SPRINT TO THE TAPE

MACROECONOMY

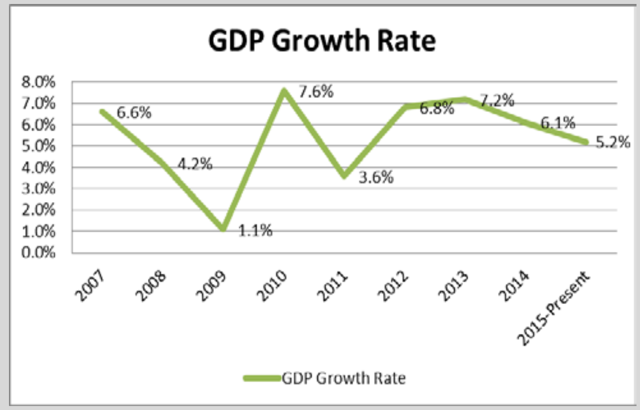
National politics has been claiming the center stage in recent months. Telenovela-loving Filipinos are treated with the political jockeying of various politicians and political parties. Major political alliances are shaping up prior to the deadline of the filing of candidacy. Despite this politicized backdrop, the real estate industry and the economy in general are quietly churning. Real estate developers and players also have a deadline, the closing of the year that usually spells more sales; and hopefully higher stock prices for the publicly-listed companies. More importantly, astute real estate players would take advantage of the increased spending during the election season.

The country's gross domestic product (GDP) grew by 5.2% during the first half of the year based on the latest Philippine Statistics Authority (PSA) data. This is below the 6%-target, and underspending by the government is the usual punching bag especially now that national elections are looming. Nonetheless, government spending is expected to accelerate due to the number of approved and ongoing infrastructure projects. In fact, spending during "election seasons" has been observed to be high and inflationary at times.

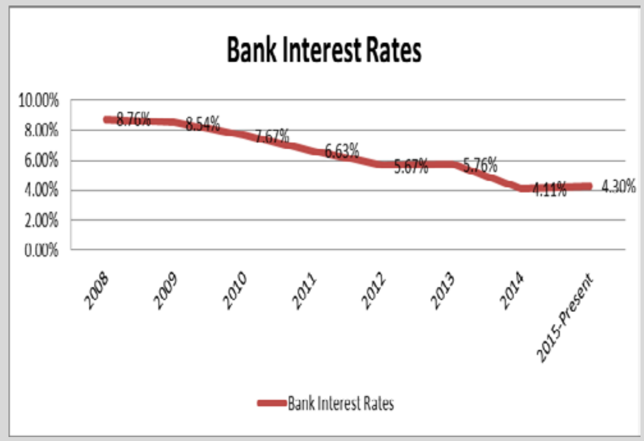
Based on the Bangko Sentral ng Pilipinas (BSP) latest statistics, the average bank interest rate inched up to 4.30% as of August as compared to 4.18% in May of this year. The Philippine Peso to US Dollar exchange slipped to Php 46.988 in September from Php 45.103 in June.

According to PSA, inflation rate further dipped to 0.8% in July as compared to 1.6% in May of this year. While this is generally correlated to weak economic activity, lower unemployment presents a slightly rosier picture. The latest unemployment rate data is pegged at 6.4% as of April, which is slightly lower than the 6.6% in January of this year.

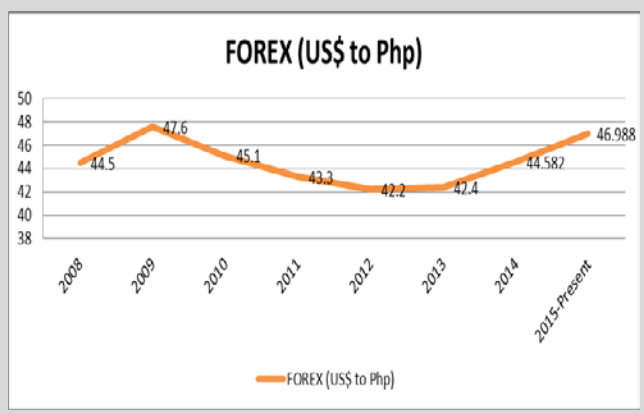
According to the Department of Tourism, the total Visitor Arrivals for the first half of the year reached 2,619,625 visitors, registering an increase of 7.65% over the last year's arrivals of 2,433,422 for the same period. Visitors from South Korea still claim the top spot at 642,985 arrivals or 24.54% of the total; second from the United States with 415,949 visitors; and third from Japan with 237,264 arrivals. Visitors from China ranked fourth with 190,325 visitors. Tourism earnings for the first half of the year reached Php 111.05 billion, up by 1.16% from the Php 109.77 billion 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)

PACE SETTERS, GO-GETTERS

With the upcoming national elections, it is easy for real estate players to have a wait-and-see attitude. For top players, however, this is an opportunity to widen their lead. Armed with double-digit earnings, supported by liquid financial market, and incisive analysis of the different real state markets and segments, top players typically go for gold. The Ayala Land Group leads the pack with its target township projects in 25 additional cities. As earlier reported by Pinnacle Research, the Group is developing Alviera, a 1,100-hectare large-scale master-planned development in Porac, Pampanga.

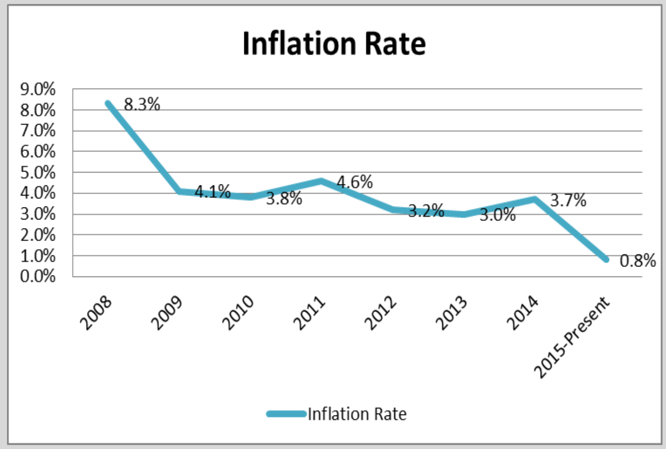
The Ayala Group is redefining the Balitawak-Quezon City landscape and skyline with the development of the 11-hectare property. The first phase includes a two-hectare shopping complex and a 250-bed hospital specializing in cardiology and cancer due for completion in the same year. It is also developing "Vermosa", a 700-hectare area that spans the Cities of Dasmariñas and Imus in Cavite.

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

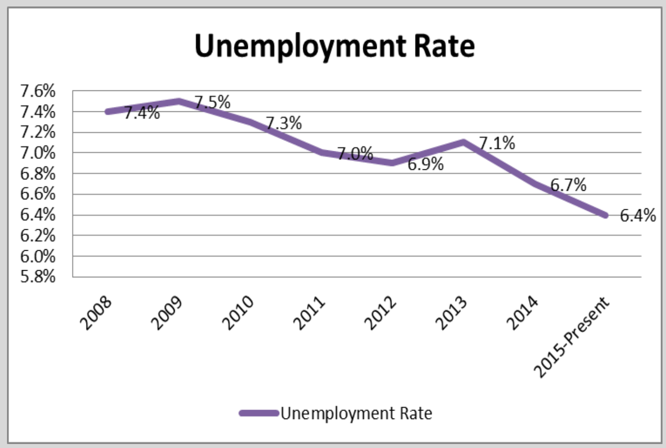
"Riomonte," the newly-introduced residential development in Nuvali will offer a total of 884 lots to potential buyers. This project will have an average of 10 lots per hectare, or only about 160 homes in each pocket of neighborhood.

Morevoer, the Ayala Group has been aggressive in partnering with other players. It has signed a joint venture deal with GT Capital Holdings Inc. to develop a 45-hectare township along Laguna Boulevard in Biñan, Laguna. The Group will jointly plan with SM Group the development of a 26-hectare property in South Road Property (SRP) in Cebu City, that will then be divided equally after the master plan has been completed. The group even partnered with Puregold to set up the AyaGold Retailers, Inc. to offer "Merkado" or community malls in the maket.

For its part, the SM Group will continue to build "micro cities" around its shopping malls. This would include apartments, offices and hotels to maximize the value of its property holdings. At least fifteen of the SM shopping malls are on large land that can accommodate high-density and mixed-used developments. SM Group intends to pour in Php 100 billion of investments in the sprawling 600-hectares Manila Bay reclamation 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)

SM Group intends to increase its current 52 shopping malls to 75 by 2018. Recurring income from its malls is a main source of profitability of SM Group. It almost doubled its first-half net income from Php 9.8 billion last year to Php 18.7 billion this year. Recurring income accounts for Php 11.2 billion according to a Business World article on August 3, 2015.

The projects for the rest of the year include opening three more malls, 12,000 to 15,000 residential units from subsidiary SM Development Corp., the opening of Conrad Manila at the Mall of Asia Complex as well as the Park Inn by Radisson Clark in Pampanga, and the start of construction of residential projects in Chengdu, China.

The Megaworld Group has been busy with its five new townships all over the country. Recently, the group announced its intention of building 20 malls in the next five year. While Megaworld has been successful with its sales, mall operation spells recurring income. Thus, the group is joining the retail mall race.

The Vista Land Group already unveiled 27 projects in the previous months that may rake in Php 20.7 billion of sales. It intends to launch more projects before the year ends at an estimated sales value of Php 15 billion. More importantly, the Group has been beefing up its AllDay and AllHome retail platforms to drive recurring income. Vista Land is also building office spaces presumably to get a slice of the BPO market.

DMCI and Rockwell Groups are also beefing up their residential projects. DMCI is allotting Php 60 billion for its 12 projects next year. Rockwell is developing a township project in Iloilo, and it recently launched The Vantage at Kapitolyo in Pasig City and the East Bay Residences in Muntinlupa City.

OFFICE MARKET

Most industry players are expecting that the Business Process Outsourcing (BPO) industry will have a slower growth by 2020. It is important to note that the industry has over 1,000 companies and employing over 1 million people by the end of 2014, according to the Philippine Economic Zone Authority. This phenomenal growth has been seen in just over a decade. Major players are already talking about moving up in the value chain.

According to the Information Technology and Business Processing Association of the Philippines (IBPAP), the BPO industry is expected to generate US$ 20 billion by 2016. Based on the September 4, 2015 Manila Bulletin article, the World Bank is even estimating a total revenue of US$ 50 billion from the BPO industry by 2020.

Whatever the level of growth, the BPO industry is currently filling up office buildings even with the faster pace of new supply. Pinnacle Research monitored a total take up of approximately 40,000 sqm of office space has been filled up by BPO companies in the past three months.

SNAPSHOTS

SECTOR	TREND	COMMENT
OFFICE	▲	Robust demand from BPOs, low vacancy, increasing rents even with new supply
RESIDENTIAL	▲	Wide-range of choices; competitive sales but prices are increasing; growing rental market
RETAIL	▲	Further expansion of the big players; proliferation of different retail platforms
HOTEL & GAMING	—	Diversifying supply and attraction catering to the ever-increasing tourist arrivals; slightly lower tourist spending
INDUSTRIAL	▲	Increasing demand for industrial spaces; expansion of manufacturers

The overall vacancy rate of major business districts in Metro Manila is below 3% even with the new buildings coming online. Makati rents of Premium Grade A buildings have a weighted average of Php 1,280 per sqm per month; for Grade A buildings, the weighted average is Php 865 per sqm per month; and for Grade B&C Buildings, the weighted average is Php 675 per sqm per month. These rents grew at approximately 1% quarter-on-quarter.

The weighted average rent in BGC of Php 870 per sqm per month is comparable to slightly higher when compared to Makati Grade A buildings. The weighted average rent of Grade A office buildings in both Ortigas and Alabang business districts is estimated at Php 650 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

Delivery of new residential condominium units are expected for the rest of 2015. Approximately 5,500 units are expected to be completed in the major business districts. These upcoming projects include Park Terraces Tower in In Makati CBD; West Tower, Meranti Tower and Sequoia Tower in in Bonifacio Global City; and One Shangri-La Place North Tower in Ortigas Center. Real estate developers are typically motivated to turnover units for them to collect the full payment and realize their profits.

Moreover, top players are not shy with their new launches with SMDC leading the way. The SM Group launched projects such as SMDC's Trees Residences, Grass Residences and Shore Residences 2 with a projected total of more than 9,000 units. DMCI introduced its Asteria and Ivorywood projects, while Ortigas & Company launched "The Maven", third tower of its Capitol Commons project in Pasig. The Ayala Land Group has consistently packaged its residential projects with mixed used and township developments.

To some, these figures may appear to be high. Based on the previous Pinnacle Report, the National Economic and Development Authority (NEDA) estimated the housing need is over 800,000 per annum; of this, close to 400,000 households annually can afford to buy housing units while the remaining households are mainly from the informal settler families. The private real estate developers typically target to carve a market share from this 400,000 per annum demand for housing all over the Philippines.

The Housing and Urban Development Coordinating Council (HUDCC) approved in its June 8, 2015 meeting the adjustment of the economic housing loan ceiling to Php 1.7 million from Php 1.25 million. This will give chance to average income earners living in highly urbanized cities to avail of a higher loan for economic housing. The general notion is that average income earners are priced out in highly urbanized areas and are forced to buy-through-mortgage housing units that are far from their places of work.

Leasing of residential condominium units continues to be steady. Rents have been generally stable, given the wide range of options in the market. Luxury condominium units command the highest rents at Php 300,000 per month-level, especially for big units hovering at the 300 sqm-cut. The typical rental range for luxury three-bedroom unit is between Php 120,000 to Php 250,000 depending on the size, location and furnishing. 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 building.

Quoting rentals of residential condominium in square meter is not an exact science but is very useful in computing for yields. Since rents are generally stable and the sizes and options of units are varied, it is difficult to come up with weighted average. At any rate, Makati CBD condominium units have a very 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.

RETAIL MARKET

The retail market with its various platforms is again being aggressively pursued by the top developers, because of its power of recurring income. While residential sales are generally brisk, once a project is fully sold out, a developer would have to do it all over again for another project in a different location. Unlike a strategically located shopping mall, it would provide steady annual net income.

As mentioned above, the SM Group has a total net income of Php 18.7 billion for the first half of the year, and almost 60% comes from recurring income. This is the power of 52 SM Stores, 41 SM Supermarkets, 43 SM Hypermarkets, 127 Savemore stores and 27 WalterMart stores. The Group recently acquired three Cherry Foodarama stores that are scheduled to re-open before the holiday season. SM also teamed up with the Indonesian Alfamart to venture on the operations of initially 50 minimarts. For community malls, SM’s joint venture with by DoubleDragon to put up 100 CityMalls is well underway. The partnership already secured 32 sites all over the country and intends to open 25 stores by 2016.

Ayala Land Inc. (ALI) is planning to open at least five new shopping malls in the next few years in line with its goal to earn a net income of Php 40 billion by 2020. It also plans to develop the nine-hectare mixed-use complex in Parañaque City with an anchor shopping mall. The Ayala Land Group earlier secured a 45-year lease for the 9.2-hectare property from the Wenceslao group, the owner of the Aseana Business Park complex, for the project.

COSCO Capital Inc., the listed company of Puregold's Lucio Co, recently acquired RFC mall along Alabang Zapote in Las Piñas City. RFC has a total lot area of about 7,600 sqm and a gross floor area of about 23,000 sqm. The acquisition will add to the Group's existing 35 stores with a total GFA of 343,000 sqm. Cosco/Puregold Group is planning to open eight stores in the next three years.

The Megaworld Group is joining the race with its plan of putting up 20 malls in the next five years. As earlier reported by Pinnacle Research, the Vista Land Group is integrating its retail platforms with its housing projects. The Groups intends to open six to seven "AllHome" annually over the next five years.

Another player that is making its presence felt is the Cebu-based Gaisano-owned Metro Retail Stores Group, Inc. (MRSGI). It recently opened its 20th branch Luzon, located in Calamba, Laguna. The Gaisano Group has grown its hypermarket portfolio to 12 stores in just three years. In total, it has 46 stores in key cities around the Philippines.

One traditional retail market leader appears to be quiet, the Robinsons Land Group. While the Group has been ramping up its residential sales and recently acquired the 18.5-hectare Ortigas Extension property, it is not rampaging to increase its almost 100 stores, including the 37 malls. It is also operating more than 400 Ministop stores. The target is modest growth on the number of malls and stores of different platforms. According to industry sources, Robinsons Land has been focusing on tenant mixes that are both symbiotic and profitable, and on managing cost to increase the bottom line. Coming from a high base, Robinsons Land Group is basically choosing profitability over rapid expansion.

HOTEL AND GAMING MARKET

Hotel operation is one of the most, if not THE most, expensive real estate segment. A hotel needs to be fully built up, furnished and operational before it earns its first Peso. Unlike residential condominium projects where developers can easily do pre-selling, proceeds from sales defray some of the developmental costs. When the operations start, however, the hotel would bring in recurring income especially when managed properly. When the developer includes gaming operations in the mix, then, this hotel becomes a game changer. This is the reason why hotels with casinos are sprouting, even with the tight regulation of the Philippine Amusement and Gaming Corporation (PAGCOR).

At any rate, hotel and tourism is not just about gaming. The typical "MICE" that stands for Meetings, Incentives, Conventions and Exhibitions/Events is the country mantra in hotel development. The Ayala Land Group plans to invest as much as Php 30 billion in the next five years to put up Seda hotels across the country. It is even considering bringing the Seda brand broad. The Ayala group currently has four Seda hotels located in Bonifacio Global City, Cagayan de Oro City, Davao City and Sta. Rosa, Laguna.

Robinsons Land Group is another veteran in hotel development. While it has foreign partners running the Crowne Plaza and Holiday Inn, it has been steadily increasing its budget hotel--- Go Hotel. At present, it is operating nine hotels and is gearing up for its 10th location, probably in Davao. The nine sites are in: Bacolod, Butuan, Dumaguete, Iloilo, EDSA-Mandaluyong, Ortigas Center, Otis-Manila, Puerto Princesa and Tacloban.

To boost hotel development, the Department of Tourism (DOT) is motivating developers by endorsing for incentives a total of over Php 12 billion worth of tourism projects with the Board of Investments (BOI) and the Philippine Economic Zone Authority (PEZA). DOT identified nine hotels that will add 651 rooms to the industry. These are: Windored Hotel, Discovery Primea, Amanpulo Villas, Best Western Ivy Wall Hotel, Blue Palawan Beach Club, Seda Atria Hotel in Bohol, Executive Tulip Apartelle in Davao City, Belian Hotel, and Eskaya Beach Resort and Spa.

INDUSTRIAL MARKET

The Philippine Economic Zone Authority (PEZA) has 316 operating economic zones under its supervision, hosting approximately 3,500 companies. Apart from these ecozones, the Clark Special Economic Zone (CLARK) and the Subic Bay Freeport Zone (SUBIC) have offered thousands of hectares to manufacturers in the past. In recent months, even with the sprawling CLARK and SUBIC, vacancy of industrial space is less than 200 hectares.

More importantly, a number of foreign manufacturers have been looking for suitable industrial properties. Cognizant of this demand, PEZA intends to expand its Mactan Cebu International Airport (MCIA) by at least 30 hectares. The Bases Conversion and Development Authority (BCDA) intended to privatize the 200-hectare Clark Green City by way of joint venture, but the public bidding failed to enticed investors. While the government is going through its usual process of land development, supply of suitable industrial space is expected to tighten.

Private developers are busy mapping out potential PEZA-accredited industrial zone. The Ayala Land Group is offer the Alviera Industrial Park (AIP) to the market as part of its master-planned development in Porac, Pampanga. At least sixteen lots of the 31-hectare industrial park have already been reported sold. AIP is seen to complement the industrial hubs in CLARK and SUBIC, targeting companies in light to medium, non-polluting enterprises.

OF MARATHON, HURDLE, RELAY AND CYCLE

While it is typical for companies to sprint to the tape or finish line before the year ends, or “finish the year strong”, especially for publicly-listed entities, the real estate market may be viewed as a long distance marathon. Developing real estate products takes months, and even years. True, there are ways on how to push forward profitability. For some developers, they would turnover their products ahead of time to collect the “bullet” or “lump sum” payments. Some commercials spaces like malls, hotels and even offices would bump up profitability by squeezing interested tenants on weekly or monthly basis, who would in turn take advantage of the shopping season before Christmas. Even open spaces and parking lots are transformed into "*tiangge*" to serve the shoppers.

The real estate market is considered a marathon due to its requirement of time-consuming and labor-intensive construction. This is the reason why it has a very high multiplier effect in the economy. For construction, the first two years are typically in the red, even if pre-selling and pre-leasing are possible in some segments. This may be considered a major "hurdle" in the property market. This is the reason why due diligence and market scanning is very important in any segment of the property market. While some players may be satisfied with the market study prior to construction, the top developers conduct their market scanning and research, especially during construction to monitor the competition.

The best part of the marathon is when developers are turning over their products. Then, they will realize their profits. More so for properties with recurring income, the positive net income is pretty much assured during the life cycle of the development, sans disaster. Considering all expenses and revenues, the company should have exceeded its hurdle rate. Then, whether from sales or leasing, earnings can then be plowed back to new developments, and hopefully, a real estate player can increase its market share. Of course, some earnings need to be apportioned for dividends to keep the investing public happy. The investing public would then continue to support the successful player. In a nutshell, this is a cycle that most property players would want.

Some have argued that the property cycle is closely linked to the political cycle. Positive governance breeds positive business sentiment and environment for property development. While the property market is like a marathon race as mentioned above, the political arena is like a relay where one administration passes the baton to the next. Political noise would increase in the coming months and may sharpen to mudslinging. While politics is assured to heat up, the passing of the baton may not be to the same team. The former President Gloria Macapagal Arroyo stepped down and transferred power to her staunchest critics, to President Benigno Aquino III and his allies.

Perhaps this is the major advantage of Philippine democracy. Politicians and voters are mature enough to accept the consequences of their decisions; even if these decisions may be viewed as immature by others. The tale of the tape for politicians is usually paraded before elections, and may even be reinforced by surveys. But the real winner is determined during the Election Day. The tale of the tape for property developers is usually propped up with press releases and briefings. But the real sentiment of the investment public is shown in the ticker of the stock price. In the final analysis, these are big rocks or hurdles. To the public, what is more important is having jobs, whether in traditional or BPO offices; having suitable shelter to buy or rent; having affordable food readily available in the market; having reliable power and potable water; having the means to move around; and having spare change for little luxuries like watching movies and sumptuous dining. These seemingly small rocks may actually keep the cycle moving.

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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