Metro Manila Office Market Update

Market Externalities Stimulate Movements of Metro Manila Office Market

Q2 2021

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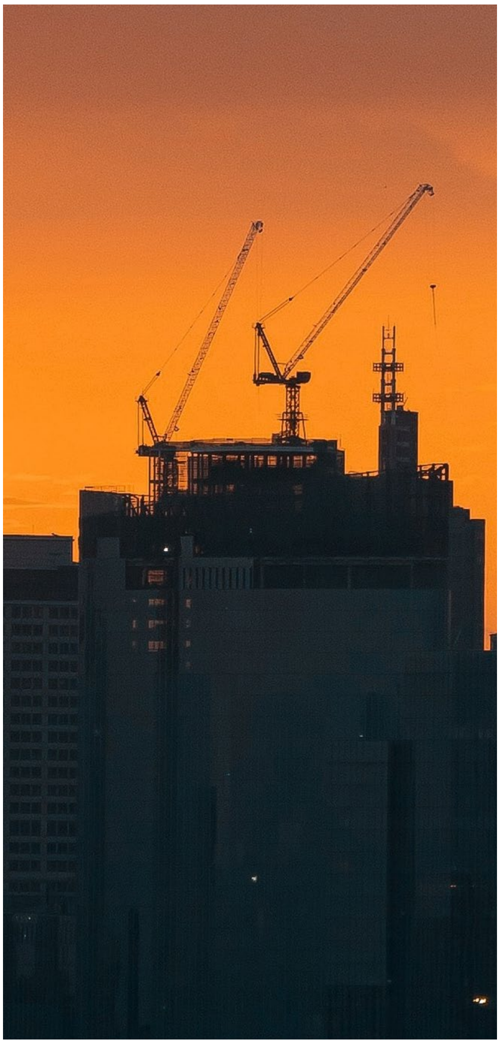
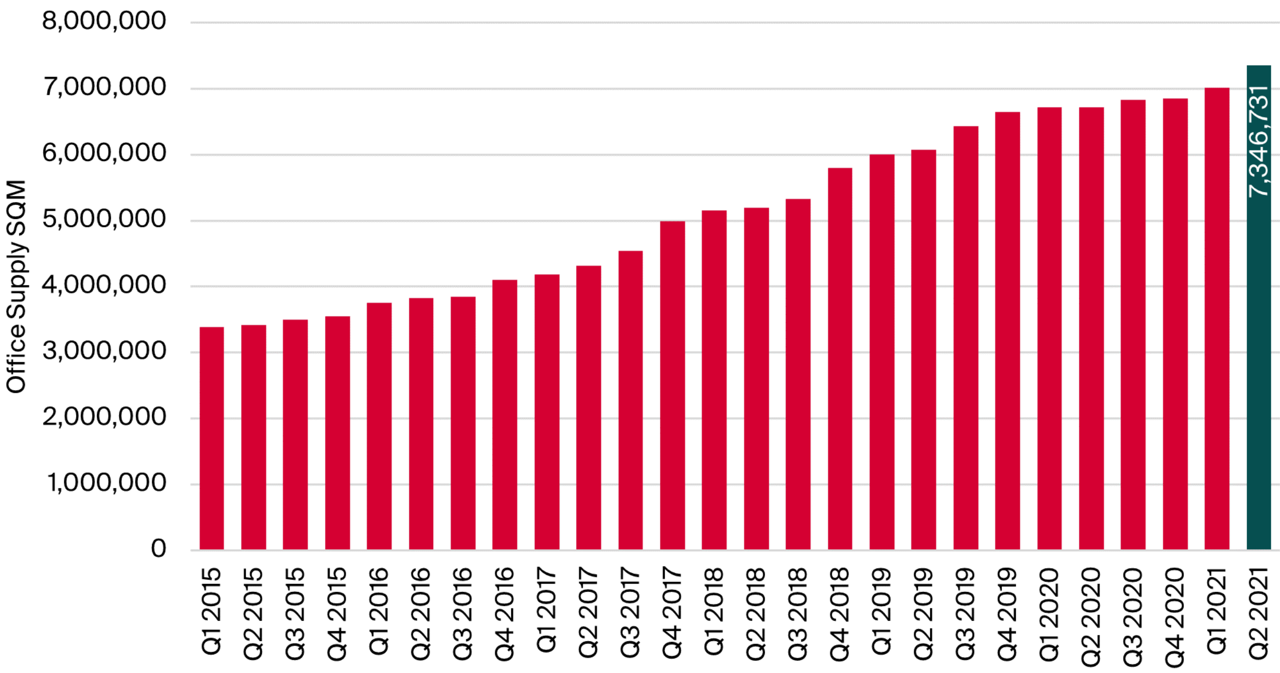
General Overview



The Metro Manila office market continues to be battered by pandemic headwinds stemming from varying quarantine protocols, growing concerns over the COVID-19 Delta Variant, and continuous implementation of remote work. Various office stakeholders banking on the prospects of an improved market setting were left disappointed once again as the market continued to slide with the vaccination rollout being much slower than expected and the limited availability of public transportation.

The local office sector witnessed robust growth in supply during the quarter as developers rushed to complete their stalled office building constructions. As a result, Metro Manila office stock grew by 4.8%, translating to 334,705 sqm of Grade A office space. Notable completions were observed within the business districts of Ortigas Center, Fort Bonifacio, and the Bay Area. Cumulatively, the total office stock in Metro Manila stands around 7.35 million sqm.

Figure 1. Metro Manila Historical Office Supply



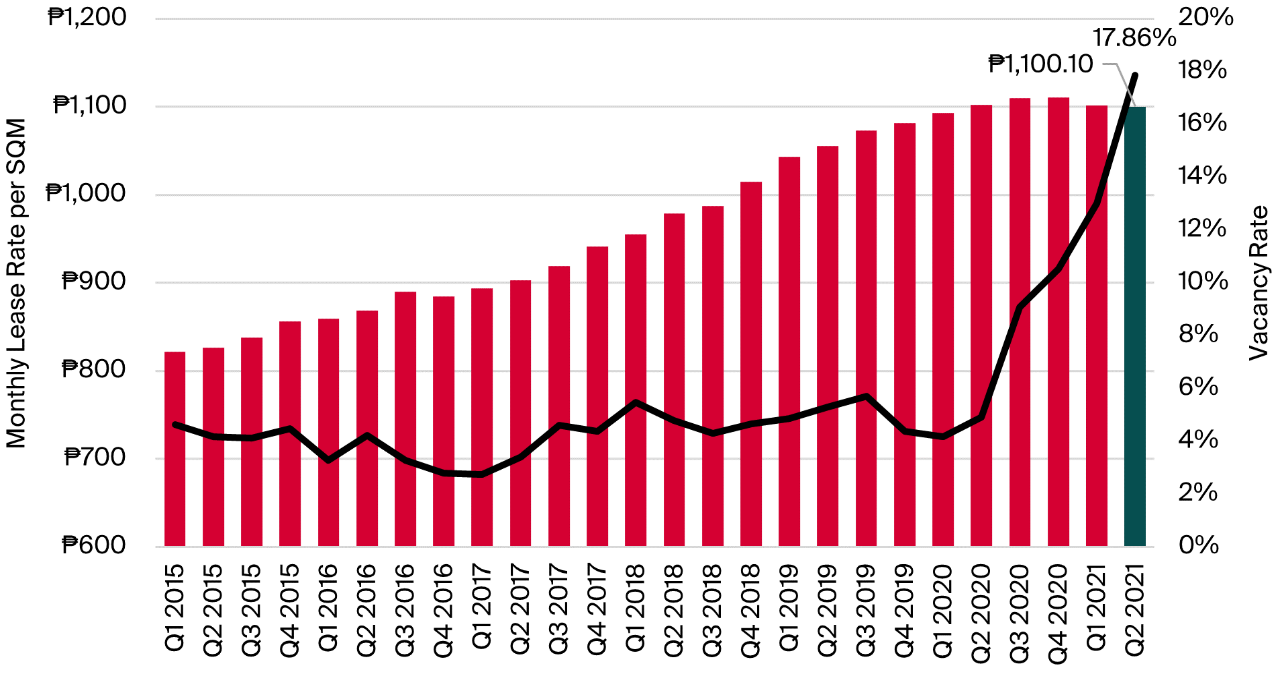
Source: Santos Knight Frank Research

Consequently, office vacancies in Metro Manila rose to 17.9% during the period. This indicated the highest vacancy level since 2009 due to the adverse effects of the 2008 Global Financial Crisis, where vacancy rates peaked at 11.8%. The surge in office vacancies stemmed from the rapid supply growth and cost-cutting initiatives of most occupiers.

Lackluster demand from different tenant groups also hindered the movement of the office market in Metro Manila. Frequent changes in the quarantine protocols in Metro Manila disrupted business activities in most business sectors. Traditional occupiers have become less aggressive to office expansions due to the recurring remote work setup to ensure the safety of their employees. Transactions were also minimal from BPO companies due to the PEZA moratorium allowing BPO companies in ecozones to implement offsite work arrangements to 90% of their employees. The gaming industry was also heavily affected by the tax legislation under Republic Act 11590 that resulted in the exit of numerous POGO companies in the country.

Average office rents in Metro Manila marginally declined to PHP 1,100.10 per sqm as rental growth slightly went down by 0.14% q-o-q. Rental growth continued to go on a downward trend due to the abundance of available office stock in the market. Various rent concessions were still applied by office landlords in hopes of attracting potential tenants. Average office rents in Metro Manila marginally declined to PHP 1,100.10 per sqm as rental growth slightly went down by 0.14% q-o-q. Rental growth continued to go on a downward trend due to the abundance of available office stock in the market. Various rent concessions were still applied by office landlords in hopes of attracting potential tenants.

Figure 2. Metro Manila Historical Lease & Vacancy Rates



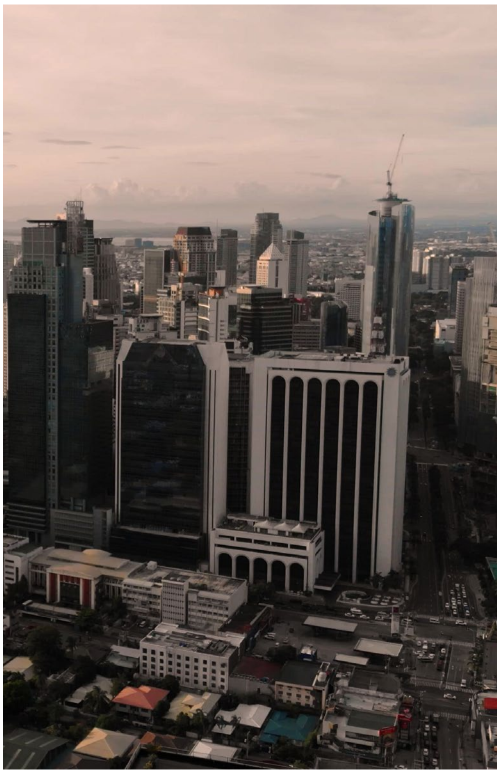
Source: Santos Knight Frank Research

Makati

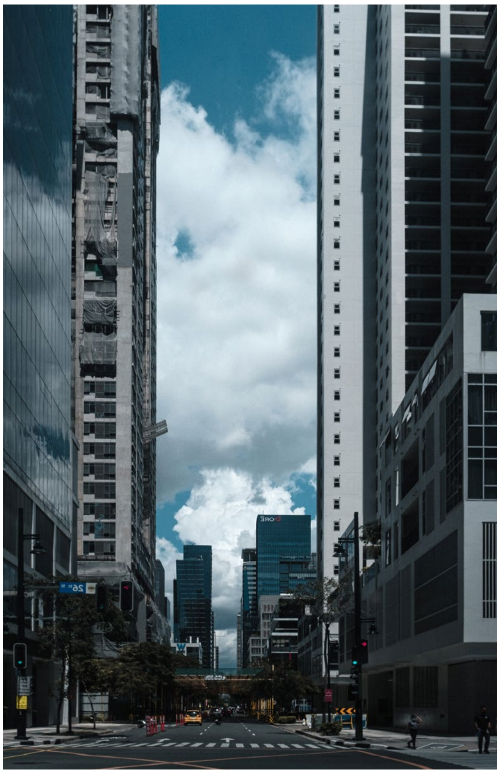
The country's financial capital continued to face hurdles from the adverse effects of the pandemic during the quarter. Office demand remained bearish as numerous tenants vacated their spaces and pre-terminated lease contracts. Consequently, Makati recorded a negative net absorption of close to 40,000 sqm, with vacancy rates surging to 14.4% in Q2 2021.

The weakening demand in Makati was driven by cost-cutting measures by a number of tenants. Tenants continue to rationalize their space requirements due to the remote work and skeletal workforce arrangements in most traditional occupiers. Despite this, landlords still maintained their asking rents as they persistently bank on Makati's prime address. Average monthly office rates in the area dipped by 0.8%, q-o-q, but was still recorded as the highest in Metro Manila at PHP 1,338 per sqm.

Developers remained bullish in Makati's office sector, perceiving it as one of the primary business districts in Metro Manila. More than 485,000 sqm of upcoming office space is still in the pipeline. However, supply growth in the area is close to exhaustion due to scarcity of developable lands and increasing property values. In line with this, upcoming office developments are spurring outside the CBD, going towards the Poblacion, Gil Puyat Avenue, and Circuit Makati areas.



Fort Bonifacio



The Fort Bonifacio office market further grew in Q2 2021 with the completion of the GSC Corporate Center. This pushed the overall office supply in the area to 2.08 million sqm. However, the area has also experienced a weakened demand during the period. Though the district recorded the lowest office vacancy level in Metro Manila at 11.4%, a significant volume of office space was vacated which was at 55,000 sqm.

Rental rates are still the main factor in the sluggish demand in the area as average office rents posted at PHP 1,267 per sqm, the second-highest in Metro Manila after Makati. Yet, this prevailing rate has already contracted by 1.68% q-o-q as several landlords are becoming inclined in price reductions to appeal to locators.

The office market outlook for Fort Bonifacio remains promising as the area still possesses a massive office footprint of 891,000 sqm lined up in the next five years. The business district continues to be a top investment destination in Metro Manila being a master-planned estate. The vast upcoming office inventory may absorb the investments poured into the district in the coming years when the market regains momentum. Likewise, office growth is becoming more visible in Taguig's immediate areas with Arca South seeing the completion of approximately 343,000 sqm of office space.

Ortigas

Simultaneous completion of office buildings resulted in a massive supply influx in Ortigas Center. Approximately 230,000 sqm of Grade A office space was introduced in the market through Jollibee Tower, Cyber Omega Tower, SM Mega Tower, and One Paseo. This has pushed the total office stock to 1.36 million sqm as of Q2 2021. In turn, vacancy rates witnessed a surge during the quarter, reaching 25.8%.

Average office rents in Ortigas were observed at PHP 837 per sqm, indicating a positive growth rate of 3% quarterly and 6.8% annually. The appreciation of rents was due to the introduction of new high-quality office stock in the area that commands higher prices compared to the majority of older office buildings in Ortigas. This has ultimately pulled the average rents up.

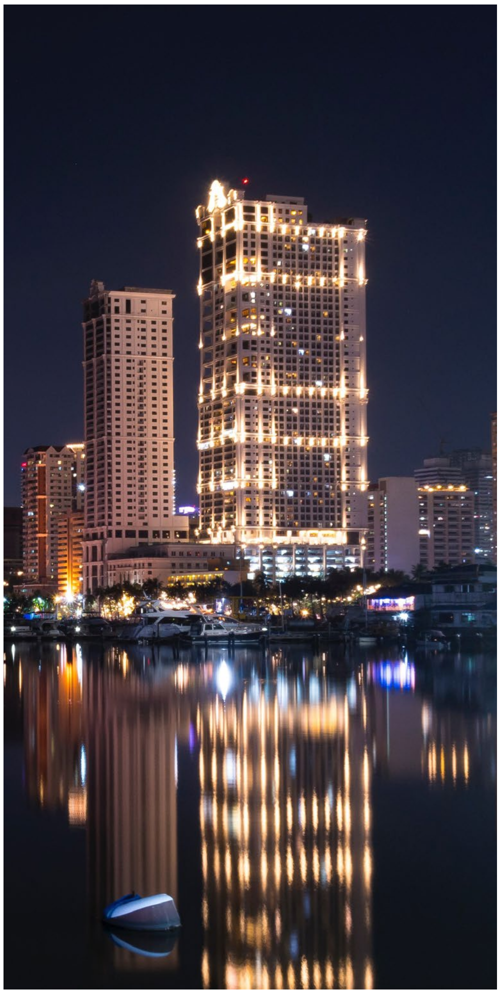
Growth prospects in Ortigas remain high as about 550,000 sqm will be introduced in the next five years. Moreover, about 158,000 sqm of Grade A office space will commence operations by the end of the year due to increased redevelopment and modernization efforts in the business district.

Bay Area

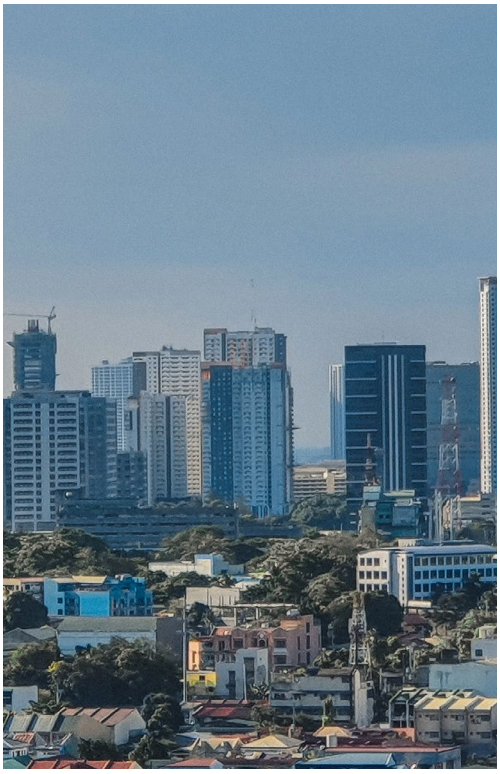
Office supply in Bay Area grew past 1 million sqm in Q2 2021 due to the completion of Aspire Corporate Plaza and The Centrium that caters to the BPO and POGO tenants. However, the supply growth in the area failed to translate into demand growth due to the recent tax legislation of the national government that regulates the gaming industry in the country. The enactment of RA 11590 and the PEZA moratorium on work-from-home arrangements resulted in the surge of office vacancy to 24%.

Bay Area recorded an average asking lease rate of PHP 1,162 per sqm. Prevailing rates continued to be driven by the speculation on the demand from BPO and POGO companies, and by the bullishness of new office landlords. This translated to the highest rental growth rates in Metro Manila at 7.3% quarterly and 11.4% annually.

Bay Area continues to emerge as a prominent business district in the coming years, with a massive office pipeline of 620,000 sqm lined up to become operational in the next five years. The business district remains poised to be an attractive destination with the different planned developments lined up by the developers in the area such as DMWAI, SM, and Megaworld.



Quezon City



The Quezon City (QC) office market showed improvements in demand with a recorded space take-up of 36,450 sqm during the period. In line with this, vacancy rates significantly declined to 17.5% in Q2 2021, from approximately 21% vacancy rating in the preceding quarter. This improvement arose from the area's low average office rents recorded at PHP 907 per sqm, making it an ideal destination for potential locators to set up shop in the area.

The office landscape in Quezon City shows bright prospects as developers set their sights in the area due to the vast availability of developable lands and affordable land values. QC office pipeline consists of 561,000 sqm of Prime and Grade A office space, slated to open in the next five years. Upcoming developments may spur new growth areas, particularly in Northern QC (Fairview, Cloverleaf, and Vertis North) and C5 Corridor (Bridgetowne and Parklinks).

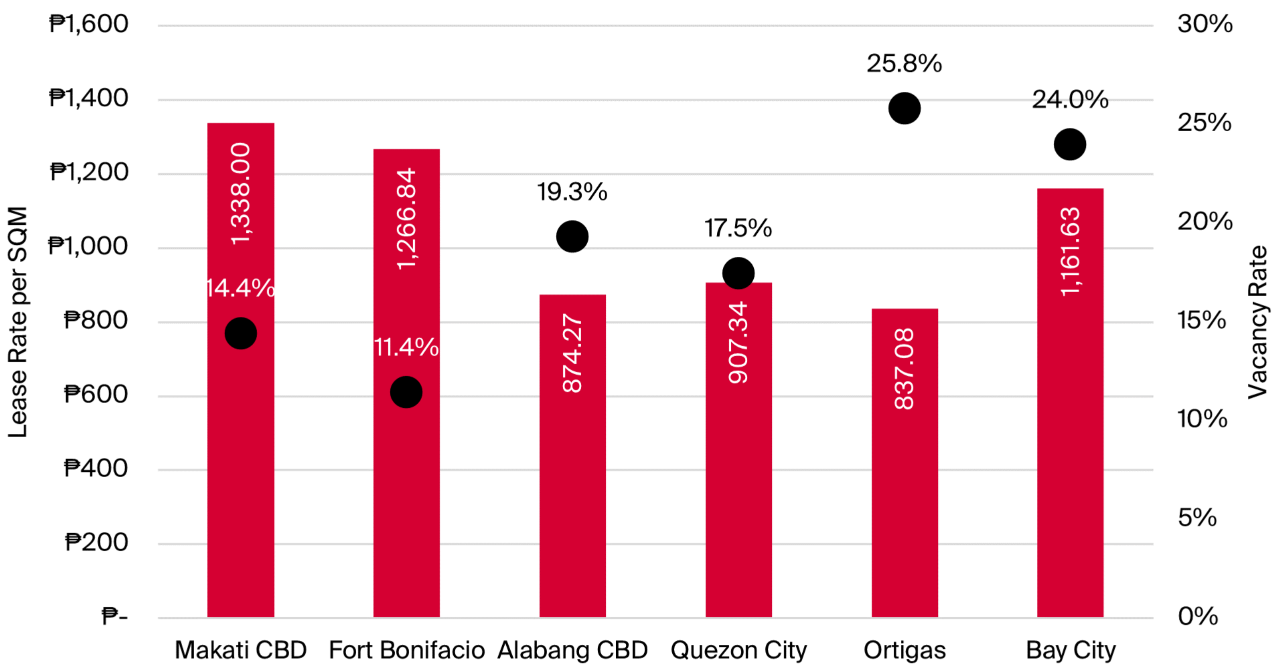
Alabang

The Alabang office market continued to experience the adverse effects of the global pandemic as postponements of lease contracts led to sluggish office activity. A decline in occupied office space by 15,500 sqm was even observed during the quarter. In relation to this, office vacancies in the business district rose to 19.3% in Q2 2021.

Landlords in the business district started to display bright prospects amid the vaccine roll-out. Asking rents in Alabang started to escalate by 3.3% quarterly and 1.7% annually at PHP 874 per sqm, amidst the widespread vacancies in the area.

Growth prospects remain evident in the southern office market amidst its lackluster demand. Developers remain keen on expanding their office footprint in the area, with approximately 237,000 sqm expected in the coming years. Filinvest continues to bolster its office inventory as it plans to introduce an estimated GLA 180,000 sqm of Grade A office space by 2024. The overall market in Alabang banks on improved railway and road infrastructure that would significantly enhance the accessibility of the business district.

Figure 3. Metro Manila Lease & Vacancy Rates per CBD



Source: Santos Knight Frank Research

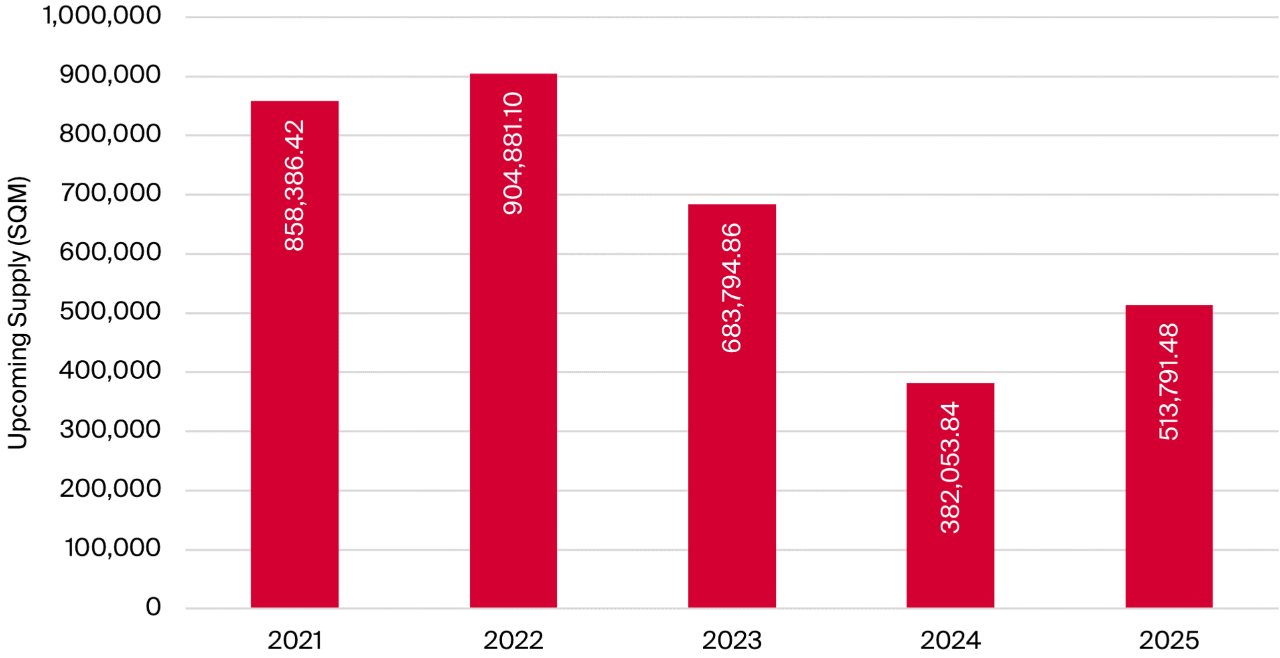
Figure 4. Metro Manila Office Pipeline per CBD

Source: Santos Knight Frank Research

Office Market Outlook

The Metro Manila office market is poised to grow further amidst the rising concerns over market stability brought about by the COVID-19 Delta Variant and frequent changes in Metro Manila's quarantine status. Developers are keen on expanding their office inventory as 3.3 million sqm of Prime and Grade A office spaces are lined up in the next five years. However, this may result in a surplus of office spaces due to stagnant demand stemming from remote work arrangements.

Figure 5. Metro Manila Office Pipeline (End of 2021 to 2025)



Source: Santos Knight Frank Research

On the other hand, movement in office demand will heavily bank on the pandemic situation of the country in the coming months. The easing of quarantine restrictions in Metro Manila due to lower COVID-19 cases and improved vaccination drive would entail the possibility of the workforce gradually returning to work - therefore increasing office transactions.

On the prospects of returning to work, locators are more open to geographically diversifying their office spaces as they look to occupy multiple spaces in various cities to ensure business continuity in the event of rising COVID-19 cases within the workplace. In addition, office landlords and occupiers must retrofit their spaces to comply with the mandated health protocols that would ensure the safety of workers when they return to the workplace.

Recent government policies are also detrimental to the movement of the office market. Office take-up from BPO companies may decline in light of the PEZA moratorium concerning the extension of remote work arrangements for BPO companies. Meanwhile, market activity from the POGO market remains stagnated while new entrants may not be present in the coming months due to the recent legislation of RA 11590.

In the absence of POGOs, BPO companies are expected to catch up in office demand as they are speculated to capture the spaces vacated by POGOs. Despite the existing PEZA moratorium, office take-up from BPO companies as well as traditional occupiers may still increase amidst growing concerns towards the remote work model particularly infrastructure limitations, workplace connectivity, and data security.

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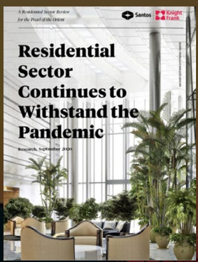

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