Metro Manila Office Market Update

Office Rent Rollbacks Cushion Increasing Vacancies

Q1 2021

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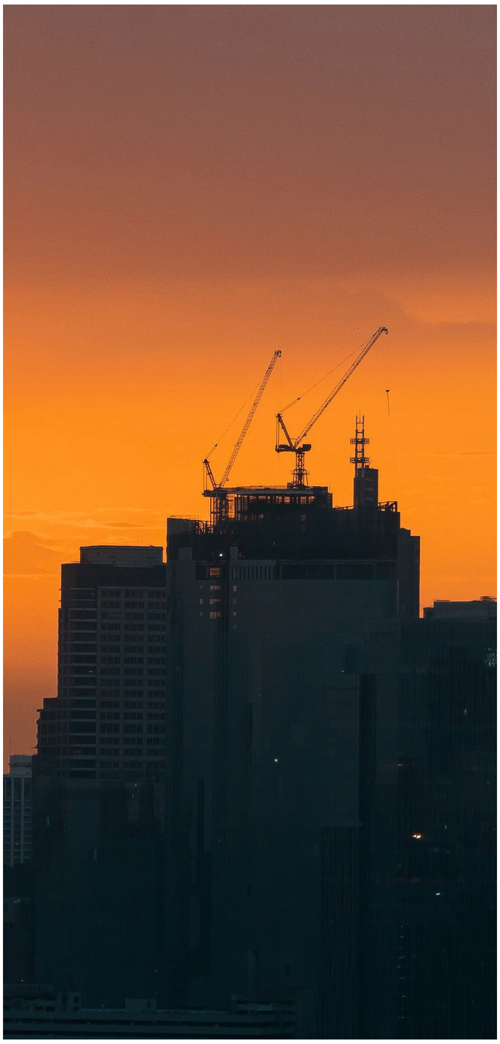
General Overview



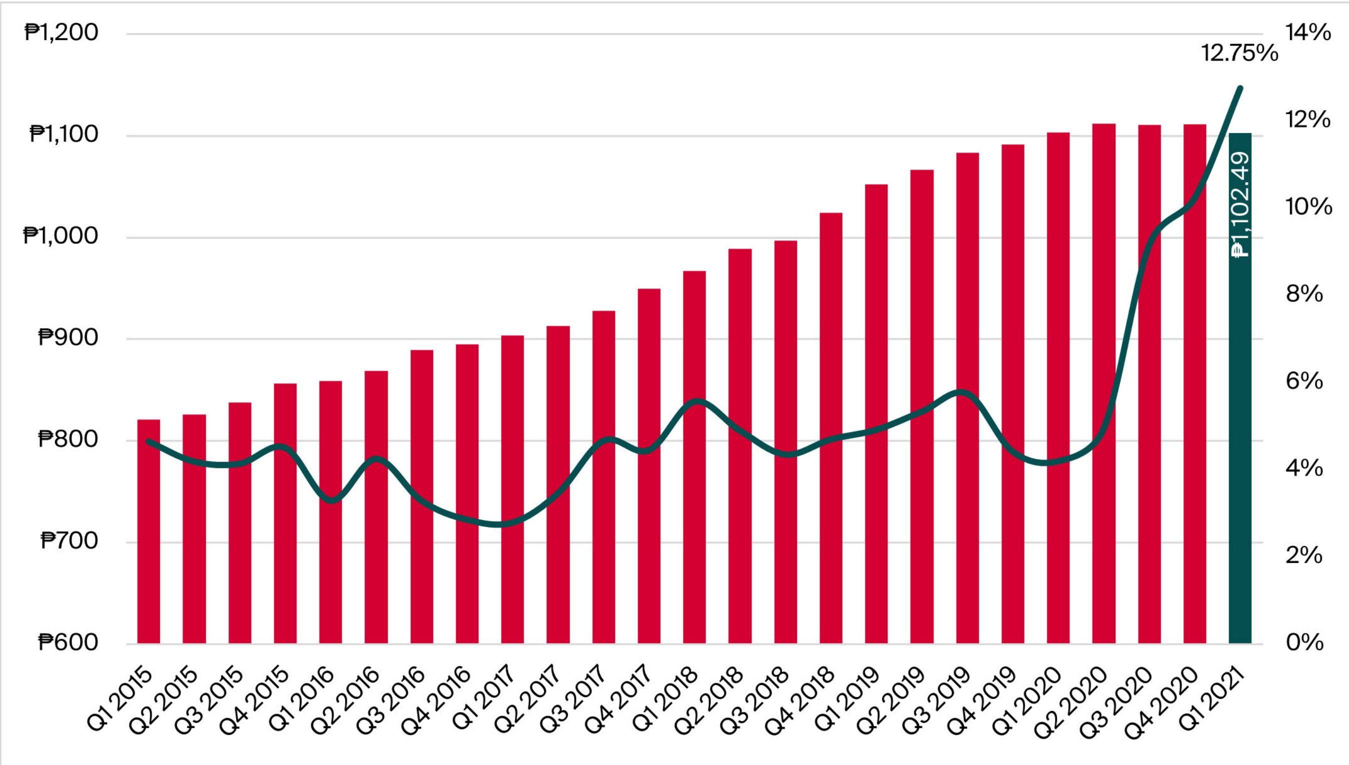
The Metro Manila office market displayed modest market movement at the start of 2021 owing to the sluggish demand driven by the market uncertainties caused by changing lockdown scenarios in Metro Manila. Landlords were challenged to remain relevant as potential occupiers continued to take a cautious approach caused by the growing COVID-19 cases and slow vaccine roll-outs.

Still, new office spaces were introduced during the quarter as developers capitalized on the relaxed quarantine measures to resume their halted construction activities. The local office market supply grew by 163,136 sqm of Grade A office space that mostly catered to IT-BPO companies. Several buildings were completed in Fort Bonifacio, Bay Area, and Quezon City, resulting in an overall office supply in Metro Manila of about 6.9 million sqm.

Consequently, supply growth resulted in an increase in vacancies throughout the metropolis. Office vacancy rates in Metro Manila further spiked to 12.75%, the highest since 2009. Current and potential occupiers remained vigilant towards the health situation of the country. Numerous companies continued to implement Work-From-Home and skeletal workforce arrangements. Office take-up contracted by 28,696 sqm as locators reassessed their need for spaces amid their bid to reduce operational costs.

Monthly average lease rates in Metro Manila further dipped to PHP 1,102.49 per sqm, declining by 0.78% quarter-on-quarter (q-o-q) and 0.07% year-on-year (y-o-y). The downward trend of rents was caused by the landlords' bid to provide more competitive packages to appeal to prospective tenants.

Figure 1. Metro Manila Historical Lease & Vacancy Rates



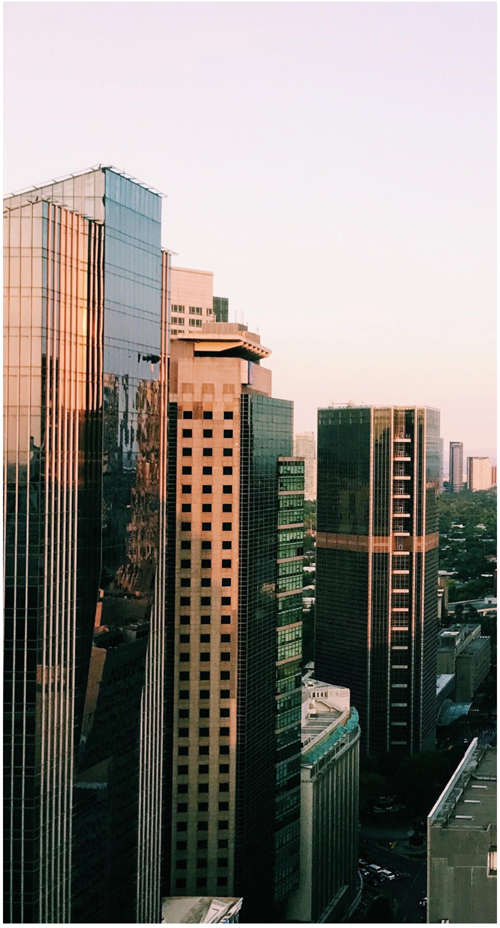
Source: Santos Knight Frank Research

Makati

The adverse effects of the pandemic and the prolonged lockdowns remained evident in the most prominent business district in the country. Vacancy rates spiked to 11.17%, considered to be the highest in the past ten years. Moreover, the expensive rents in Makati CBD were detrimental to the retention of office occupiers. Locators looking to minimize their expenses opted to discontinue their lease, resulting in about 25,557 sqm of office space vacated during the quarter.

Sluggish leasing activity persisted in the area as existing and upcoming locators in Makati were less willing to take up spaces due to the financial distress brought about by the global pandemic. The average monthly rents recorded in Makati went down to PHP 1,348.19 per sqm, contracting by 0.93% q-o-q and 6.05% y-o-y. Despite this, rates in Makati remained the highest in the metropolis.

Several property players are still looking forward to the materialization of their projects in the pipeline. More than 447,552 sqm of Prime and Grade A office supply are anticipated to come online in the next three years, with approximately 164,000 sqm being operational by the end of 2021. The massive influx of upcoming office developments in Makati comes from the backlogs and spillovers from 2019 up to the latter part of 2020.



Taguig

Slow demand in Taguig was also evident as vacancy levels continuously increased to 8.37% from 7.74% in Q4 2020. Despite having the largest supply share in Metro Manila of more than 2 million sqm, the downsized space requirements were seen as the factor in the rising vacancies as locators looked to lessen their operational cost. Moreover, average monthly rental rates in Fort Bonifacio also went down to PHP 1,289.75, translating to a contraction of 0.89% q-o-q.

The ease in quarantine measures allowed private and public projects to resume construction. Office supply in Fort Bonifacio further grew by 28,000 sqm through the completion of BGC Corporate Center 2. Despite the growing vacancy levels, potential developers still have bright prospects in Taguig as it was seen as the youngest but fastest growing business district in Metro Manila. In line with this, upcoming office supply is seen to be augmented by about 864,100 sqm of office space within the next five years. About 344,000 sqm of this will be coming from Arca South which is poised to become a new business district in the south.

Bay Area

The POGO industry exodus has significantly contributed to the spiking vacancy levels in the Bay Area during Q1 2021, recorded at 12.82%. Slower demand from the sector is seen in the coming periods as more firms have started to postpone their lease contracts. This occurrence implied challenges in the recently fast-moving office market of the Bay Area.

The upsurge in vacancy was also attributed to the completion of Four E-com during the quarter with an additional 89,132 sqm of Grade A office space. Priced above its competitors, this building has helped in pushing the average rents in the area to PHP 1,083.41 per sqm, increasing by 1.66% q-o-q.

The Bay Area is still foreseeing a huge amount of upcoming office supply in the coming years. Developers still recognize the opportunity to invest in the area due to its accessibility and availability of developable land. Approximately, 578,800 sqm of office developments are anticipated to be introduced in the market for the next five years, while 258,000 sqm are expected to become operational by the end of 2021.

Ortigas Center

Vacancy levels in Ortigas Center gradually eased to 12.75% in contrast to 12.88% of the preceding quarter. Despite this, pre-terminated contracts and non-renewals were still observed, as most of the companies are still on a wait-and-see approach towards the office market. Meanwhile, the slow-moving leasing transaction was also felt in the district as the rental rates went down to PHP 806.29 per sqm, contracting by 1.15% q-o-q and still considered the lowest as compared to other major CBDs in the metropolis.

Moreover, the upcoming office supply in Ortigas Center remained high as more than 671,000 sqm of Prime and Grade A office spaces are slated to introduce in the next five years. In addition, the massive influx of 373,000 sqm of space is scheduled to commence their operations within the year such as Cyber Omega, SM Mega Tower, and Jollibee Tower. This includes the spillover from 2019 up to the remaining quarters of 2020 that has been halted due to subsequent lockdowns.

Quezon City

Vacancy rates in Quezon City spiked up to 20.64% as opposed to 16.21% of the preceding quarter, indicating the highest level across all of Metro Manila. Approximately 13,690 sqm of office spaces were freed up in the city during the quarter. Occupiers in the area were more sensitive to the health crisis as compared to locators in other districts The lack of recognized established business districts and limited connectivity of certain townships contributed to the slow demand in the area. Furthermore, the upsurge in vacancy levels was also driven by the opening of SM North Towers 1 and 2 that added more than 45,200 sqm in the massive office supply in Quezon City, and are yet to lease out the majority of their spaces.

Office landlords are trying to alleviate this downtrend and are still vying to mitigate lease terminations. To this end, average headline rates contracted to PHP 925.55 per sqm, translating to a 1.81% decline from the preceding quarter.

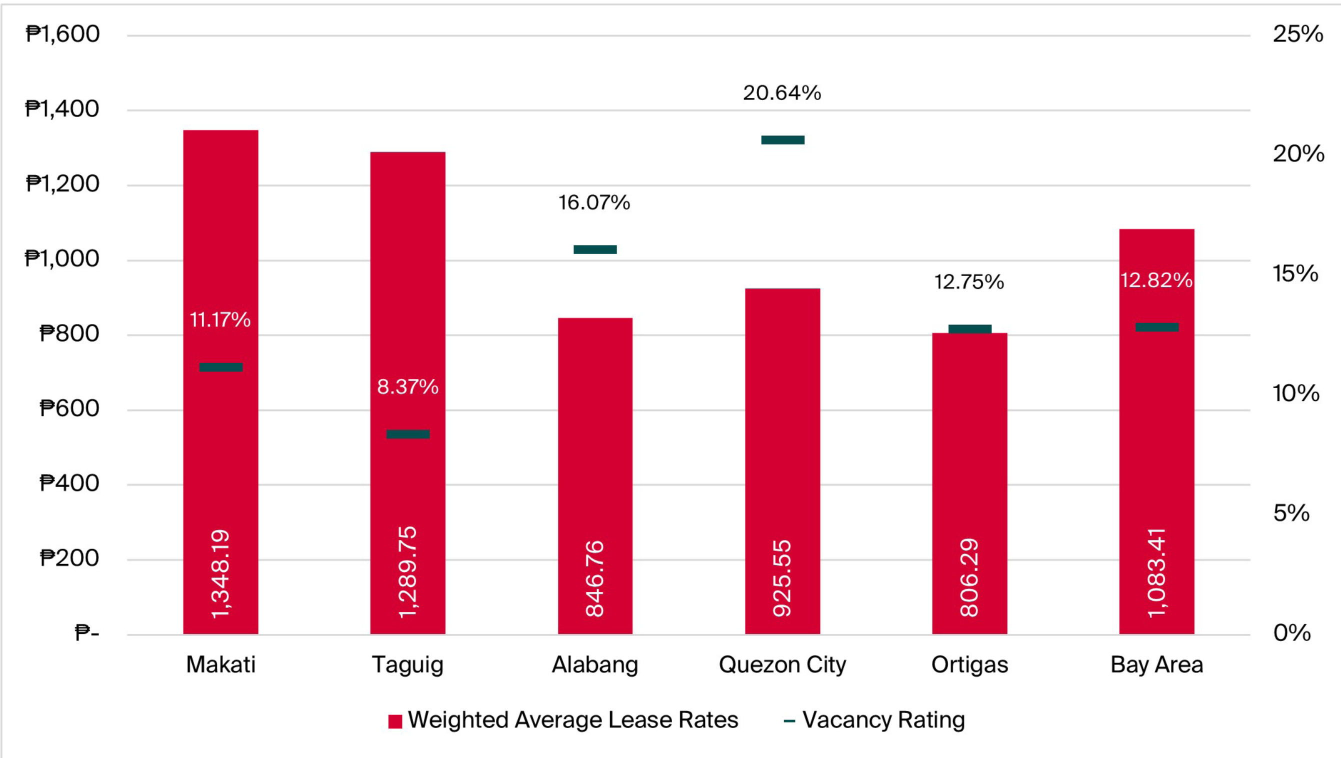
Albeit the fast-growing vacancy levels, Quezon City is still expecting a large office supply boost in the coming years. Approximately, 333,700 sqm is anticipated to be introduced in the market in the next five years, in which more than 149,000 sqm will be coming from SM Prime Holdings.

Alabang

Similarly, Alabang CBD experienced rising vacancy levels in Q1 2021 at 16.07% from 14.53% in the preceding quarter. As a result, increased pressures on office landlords in the district were felt as they remain responsive to the slow movement in the office market. This caused rental rates to gradually contract to PHP 846.76 per sqm.

Alabang still holds on to the possibility of becoming one of the major investment hubs in the metropolis due to its vast developable land. Approximately 209,900 sqm of upcoming Grade A office space is anticipated to be operational in the next five years, while 13,800 sqm is slated to become operational by 2021.

Figure 2. Metro Manila Lease & Vacancy Rates per CBD



Source: Santos Knight Frank Research

Office Outlook

The easing quarantine measures that started in the second half of 2020 allowed the developers to restart their impeded construction activities. Developers remain bullish in expanding their office footprint in Metro Manila with more than 3 million sqm of office space are slated to operate in the next five years. The nation's economic center is also set to have an additional supply of 1.1 million sqm of Prime and Grade A office space by the end of 2021. This massive influx still stems from the construction backlogs from the developers in 2020.

The robust expansion of office supply in Metro Manila is seen to further propel the vacancy rates in the local office market in the coming quarters. Along with the stagnant office demand, downward pressure on office rents still expected. Office landlords will be forced to implement more flexible payment terms to existing and potential tenants to market their spaces and continue cash flow from their buildings.

The recovery of the office market is also dependent on the pace of vaccine roll-outs in the country. The slow pace in inoculations is seen to weigh down on the recovery of the market. Attaining herd immunity as soon as possible can reinvigorate the interest in the office market.

In the medium- to long-term Green Buildings are seen to gain a competitive edge compared to ordinary office buildings. Buildings accredited by the US Green Building Council (LEED) and the Philippine Green Building Council (BERDE) will be more sought-after for potential office locators. The efficient design that provides better air circulation, ventilation and filtration, and increased open space, will be more appealing to the market as it puts a premium on the health and well-being of its tenants.

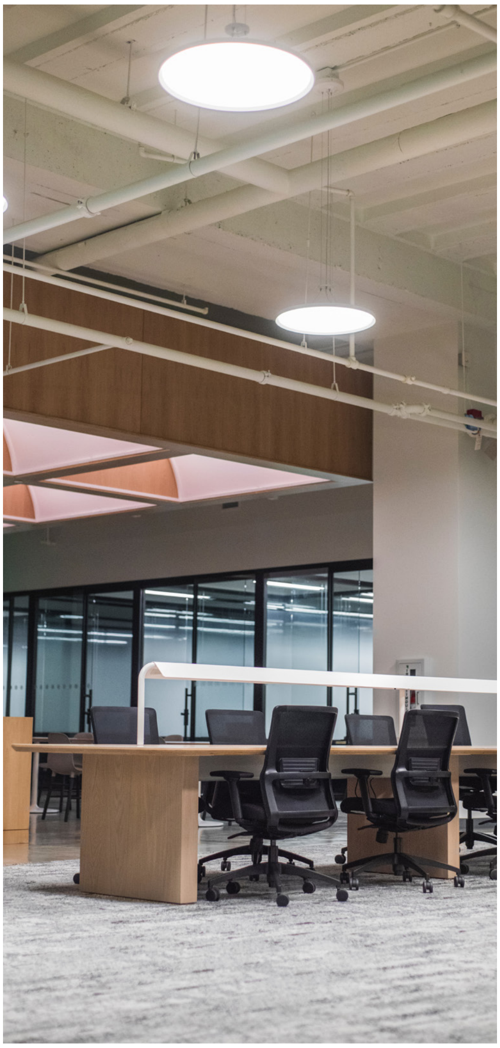
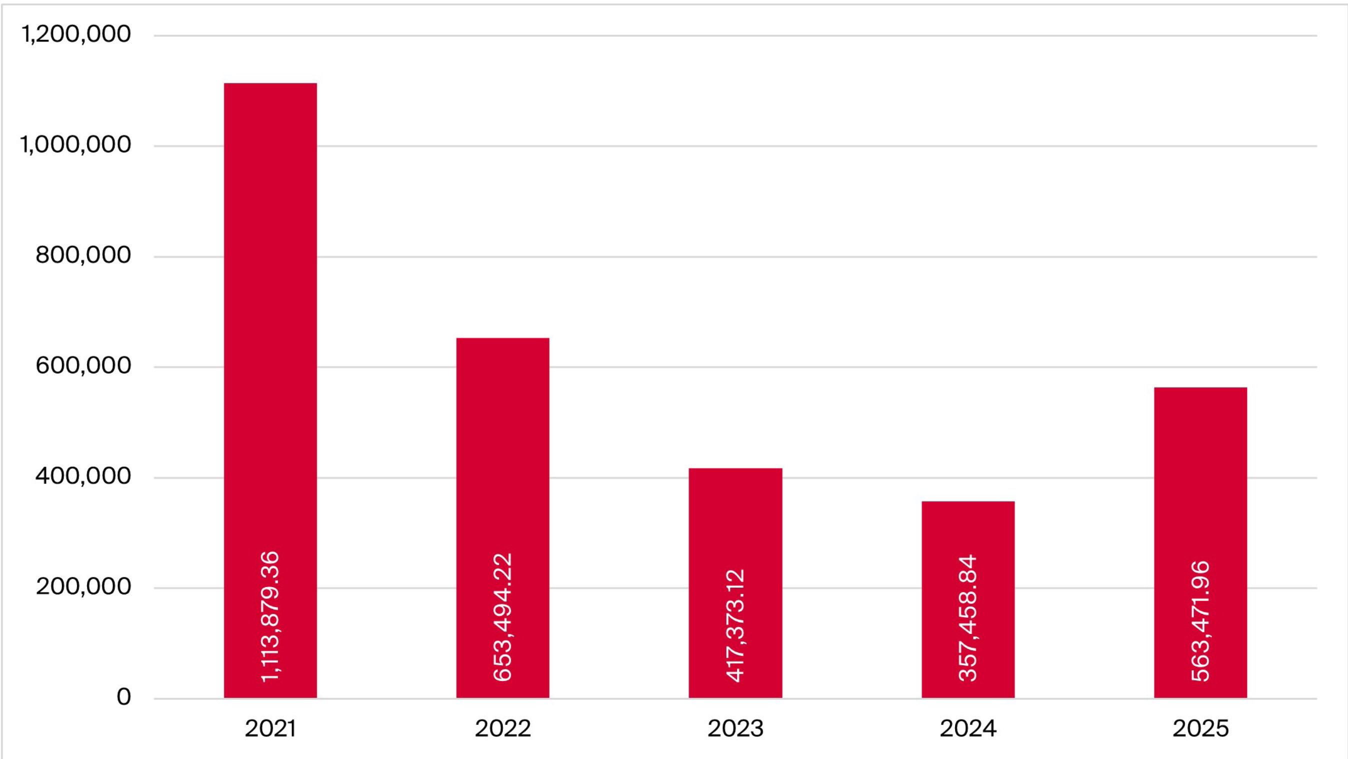


Figure 3. Metro Manila Office Pipeline



Source: Santos Knight Frank Research

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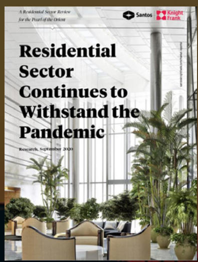

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