130,374 arrivals. Visitors from China still grabbed the fourth spot with 93,043 visitors. Tourism earnings for the first quarter of 2015 reached Php 58.96B, up by 2.21% from the Php 57.68B for the same period last year.



GDP Growth Rate
Source: Philippine Statistics Authority (PSA)



Bank Interest Rates
Source: Bangko Sentral ng Pilipinas (BSP)



Foreign Exchange
Source: Bangko Sentral ng Pilipinas (BSP)

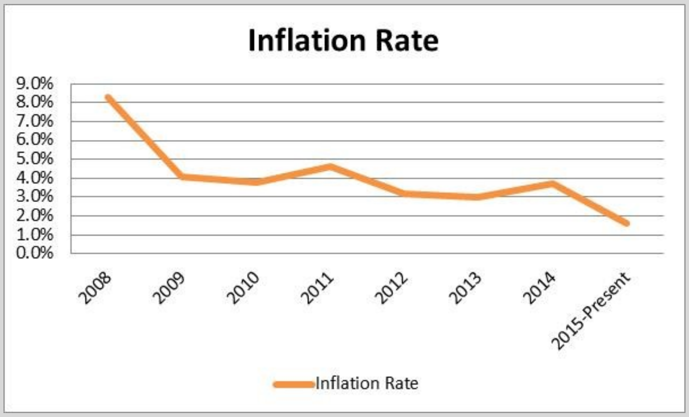
BRACING FOR THE STORMY ELECTION SEASON

If one is looking for bell weather, checking the top real estate developers is a good place to start. The Ayala Land Group, which announced a target capital expenditure of Php 100 billion this year, is keen to build township projects in 25 additional Philippine cities over three to five years. As earlier reported by Pinnacle, building townships widens the offerings of the corresponding developer and often result to big leap in profitability, and inevitably, the company's stock price.

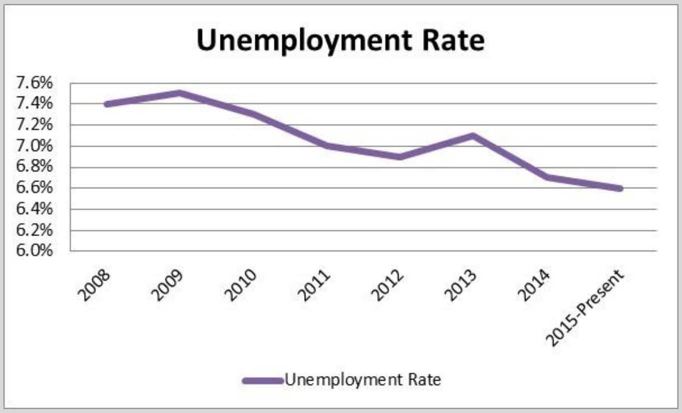
The Ayala Land Group is building Alviera, in Porac, Pampanga, which is envisioned to be another premier township. Alviera is a 1,100-hectare large-scale master-planned development that is being positioned as the premier business and leisure hub in Central Luzon. After the Mt. Pinatubo eruption in the Nineties, and the subsequent lahar flows and related flooding, many developers skipped the former rice bowl of the country. Given the rejuvenated Clark Special Economic Zone and Subic Bay Freeport Zone, and the vital connection of the Subic Clark Tarlac Expressway, local and national players have been carving out prime spots to service the high population and income growth rate of the region.

In addition, the group is increasing its usual residential developments catering to all segments of the market, including the socialized housing; and boosting its office, shopping center and hotel portfolio as well. It is even embarking on education venture as earlier reported.

For its part, the SM Group will build “micro cities” around its shopping malls by developing apartments, offices and hotels to maximize the value of its property holdings. Fifteen of the over 50 shopping malls are on land large enough for high-density and mixed-used developments. The biggest bet is on the planned Manila Bay reclamation of 600 hectares, and the group intends to pour in Php 100 billion of investments, that would turn the property into a master-planned, integrated and mixed-use community.



Inflation Rate
Source: Philippine Statistics Authority (PSA)



Unemployment Rate
Source: Philippine Statistics Authority (PSA)

Pinnacle cited in its previous report that Megaworld together with its subsidiaries shall launch five new townships: two in Luzon, two in the Visayas and one in Mindanao, with a total land area of around 400 hectares. This will bring Megaworld Groups’s total township land area to 3,100 hectares by year-end.

Building mixed use developments and townships has proven to be a successful concept of economy of scale and multiplying profits. Based on the April release of the Bloomberg Asia Pacific Real Estate Index, SM Prime has gained 37% over the last year, Megaworld grew by 30%, and Ayala Land increased by 29 percent. The Philippine Stock Exchange index grew by 24% during the same period.

While the big three have been scaling up townships, the other top developers have been busy carving out their market share by focusing on their core competence. Robinsons Land Group acquired the 18.5-hectare property along Ortigas Avenue extension, where it would build a major township. In addition, it is expanding its residential, office, hotel and mall portfolios nationwide. Recently, the Greenfield/Unilab

Group announced to develop the 12.8 hectare expansion of the "EDSA Central" complex into a mixed use community as well. Meanwhile, the Vista Land Group has been penetrating tertiary cities where other national brands are still contemplating on, and has been expanding its commercial retail investments. The Puregold Group for its part has been solidifying its position in the retail sector.

Apart from the different segments in the real estate market, some major players have expanded into other sectors such as transportation and toll ways. DMCI, Filinvest, Metrobank/Federal Land Groups have been steadily investing in the power sector as well.

One vivid trend is the drive for recurring income. After years of raking from brisk sales, all of these players have been steadily building up their office, retail, hotel and even industrial portfolios to generate rental income. Even the Eton Group reported a shift in strategy; from the residential bandwagon, it is now accelerating its in gear in offering more office spaces.

For these top developers, the weather is fine even with the upcoming elections. They will always try to be ahead of the curve and fill the gaps in the real estate market.

OFFICE MARKET

The Business Process Outsourcing (BPO) industry is the biggest contributor to the Philippines' gross domestic product (GDP) and is expected to generate 1.23 million jobs and US$21.8B in revenues this year. BSP Deputy Governor Diwa Guinigundo even characterized the BPO industry as both pro-cyclical and anti-cyclical since BPOs have the tendency to grow regardless of economic conditions. He noted that if times are good, offshore companies need to outsource non-core services to remain competitive, but when their economies are not doing well, they have to resort to outsourcing because of the need to cut on costs.

This continuous growth of the industry translates to additional demand for office spaces across all major business districts. The overall vacancy rate of major business districts in Metro Manila is below 4%, which slightly spiked due to new buildings in Makati CBD (including Alphaland Tower) and in Bonifacio Global City. Makati rents of Premium Grade A

SNAPSHOTS

SECTOR	TREND	COMMENT
OFFICE	▲	Robust demand from BPOs, low vacancy, increasing rents; new supply
RESIDENTIAL	▲	Diversifying supply, successful but competitive sales, growing rental market
RETAIL	▲	Further expansion of the big players; proliferation of different retail platforms
HOTEL & GAMING	▲	New supply and attraction servicing the demand from the ever-increasing tourist arrivals
INDUSTRIAL	▲	Increasing demand for industrial spaces; expansion of manufacturers

buildings have a weighted average of Php 1,275 per sqm per month; for Grade A buildings, the weighted average is Php 850 per sqm per month; and for Grade B&C Buildings, the weighted average is Php 650 per sqm per month.

The weighted average rent in BGC is comparable to Makati Grade A at Php 850 per sqm per month. The weighted average rent of Grade A office buildings in both Ortigas and Alabang business districts is estimated at Php 625 per sqm per month. Quezon City Grade A buildings are practically fully leased out and the average rent remains unchanged at Php 625 per sqm per month.

RESIDENTIAL MARKET

Based on the Housing and Land Use Regulatory Board (HLURB) figures of approved licenses to sell in the past five years, the average annual production reached over 200,000 residential lots/units, including condominium units. Condominium units and economic housing are the top two categories.

Number of Residential Units Based on Approved License to Sell

	2010	2011	2012	2013	2014
Open Market	39,732	38,192	35,213	37,719	35,029
Economic	63,997	45,117	54,535	59,464	63,398
Socialized	52,602	35,682	45,285	49,410	41,663
Condominium	39,476	51,388	129,204	78,458	76,413
TOTAL	195,807	170,379	264,237	225,051	216,503

Source: Housing and Land Use Regulatory Board

While these figures appear to be high, they pale in comparison to the projected housing needs. The Statistical Research and Training Center, an attached agency of National Economic and Development Authority (NEDA) projected in 2013 the housing needs up to 2017 using the Census of Population and Housing 2010 data. The estimated housing needs is over 800,000 per annum; of this, close to 400,000 households annually can afford to by acceptable housing units. The table below presents the summary.

Leasing activity has been increasing in recent years, especially with the residential condominium market. The usual practice has been quoting the total monthly rent of these residential units rather than the rent on per square meter basis used in office and commercial spaces. Rents have been generally stable, where high-end and upper-mid market condominium units have dominated the rental market with leasing rates from Php 50,000 to Php 100,000 per month for upper-mid condominium units, and over Php 100,000 per month for high-end, depending on the sizes. Luxury condominium units can command rents at Php 300,000 per month-level, even breaching the Php 400,000 per month-rent. Leasing of studio and one-bedroom units ranges between Php 15,000 to Php 30,000, and may reach the Php 50,000 per month-level, depending on the location, furnishing, and amenities of the condominium unit.

The rentals of residential condominium market in Makati CBD, Rockwell and BGC are now quoted on per square meter rate just like the office rents, but are likewise generally stable. The Makati CBD has a more varied rental levels, ranging from Php 575 per square meter per month to Php 1,100 per sqm per month. One has to multiply the floor area to compute for the approximate monthly rent. Rockwell condominium units have a higher base of Php 700 per sqm per month, but have the same upper range of Php 1,100 per sqm per month. Bonifacio Global City units have a lower range of Php 600 per sqm per month, and an upper range of Php 1,000 per sqm per month.

Projections of Housing Needs, 2011-2017

Components of Housing Needs	Initial Needs (As of Jan 1, 2011) BACKLOG	Incremental Needs as of December 31							Total Housing Needs
		2011 (Jan 2-Dec 31)	CY2012	CY2013	CY2014	CY2015	CY2016	CY2017	CY 2011-2017
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Total Housing Needs	1,225,343	688,318	701,396	714,723	728,302	742,140	756,241	770,609	6,327,072
A. Accumulated Needs	1,225,343	23,282	23,724	24,175	24,634	25,102	25,579	26,065	1,397,902
1. HH in Unacceptable Housing	787,731	14,967	15,251	15,541	15,836	16,137	16,444	16,756	898,663
a. Rent-free without consent of owners + Marginal Housing	700,239	13,305	13,557	13,815	14,077	14,345	14,617	14,895	798851
b. Homeless	4,799	91	93	95	96	98	100	102	5475
c. Dilapidated/ condemned	82,692	1,571	1601	1631	1662	1694	1726	1759	94338
2. Doubled-up HH in Acceptable HU	437,612	8,315	8473	8634	8798	8965	9135	9309	499239
B. Future/Recurrent Needs		665,037	677,672	690,548	703,668	717,038	730,662	744,544	4,929,170
1. Allowance for Inventory losses		306,515	312,338	318,273	324,320	330,482	336,761	343,160	2,271,849
2. Increase in HHs (likely to afford to own acceptable HU)		358,522	365,334	372,275	379,348	386,556	393,901	401,385	2,657,320

Source: Statistical Research and Training Center

RETAIL MARKET

This segment continues to be dominated by the SM, Robinsons and Puregold Groups. In recent months, the market has seen a phenomenal growth in the convenience store platform. Family Mart breached the 100-mark outlets by April this year. The Villar/Vista Land Group is also expanding its “All Day Mart” platform.

In addition, the Vista Land Group intends to integrate their retail platforms in their housing projects. “AllHome” stores will be opening six to seven stores annually over the next five years. The Wilcon Group, for its part, now has 33 stores all over the country. The joint venture of Jollibee and SM Groups recently opened its first community mall in Roxas City, Capiz. This is the first of the 100 CityMall branches it plans to roll out nationwide over a five-year period. The CityMall-Arnaldo Roxas is located on a 1.4 hectare prime property along Arnaldo Boulevard, with more than 7,000 square meters of retail space and is reported to be 100% leased out.

It should be reiterated that the retail market is the most resilient sector that bucked the trend even during the Asian financial crisis in the late Nineties, political crises in the early years of the new Millennium, and the financial crunches of the global powerhouses in recent years. This resilience is due to the ever growing Philippine population and its propensity to spend.

The proven formula by the retail landlords is offering spaces to house the thousands of products. This is typically on consignment basis, where up to 90% of items being sold are actually supplied by tenants or consignees. Retail players are raking on rents and/or even on “percentage of gross sales,” but tenants/consignors are still willing to queue to get mall/retail spaces because they provide the necessary foot traffic. Rents of retail spaces are very stable and have been inching up in recent years.

One retail group has been growing its business on a different model, that is, by owning majority of the items it is selling. HMR Philippines now has 12 big stores and 3 “SOS” outlets, and has over 35 “SOS” franchisee outlets. For the 15 shops that HMR owns, the company owns majority of the products, which are then aggressively sold to small-to-medium retailers on business-to-business format. HMR Philippines has been buying its stocks for sale at a steep discount, mainly surplus items from the US, Australia and China. Profitability is reported to be high, but the risk is sitting on the unsold items. The solution of HMR Philippines is simple--- sell the items through HMR Auctions.

HOTEL AND GAMING MARKET

Pinnacle reported in its previous releases that the big players are positioning to get huge chunks of the hotel and gaming market share. The SM Group partnered with Macau’s Lawrence Ho in building the City of Dreams Manila. The hotel complex includes three hotel towers offering these brands: Nobu Hotel, Crown Towers and Hyatt Hotel with a combined total of 940 rooms. City of Dreams has 380 gaming tables, 1,700 slot machines and 1,700 electronic table games.

Bloomberry Resorts Corp. opened its Solaire Resort and Casino in 2013. In addition, Japanese billionaire Kazuo Okada and the joint venture of Megaworld's Andrew L. Tan and Genting Hong Kong Ltd. are expected to open their hotel casino resorts between 2016 and 2018.

The Ayala Group has been ramping up its SEDA brand apart from its partnership with international brands like Intercontinental/Six Continents and Marriott Groups. Robinsons Land Group, for its part, has been beefing up its GoHotels, in tandem with its partnership with Six Continent's Crowne Plaza. Federal Land/Metrobank Group has partnered with the Hyatt Group. The Shangri-la Group has leveraged its successful hotel brand in offering condominium units for sale.

What is amazing is the mushrooming of local brands such as Sogo and Nice Hotels, and even international brands such as Tune Hotels. In addition, the iconic Max's Group, Inc. joined the fray. It intends to open its first hotel venture by this year. This is being developed at the property adjacent to the company's "heritage store" in Quezon City. The 60-room hotel along Scout Tuazon called "Meranti" hotel will be targeting the domestic and foreign tourists, business travelers and locals who indulge in "staycations" and will be equipped with recreational facilities. It is important to note that the "heritage store" sits on a sprawling site and has been a popular venue for events such as birthdays and other parties.

INDUSTRIAL MARKET

Pinnacle Research earlier reported the Bases Conversion and Development Authority (BCDA) is bidding out at least 200 hectares in the Clark Green City by way of joint venture since there is limited leasable land in both Clark Special Economic Zone and Subic Bay Freeport Zone. Recently, it is reported that Cebu is also running out of Philippine Economic Zone Authority (PEZA)- accredited ecozone spaces for manufacturing. PEZA is now negotiating with Mactan Cebu International Airport (MCIA) for the lease of an additional 30-hectare property to address the current tightness in the industrial supply.

PEZA reported during its 20th Anniversary in April a total revenue generation of Php 2.862 trillion worth of investments in the past two decades, and more than 45% percent of which came in during the past four years. In addition, PEZA enterprises exported a total of US$563 billion and provided a cumulative direct employment of 1.170 million. At present, PEZA has 316 operating economic zones in the country hosting a total of 3,447 companies.

There are number of foreign companies looking to establish manufacturing operations in the Philippines, especially among the Japanese businessmen. Even prior to President Benigno Aquino Jr.'s visit to Japan, there is already a substantial Japanese investment in the Philippines, with two Japanese suppliers of aircraft interiors and components recently investing Php 106 million in the Clark to expand their operations. The Japanese bicycle manufacturer Shimano Inc. has just opened its Php 1.32-billion facility in Batangas, creating approximately 1,000 new jobs. With the successful Japan visit of the President, this will further solidify the interest of Japanese in locating some of their operations here, especially those operations coming from China, given the current economic (higher labor cost) and security (lingering territorial disputes) conditions.

There is no wonder why Ayala Land Group included industrial spaces in its Porac, Pampanga master development plan. The Alviera Industrial Park (AIP) is seen to capture the excess demand for industrial space and drive economic activity in the region. Sixteen lots of the 31-hectare industrial park have already been reported sold. Three clusters of standard factory buildings are still available for lease. AIP is seen to complement the industrial hubs in Clark and Subic targeting companies in light to medium, non-polluting enterprises.

FLEXIBLE PEOPLE, RESILIENT MARKET

President Aquino and his allies were the staunchest critics of the past administration. Even with the usual political drama surrounding every national election, former President Gloria Macapagal Arroyo stepped down and transferred power to her bitter political rival. Surely, there would be heated debates and entrenching of positions along the way, and perhaps some political violence. But Filipinos are like bamboos, they tend to sway with the strongest winds. They would enjoy the festivity and even ferocity of the upcoming election season, but they will not break.

During the political noise of the election season, people would have to work and report to their offices, whether in traditional offices or IT/PEZA zones. Filipinos would continue to build and repair their homes. Families would keep on shopping and spending in malls. Fun-loving Filipinos would continue to travel and go to resort-hotels. In short, Filipinos are used to storms, and the real estate market would likely weather the political storm and remain resilient.

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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Office: Unit E-1 Garden Level, Corinthian Plaza Bldg., Paseo De Roxas cor Legaspi St., Makati City
Telephone: (02) 859-1000
Fax: (02) 859-1088
Website: **www.pinnacle.ph**