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Country Report (Philippines)

Philippine Property Market Report

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Summary

- The Philippine property market continuous its growth, fuelled by strong private consumption and investment expenditures. Supported by a strong showing in construction, the sector made its strength felt when Philippine GDP grew by an impressive 7.8% in the first quarter of 2013.

- *With the latest economic indicators, a pattern of economic expansion based on private sector consumption and capital formation has been established.*
- *Consequently, almost all property market segments continue to be strong, with values in various segments increasing 2% to 5% in the past year.*

- *And while there is some concern regarding a supply glut of high-end residential units, this should be absorbed as the economy continues to grow. Business sentiments remain upbeat despite the recent outflow of hot money from May through June 2013.*

Table 1: The Philippine Economy at a Glance

Indicator	1Q13	1Q12	%Change	Remarks
Gross National Income	7.10%	5.10%	39.22%	in 2002 prices
Gross Domestic Product	7.80%	6.30%	23.81%	in 2002 prices
Exports	3,741	4,430	-15.55%	in US$ millions
Imports	4,708	4,997	-5.78%	in US$ millions
Trade Balance	(967.00)	(567.00)	70.55%	in US$ millions
Balance of Payments	640.00	(114.00)	-661.40%	in US$ millions
Broad Money Liabilities	4,964,560	4,516,552	9.92%	in PhP millions

Indicator	1Q13	1Q12	%Change	Remarks
Interest Rate	2.40%	3.80%	-36.84%	interbank loan rate
Nat'l Gov't Revenues	113,609	115,431	-1.58%	in PHP millions
Nat'l Gov't Outstanding Debt	5,281	4,912	7.51%	in PHP millions
NG Revenues over NG Debt	21.51	23.50	-8.46%	
Philippine Peso per US Dollar	41.14	42.70	-3.65%	April 13/April 12
Stocks Composite Index	6,847.50	5,107.70	34.06%	Mar.'13/Apr'13
Consumer Price Index	132.90	129.50	2.63%	May'13/May'12

• Headline Inflation	2.60	3.00	-13.33%	May'13/May'13
• Core Inflation	3.00	3.70	-18.92%	May'13/May'14
• Visitor Arrivals	418,108	361,925	15.52%	Feb'13/Feb'12
• Underemployment	21%	19%	10.53%	Jan'13/Jan'12
• Unemployment	7%	7%	0.00%	Jan'13/Jan'13

- *Source: National Statistical Coordination Board, Philippines.*

Economic Outlook

- Prospects for the Philippine economy wax increasingly positive for 2013 through 2014. Continuing economic and fiscal reforms have yielded dividends in terms of investment confidence by Filipino businessmen and consumers.

- This confidence has been mirrored in the international investment community as the country has received investment-grade ratings upgrades from Fitch (March) and S&P (May) as well as JCR (May) and other regional rating agencies.

- The growth drivers have basically remained the same from previous periods, including robust domestic consumption, persistently-strong overseas remittances, high growth rates of over 10% in the IT-BPO and tourism sectors, and an on-going public-private partnership program (a government investment surge) that began in the previous year and is increasing traction in 2013. Even then, GDP growth for the first quarter surpassed expectations as the economy grew by 7.8%.

Overview

- The Philippines is a non-traditional Asian country in the sense that it is a Christian country (80% Roman Catholic) and the majority of the population has a degree of proficiency in the English language. The country is one of the most cosmopolitan in the world, scoring the highest in Asia for gender equality and gay rights.

- A pluralistic, semi-westernized culture has allowed two economic phenomena to flourish in the Philippines that differentiate the country from the rest of Asia.

- The first is its overseas Filipino workers, or OFWs. OFWs are mostly composed of semi-skilled and professional workers that remit annual dollar inflows to the tune of US$23 billion. These remittances have enabled the Philippines to accumulate large foreign reserves and afford it flexibility in the management of its external balances.

- OFW family dependents fuel a retail boom that has been on-going for 8 years now, only marginally-affected by the global financial crisis from 2007-2009. The same inflows also significantly support other sectors such as the low cost and middle cost residential real estate sectors and education.

- The second is the IT-BPO industry, now the largest in the world, worth US$11 billion annually and expected to reach US$16 billion annually in 2015. 50% of the industry is composed of contact centres or traditional call centres while the remaining 50% involve more technical work in software development, animation, finance, engineering and architectural design.

- Besides OFW remittances and contributions of the IT-BPO industry, the Philippine economy is also characterized by strong consumption patterns in the services sector, which takes up approximately 50% of the domestic economy.

- The recent 7.8% growth reported in the first quarter of 2013 was largely driven by private consumption and a significant portion of the segment came from financial services income.

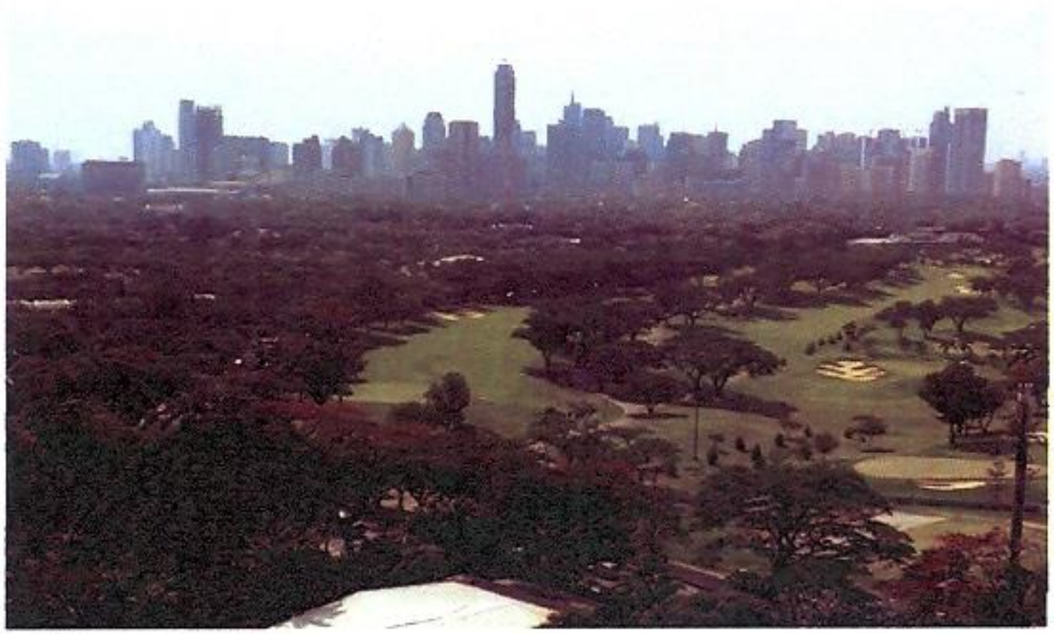
- Tourism continues to play an expanding role. The current government is heavily promoting tourism and visitor arrivals breached 1.27 million in the first four months of 2013. The Department of Tourism, or DOT, reports that, at the current rate, the target 5.5 million visitor arrivals can be met by the end of the year. Currently, the DOT has rationalized its departments to promote specific aspects of tourism for growth.

- These include segments such as diving, eco-tourism and retirement life, and so on. Consequently, hospitality sector RevPARs continue to be at an all-time high along with average annual occupancy rates in excess of 73%. There are currently shortages in hotel rooms in major island destinations and the country's emerging premier central business district, Bonifacio Global City or BGC.

- Exports are dominated by a large and concentrated electronics industry, highly sensitive to global demand. Due to weak global demand, exports have contracted by 5% in the first quarter of 2013.

GDP

- The 7.8% GDP growth rate experienced in the first quarter of 2013 surpassed expectations from both local and international economists, a majority of whom expected growth ranging from 5.5% to at most 6.5%. The first quarter was also the 13th consecutive quarter of unbroken positive growth that many analysts are claiming to be indicative of sustained, take-off growth. Figure 1 below details the quarterly growth rate of the country since the first quarter of 2011.

- 
- **Prospects**

  The Philippines continues to enjoy measurable quantitative strengths in the form of strong macroeconomic fundamentals fuelled by dollar remittances and its fast-growing IT and tourism sectors. These factors will enable the country to post GDP growth rates of at least 5% to 6% for the next half decade.

- However, recent experience seems to indicate a much-higher growth trajectory, in the order of 7% to 8% as being probable, given higher household expenditures and new levels of capital formation.

- And for the first time in many years, there has been renewed interest in the Philippine industrial sector. Korean and Japanese firms are stoking interest in industrial properties as business interests in mainland China are threatened by political and market risks.

- The country is expected to be one of the beneficiaries of production moving out of coastal China, as mainland labor costs are three times that of the average Philippine minimum daily wage.

- Moreover, fiscal efforts are yielding positive results. Public debt has decreased to less than 50% of GDP while the tax collection ratio is exceeding 14% of GDP. While both metrics are still below comparable economies, the Philippine fiscal position is continually-improving and this is expected to lead cement the country's investment grade rating from all three major ratings agencies by the end of the year..

- As of now, foreign investments are incoming and the cost of borrowing foreign capital has decreased significantly, making many local projects feasible.
- ***Figure 6.0***
- Philippine Sovereign Credit Ratings
- **Agency Rating Outlook**
- Fitch BB+ Stable
- Moody's BA2 Positive
- S&P BB Positive
- Japan CRA n.a. Positive
- *Source: Respective agencies.*

Figure 6.0

Philippine Sovereign Credit Ratings

Agency	Rating	Outlook
Fitch	BB+	Stable
Moody's	BA2	Positive
S&P	BB	Positive
Japan CRA	n.a.	Positive

- *Source: Respective agencies.*

Property Market Overview

- Philippine property market performance during the first quarter of 2013 was mostly positive, with some concerns regarding the high end residential segment. Listed company earnings grew by 17.7% while revenues grew by 22.9%.

- This was made possible by an increase in inventory sales in projects, particularly low and middle cost residential and commercial projects, which pulled up the whole market. Expectations for the rest of 2013 are generally positive.

- According to the NSCB, for the four quarters of 2012; "*Among industries, Real Estate still registered the fastest growth at 22.0 percent, from 25.2 percent in the previous year. Private Services followed with 11.8 percent from 8.9 percent; Finance grew by 9.9 percent from 11.1 percent; Trade was up by 7.7 percent from 10.5 percent; Manufacturing grew by 6.2 percent; and Transport and Communication rose by 4.8 percent from 4.9 percent.*"

Commercial Sector

- Commercial spaces exhibited enduring growth from the previous periods, sustained by continuous remittances from overseas workers and IT-BPO industry expansion.

- To be sure, other more traditional market segments also contributed to the demand pull factor as growth during the last quarter of 2012 and the first quarter of 2013 was characterized as broad-based: health, education, tourism and electronics employees and businesses all contributed to buttress demand.

Office

- Rental rates have recovered since 2010 and are now surpassing pre-2008 levels. At this rate, rental rates for office spaces will be exceeding 2012 levels by 5% by the end of the year, barring any change in demand factors.

Figure 8.0

Office Space Lease Rates

Exchange Rate US$1=PHP 43.72

	US$		**PHP**	
	High	**Low**	**High**	**Low**
Grade A	25	19	1,100	850
Grade B	15	11	650	500
Unrated	6	3	250	150

Source: IPREA

- Occupancy rates are also up with new leases being re-negotiated at either the same or slightly higher pricing. This occurs at the aggregate level reflecting increasing demand over limited available space in the short run. The high occupancy rates and the underlying positive economic factors suggest that demand will continue to be relatively high for the rest of 2013.

- IT-BPO office demand makes up 70% of new office contracts in new buildings while the remainder come from existing businesses upgrading to a new office address as well as new businesses from both local businesses and international businesses setting up shop.

- Most new office buildings are constructed with pre-commitments from offshoring businesses either expanding or setting up new offices in the country. Many office projects coming online until 2016 are developed this way. New office buildings usually have a waiting list from smaller companies in need of anywhere from 100 to 1,000 square meters.

CBD Migration Factor

- While prices and occupancy rates have remained high at the aggregate level, individual buildings, particularly Grade A and Grade B buildings are being affected by a steady migration of corporate headquarters from the traditional Makati Central Business District to the Fort Bonifacio Central Business District.

- The change has been gaining momentum since 2004 when it was noticed that more new companies were setting up offices in the Fort CBD compared to Makati CBD. The Fort CBD is better-planned, greener and more spacious compared to the older, Makati CBD. It is also the first CBD in the Philippines to strictly follow a zoning regime which maximizes property values for all properties in the CBD.

- Consequently, venerable and even relatively new, Grade A buildings in the Makati CBD have not been recovering lease rates as fast as in previous downturns and the typical lease term has gone down from 5 years to 3 years or less. Ayala Corporation, the primary developer of both Makati and Fort CBDs, plans to eventually convert Makati CBD into a residential and commercial enclave while the Fort CBD becomes the location for A1 corporate addresses.

- The previous medium-term plan called for such a transformation by 2015 at the earliest, and 2020 at the latest. At the current rate of business migration, the former scenario is the most likely. Makati CBD office leases may eventually be lowered to perhaps 10% less of current levels given prevailing demand and supply factors by 2015.

Retail

- Robust demand for retail spaces is sustained by OFW family remittance expenditures and IT-BPO growth. This translates to strong demand for retail spaces selling mass consumables like supermarkets for OFW families and electronics and apparels stores for offshoring company employees. New retailers that cater to the market profile of these two drivers generally thrive.

Lease Rates

- The Philippine retail commercial sub-sector runs on a “two-speed” system. On the high end of the spectrum are spaces in large malls and luxury boutiques in star-rated hotels that regularly fetch in excess of US$30 per square meter per month. The “high end” renting tier also includes extremely high-density retail spaces in old city shopping enclaves in Manila’s china town Binondo and parts of the old city-such as Quiapo and Divisoria-that have high pedestrian traffic.

- On the other end of the price scale are neighbourhood arcades and older buildings that can still generate incomes of US$4 per square meter per month. These retail spaces lie outside traditional shopping and central business districts in less well-travelled areas but with their own attendant, localized markets.

- ***Figure 10.0***
- Urban Retail Space Lease Rates
- Exchange Rate US$1=PhP 43.72

	US$		**PHP**	
	High	**Low**	**High**	**Low**
Prime Retail Spaces	34	19	1,500	850
High-Traffic, non-prime	13	10	550	450
Low-density or old stock	10	8	450	350

- *Source: IPREA*

Occupancy Rates

- Capacity utilization has been high in prime retail spaces but tepid in other categories. High occupancy rate is location-specific and high pedestrian and vehicle traffic is not an automatic indicator for high occupancy levels.

- In general, the prime retail spaces have better demand-management systems compared to lower-tier but high-traffic retail spaces. Prime retail spaces typically exhibit less volatility in occupancy rates in the previous and current quarter unlike the non-prime and old space segments. This differentiation is a holdover from the impact of the 2007-2008 global financial crisis, which was only felt in the retail sector in late 2008 and 2009.

- OFW remittances tend to increase during crises in the short run and the decrease in remittances usually manifest with a lag of a 8 to 24 months. Offshoring businesses are positively-affected by overseas economic depression but only in the short term. This is why the retail sector is the more resilient segment of the commercial property sector.

Residential Sector

- Revenue growth from the residential sector was the major contributor of growth to the property market during the first quarter of 2013. However, the higher middle cost and high-end residential market segment (units having a price higher than PhP3.2 million) has an inventory surplus of some 40,000 units. If the economy continues to grow this surplus should be safely absorbed.

- However, while the low cost and middle cost housing units are always in demand due to the housing backlog and the OFW and BPO families that sustain demand, the high end sector, for now, only looks towards a relatively small population of executives and high income families to maintain it. In a new luxury project in Bonifacio Global City, speculators and second home buyers made up to 70% of new purchases.

- ***Figure 12.0***
- CBD Residentials
- main pricing clusters

	Lease US$/sqm/mo	Occupancy %
Condominium Units		
High End	19-36	95%
Middle End	16-28	95%
Marginal CBD	8-12	95%
Single, Detached		
First Tier	27-45	95%
Second Tier	14-24	95%
Marginal CBD	6-10	95%

- *Source: IPREA*

- Inside Philippine CBDs, luxury condominium units are being leased 3% to 5% lower compared to early 2012 levels. Luxury residential property market values always exceed rental income values by 20%. This market segment is overdue for an adjustment.

- Central business district occupancy rates are effectively at full capacity only in select properties-notably Ayala Land projects- while most other properties are feeling softening demand, threatened by vacancies unless lease rates are adjusted downwards.

- The table above refers to residential units in and around the Makati, Ortigas, Bonifacio central business districts; as well as the Eastwood, Alabang and Rockwell mini-CBDs. Single, detached units refer to houses inside gated villages within and around the CBDs such as Forbes Park, Dasmarinas Village, Bel Air and Urdaneta Village. There are also *Marginal apartments and houses outside exclusive, higher end villages and condominium buildings that are leased by employees and professionals working in the CBDs.*

- Despite the obvious signs of oversupply, several high-profile developers are pushing through with their respective high-end residential projects and up to 30 new towers are slated for breaking ground in the next two years.

- What this indicates is a confidence in the continued expansion of the economy and its capacity to absorb new supply. Still, caution is the order of the day when it comes to the high-end residential segment of the Philippine property market.

Industrial Sector

- *This section of the property market report remains unchanged from the previous period's report.*

- Unlike other middle income Asian economies, the Philippines has a small manufacturing sector: the result of failed government policies in import substitution, high cost of labor and the highest energy cost in Asia.

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- The Philippines still has some comparative advantage in niche industries in intermediate electronics and high end furniture, which are its two main export engines. Domestic manufacturing however, is mostly uncompetitive and most goods are imported.

- This weak manufacturing sector has meant that demand for industrial properties have always been soft. In addition, the property boom in the mid-1990s created sprawling industrial parks, which remain more than 40%-60% vacant to this day. Thus, weak demand and surplus properties result in low prices and rents

- ***Figure 13.0***
- Industrial Sector

	Metro Manila	Industrial Park
Lease Rate (US$)	3.55	2.84
Mean Occupancy Rate (%)	65%	45%

- *Source: IPREA*

- In the first quarter of 2013, the manufacturing sector grew flatly and can be expected to remain soft-but possibly positive, if investment opportunities from Korean and Japanese firms materialize. The table above summarizes the current condition and-most likely-also near future conditions. Metro Manila industrial properties are mostly light manufacturing and warehouse spaces.

Hospitality Sector

- The Department of Tourism reported that visitor arrivals totalled more than 1.7 million visitors during the first quarter, keeping the department ahead of its intended target of 5.5 million visitors in 2013.
- Government-accredited hotels have been reporting high average occupancy rates for the whole year. Hotel occupancy rates during peak season is usually at full capacity, which are prompting new investments in the hospitality sector.

- Many real estate companies such as Robinson's Land and SM Properties have committed billions of pesos on hospitality CAPEX for 2012 and 2013. This is on top of the large investments foreign hotel chains and casinos are installing in the market. Tourism is one of the bright spots and a main growth driver of the Philippine economy.

End of Presentation