METRO MANILA OFFICE MARKET BRIEF – Q1 2021

Impact of the Pandemic

TFA COMMERCIAL REALTY

CORFAC International

The Philippine Economy in 2020

8.70 %
UNEMPLOYMENT RATE
As of Jan. 2021

2.0 %
INTEREST RATE
Towards end of 2020

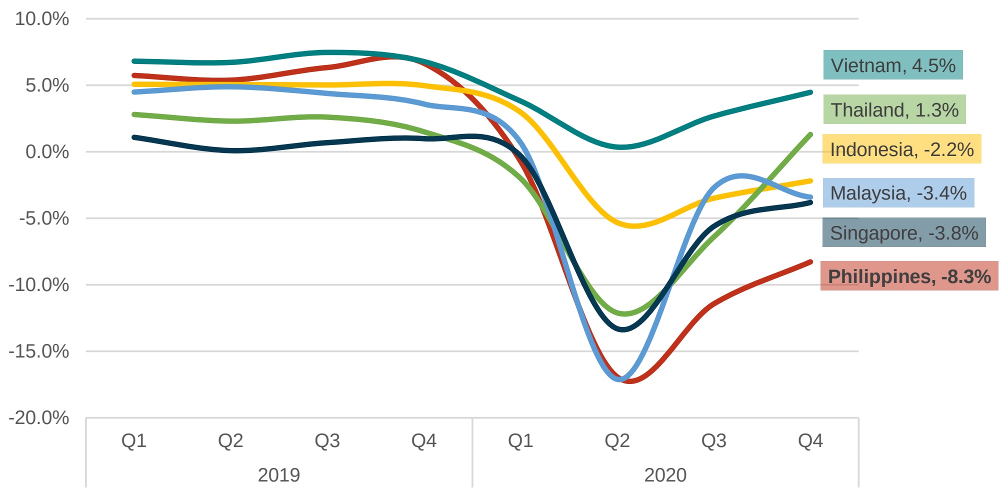
PHP 48.44
1USD EXCHANGE RATE
As of March 15, 2021

0.87 %
91-Day T-Bill Rate
As of Feb. 2021

4.70 %
INFLATION
As of Feb. 2021

6,552.46 (-2.62)
PSEi INDEX
As of March 15, 2021

Comparative ASEAN-6 GDP Growth, Q1 2019 - Q4 2020, in %



Sources: country statistics offices

- The Philippines started 2020 strong coming from a 5.9% GDP growth in 2019.
- In **January 2020**, Taal Volcano erupted causing considerable impacts in Batangas, Cavite, Laguna, and Quezon provinces, to as far north as Central Luzon and the Ilocos Region. It costs an estimated Php 4 billion of loss and damages to properties, manufacturing operations, and agricultural livelihoods.
- In **January**, the first COVID-19 case in the country was confirmed, prompting the government to immediately impose travel restrictions covering all foreign travelers from Hong Kong and China.
- In **March**, total lockdown was enforced in the entire Luzon, which gradually expanded to most areas in the country through the end of the year.
- In **March**, the Philippine Congress granted emergency powers with Php 275 billion budget to President Duterte to address the national pandemic situation through the 3-month *Bayanihan* Act 1.
- In **June,** the Bureau of Internal Revenue (BIR) took over from Philippine Amusement and Gaming Corporation (PAGCOR) the jurisdiction on overseeing the tax compliance of the Philippine Offshore Gaming Operators (POGOs), and subsequently imposed a 5% franchise tax based on total bets (but which has been suspended by the Supreme Court in January 2021) and requiring settling of unpaid arrears before being granted renewal of operations.
- In **July**, the Philippine Congress denied franchise renewal to the country's largest broadcast network, ABS-CBN, taking down one important source of information for current affairs and COVID-related news.
- In **September,** Philippine Congress passed *Bayanihan* Act 2 granting the President the same emergency powers as the first Act and an additional Php 165.5 billion budget.

Movement restriction was implemented until end of 2020 and the economic damage of the world's longest lockdown became evident in the GDP growth trajectory.

However, as many sectors gradually opened to a third of their full operational capacity towards year-end, the Philippines tamed its economic contraction to -8.27% of GDP by Q4 2020 from a -11.5% dip in Q2 2020. The lockdowns were cited by World Health Organization as a "wise" strategy for keeping COVID-19 death statistics low, and as a springboard for increasing the country's healthcare capacity for testing, treatment, and tracing. On the flipside, the lockdowns caused businesses to suffer significantly with many closing, mostly SMEs. Additionally, the back office and shared service sectors have been forced to evolve to a predominantly work from home arrangement.

Legislative & Major Industries Outlook

Legislative Updates

- **Tax Reform Package 2:** scheduled for signing by the President in March 2021, the Corporate Recovery and Tax Incentives for Enterprises (CREATE) bill will:
  - immediately reduce corporate income tax to 20% for domestic corporations with total assets not exceeding Php100 million, excluding land, and total net taxable income of not more than Php5 million, and to 25% for other enterprises
  - grant up to 17 years of incentives, including 4-7 years of income tax holiday and 10 years of special corporate income tax for exporters and "critical" domestic market enterprises
  - create a Fiscal Incentive and Review Board to authorize granting of incentives for investments more than Php1 billion threshold; Investment Promotion Agencies are expected to manage incentives below this threshold.
- **Public Service Act amendments:** pending Senate 2^{nd} hearing; approved on 3^{rd} reading in the House. The bill will amend the 83-year-old law to lift foreign ownership restrictions in certain sectors currently defined as "public utility," and relax "public services" infrastructure to allow foreign equity. The categorization of industries is to be provided by the National Economic and Development Authority (NEDA).
- **Foreign Investment Act amendments:** pending 2^{nd} reading in the Senate; approved on 3^{rd} reading in the House. The bill proposes to remove the 'practice of professions' from the foreign investment negative list and reduce the mandatory direct local hires by foreign investors.
- **Retail Trade Act amendments:** pending 2^{nd} reading in the Senate; approved on 3^{rd} reading in the House. The bill intends to lower the required minimum paid-up capital for foreign retail investors to US$200,000 (around Php10 million) from the present minimum capital of US$2.5 million.

NOTES:
* Final stage
** Pending bicameral ratification

IT-BPM Industry

Management consulting firm Everest Group, in an IBPAP-commissioned study, optimistically forecasted Philippine BPO industry revenue to likely increase by 5.5% to $29 billion by 2022 (equivalent to 130,000 jobs).

This outlook is expected to hinge on the government's effort to strengthen the telecom infrastructure, promote digitalization, ease doing business processes, accelerate talent and infrastructure development outside Metro Manila, reskilling and upskilling of the labor force, and better international marketing and promotion of the industry.

Semiconductor & Electronics Industries

The sector's umbrella organization, SEIPI, projected the industry to contract by -5% in 2020 considering the unabated COVID-19 situation and higher cost of operations. Meanwhile, it revised its semiconductor and electronics exports forecast to grow 0% to 3% in 2021 citing uncertainty over tax breaks following the legislative developments of the tax reform package 2 (CREATE Bill).

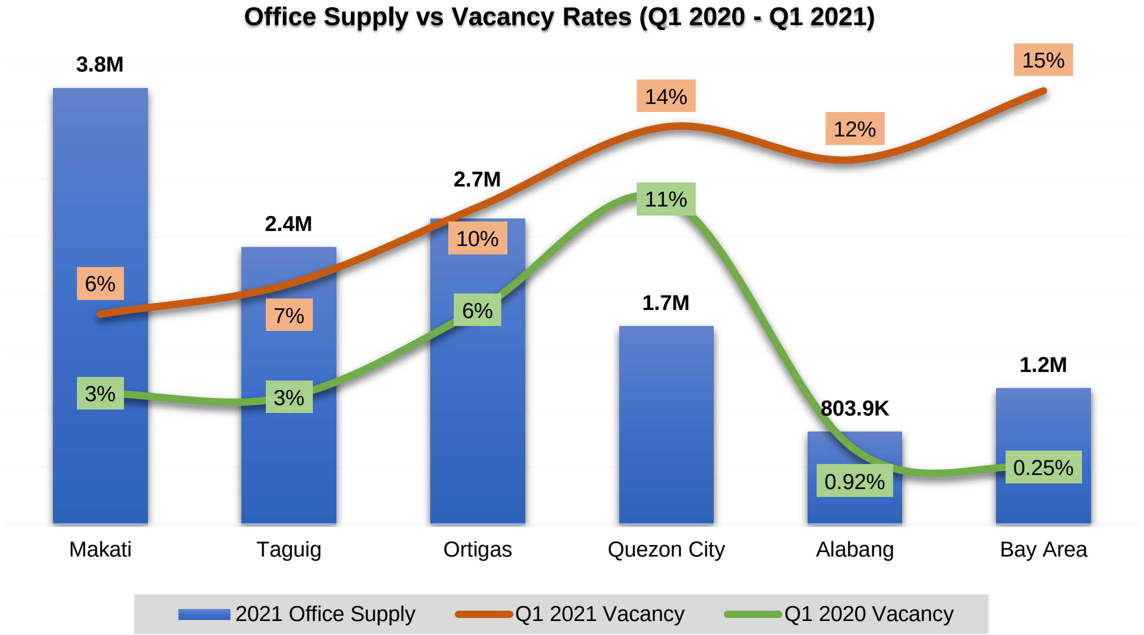
SEIPI also raised concerns on the impact of the trade tensions between China and the US, two of the world's major powerhouses of electronics manufacturing.

Philippine Offshore Gaming Operators (POGO)

The number of POGO operations following the Bureau of Internal Revenue's strict imposition of franchise tax resulted in a massive contraction in the industry, leading to a 150,000 sqm of vacated office space.

The restraining order that the Supreme Court issued in January 2021 prevented an additional 200,000 sqm of office space from becoming vacant.

13.8 MM SQM	9.5%	ALABANG AND BAY AREA
TOTAL OFFICE SUPPLY BY END OF 2021	AVERAGE VACANCY RATE ACROSS ALL CBDS	ARE THE HARDEST HIT CBDS IN TERMS OF ADDITIONAL VACANCY



Counting existing space only, a total of 800,000 sqm was vacated from February 2020 until February 2021. About 30% or 231,000 sqm was vacated by POGOs, while the rest of it was mostly vacated by SMEs and smaller BPOs. Not all multinationals in the Philippines were immune to the effects of the pandemic as there are large chunks of contiguous space that have been vacated by these companies as well.

As shown in the graph, the vacancy rate across Metro Manila has increased to 9.50% over the past year due to the effects of the pandemic compared to roughly 4.41% average in Q1 2020.

Overall, the new supply over the past year was not absorbed due to lack of demand from the market, while some existing supply was vacated due to the contraction of businesses. Aside from the COVID-19 crisis, the 5% franchise tax on the POGOs chased away many of the operators. On average, the net absorption in the market has been roughly 1.1 million sqm over the past 5 years, however in 2020, there was a negative take up of 800,000 sqm with new completions totaling 600,000 sqm.

The effect of the reduction of demand across the CBDs was varied. On one end of the spectrum, Bay Area, which has the highest concentration of POGOs, experienced a 15% vacancy rate (assuming that the buildings that came online in 2020 would have been leased according to the direction of the market). The market was so robust pre-pandemic that some landlords were bidding out the space and there were very little negotiations on the commercial terms. On the other end of the spectrum, the Taguig market was cushioned by its tenant profile, which is primarily made up of large multinational BPOs, both third party and captive. Consequently, the vacancy rate in Taguig only increased from 3% pre-pandemic to 7% currently.

10%

INCREASE IN OFFICE SUPPLY ACROSS ALL CBDS BY 2023

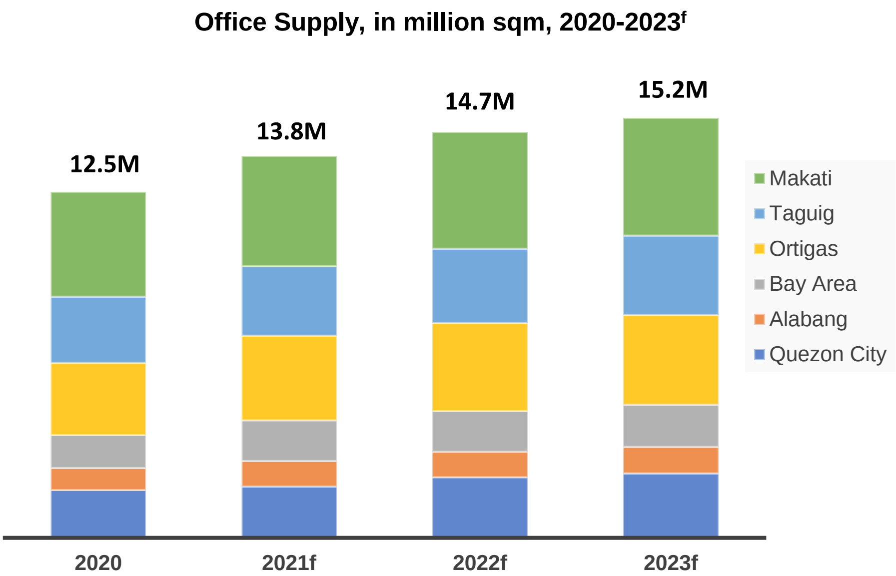
1.3 M SQM

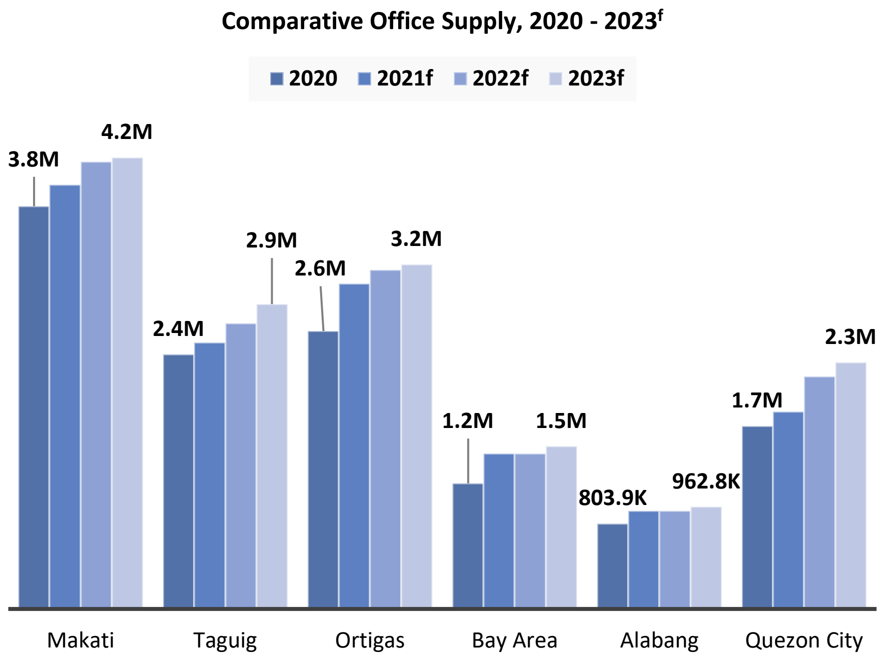
TOTAL SUPPLY COMING ONLINE IN 2021 RESULTING FROM THE COMBINED DELAYED SUPPLY IN 2020 AND PLANNED SUPPLY IN 2021

The six central business districts (CBDs) are expected to have a total of 13.8 million sqm of office supply by the end of 2021, with 480,000 sqm coming from the supply in 2020 that was delayed by the pandemic. The government-imposed lockdowns along with the prolonged effects that the pandemic will have on office demand (i.e. work-from-home) will in turn have an impact on the expected building completions from the developers. From 2016 to 2019, an average of 942,000 sqm came online annually, while from 2020 to 2023, the average annual new supply will be 815,000 sqm, based on the current building permits issued.

Total commitments that have already broken ground are estimated to add 2.2 million sqm for the period 2021 to 2023. However, government's procurement of COVID-19 vaccines in 2021 might possibly ease tensions among developers and stimulate building construction confidence.

Ortigas is expected to add the most supply in 2021 with 450,000 sqm of combined delays from 2020 and planned new supply for 2021. Bay Area on the other hand, which is popular to POGO operators, will add the second highest upcoming supply of up to 280,000 sqm.





INSIDE THE CENTRAL BUSINESS DISTRICTS

Makati CBD

Lease Rate Q1 2020	Lease Rate Q1 2021
WAR (Prime, Grade A, & IT): **Php 1,397.09**	WAR (Prime, Grade A, & IT): **Php 1,195.51**
WAR (others): **Php 741.82**	WAR (others): **Php 679.92**

Tenant Profile:

As a commercial hub, Makati CBD is a preferred destination of large and multinational BPOs, over 1,000 multinational and local corporations, and an estimated 2,000 financ-related institutions and banks. At least 30% of the IT buildings accredited by PEZA are also located in Makati.

Opportunities:

Even though the WAR in Makati is at Php 1,200, businesses can now get good deals at 2013 levels in Grade A PEZA buildings along Ayala Avenue that would not have been possible in the last few years. Apart from that, landlords offer additional incentives, as well as tenant improvements left behind by previous tenants.

Taguig

Lease Rate Q1 2020	Lease Rate Q1 2021
WAR (Prime, Grade A, & IT): **Php 1,141.62**	WAR (Prime, Grade A, & IT): **Php 1,097.12**
WAR (others): **Php 900.51**	WAR (others): **Php 842.53**

Tenant Profile:

Taguig houses Bonifacio Global City, a 240-hectare modern mix-use development that attracts luxury residential and commercial establishments, BPOs, ROHQs, and various financial institutions. BGC also houses the most number of flexible workspaces catering to small and medium enterprises.

Opportunities:

Relocation and closure of businesses brought to the market additional fitted options compared to before. Increase in availability of environmentally sustainable buildings (LEED, WELL, and BERDE). Pre-pandemic retail spaces in BGC ranged from Php 2,800 to Php 3,500 and now they are at Php 1,500 to Php 2,300.

Bay Area

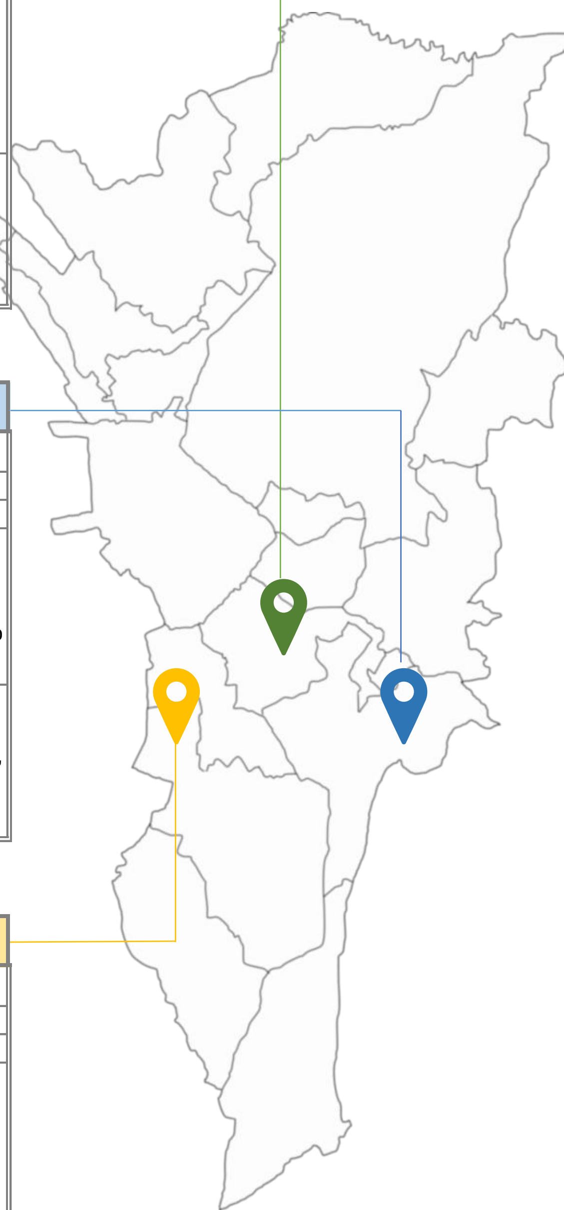
Lease Rate Q1 2020	Lease Rate Q1 2021
WAR (Prime, Grade A, & IT): **Php 1,089.52**	WAR (Prime, Grade A, & IT): **Php 965.81**
WAR (others): **Php 971.06**	WAR (others): **Php 963.79**

Tenant Profile:

Bay Area was a long preferred location for maritime industries owing to its proximity to the Manila Port. BPOs and popular integrated resort casinos are also located in the area. The POGO industry entered Bay Area in 2017 because it offered an opportunity to become the single tenant of entire buildings. It was the prime location for POGO operators before the pandemic.

Opportunities:

Availability of fitted spaces with fairly new fitout from previous tenants, and availability of repurposed warehouses and shopping centers into office space.



Inside the Central Business Districts

Alabang

Lease Rate Q1 2020	Lease Rate Q1 2021
WAR (Prime, Grade A, & IT): **Php 839.23**	WAR (Prime, Grade A, & IT): **Php 752.55**
WAR (others): **Php 585.55**	WAR (others): **Php 576.84**

Tenant Profile:
Alabang serves as a perfect location for BPOs, multinational corporations, and ROHQs wanting to capture the labor supply coming from the southern regions of Luzon. POGO operators were drawn to large contiguous office spaces and whole building availabilities.

Opportunities:
There are increasing availability of repurposed establishments to be used as offices spaces.

Ortigas

Lease Rate Q1 2020	Lease Rate Q1 2021
WAR (Prime, Grade A, & IT): **Php 809.84**	WAR (Prime, Grade A, & IT): **Php 729.91**
WAR (others): **Php 633.02**	WAR (others): **Php 586.95**

Tenant Profile:
Ortigas CBD is located within the joint boundaries of Pasig City, Mandaluyong, and Quezon City. Over the years, firms providing outsourcing, animation, and engineering, among others, had set up in Ortigas CBD. Financial institutions and flexible workspaces are among the large space occupiers.

Opportunities:
There is an opportunity to locate in Prime and Grade A buildings but at 30% to 40% lower than in BGC or Makati.

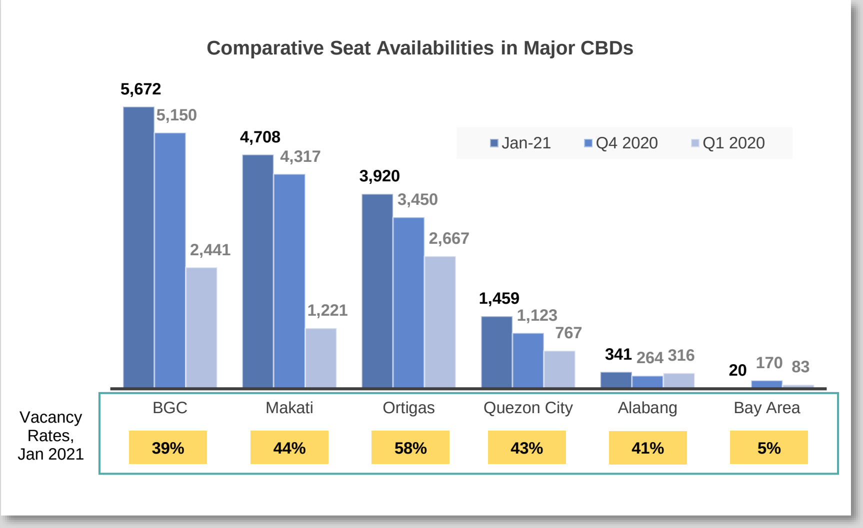
Quezon City

Lease Rate Q1 2020	Lease Rate Q1 2021
WAR (Prime, Grade A, & IT): **Php 764.76**	WAR (Prime, Grade A, & IT): **Php 750.36**
WAR (others): **Php 694.85**	WAR (others): **Php 690.59**

Tenant Profile:
Quezon City is a dense metropolitan area with least 3 mass transit lines. BPOs, multinational companies, and financial institutions comprise the largest space occupiers. The area is also in very close proximity to major academic institutions.

Opportunities:
There are emerging number of second tier developers with flagship buildings in Quezon City. These are expected to add to the CBD's supply in the coming years.

29% AVERAGE VACANCY OF FLEXIBLE WORKSPACES; 21,000 AVAILABLE SEATS IN Q1 2021



Average vacancy rate for flexible workspaces is 29% across all CBDs as of January 2021. BGC registered the most supply of available flexible workspaces with more than 5,600 seats coming from both new and existing serviced office providers.

Bay Area, despite its popularity among BPO companies and POGO operators, has had limited supply of flexible workspaces since 2019. Regus is the only player.

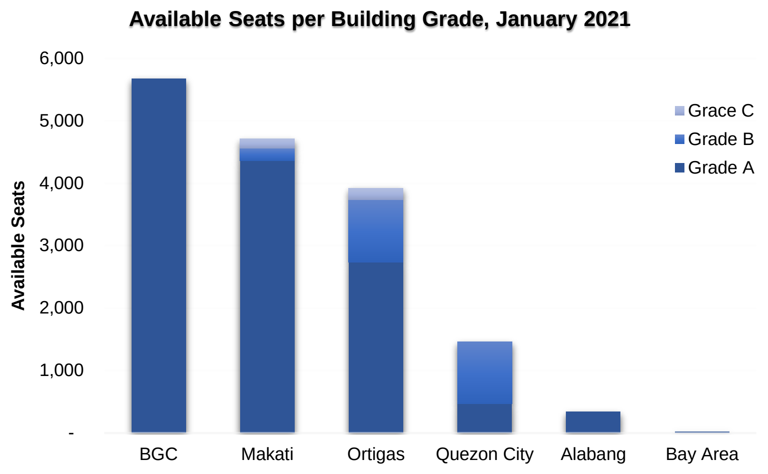
Similarly, only three serviced office providers have operated in Alabang with a combined capacity of 800 seats.

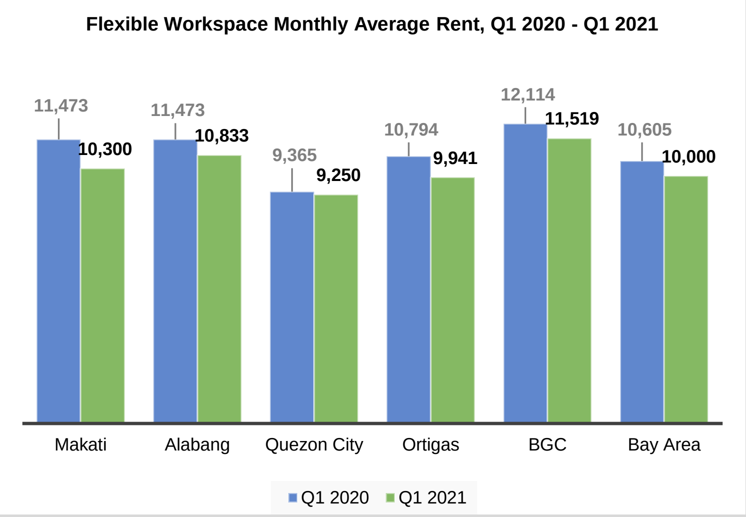
Grades A and B buildings with flexible workspaces dominate the available market listings in January 2021.

BGC's serviced offices are all housed in Grade A buildings attributed to BGC being a relatively new and the second-largest CBD in Metro Manila, with infrastructures beneficial to IT and professional services sectors.

Majority or about 4,300 seats of the flexible workspaces in Makati also come from the many existing Grade A buildings in the CBD.

Ortigas and Quezon City have a combined total of around 2,000 seats in Grade B buildings.





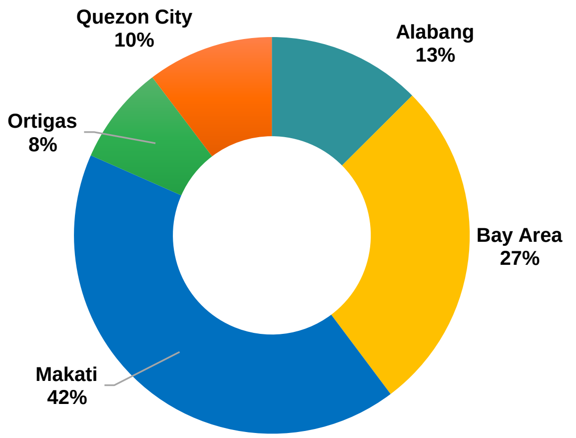
Average closing rates for flexible offices across CBDs have decreased across the board in Q1 2021 compared to pre-pandemic prices recorded in Q1 2020.

There is more room for negotiations in Makati, Taguig, Ortigas, and Quezon City as compared to Bay Area and Alabang.

The Philippine Offshore Gaming Operator (POGO) Sector

In January 2021, the Supreme Court issued a temporary restraining order discontinuing the 5% franchise taxes levied to the POGO operators in the country in hopes of saving the sector from losing operations from the non-renewal of operators.

Breakdown of Vacated Office Spaces from POGOs per CBD

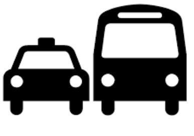


The POGO sector vacated a total of 233,000 sqm of office spaces in 2020 following the combined impact of the inconsistencies of tax implementation and the pandemic, even though the tally of the Philippine Amusement and Gaming Corporation (PAGCOR) is only at 150,000 sqm.

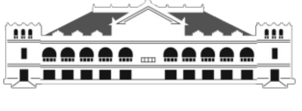
Regulatory Framework for the Pandemic

While the Philippines is still in the transition period towards opening most of its sectors while mitigating the impacts of the pandemic, the Department of Labor and Employment (DOLE) and a major investment promotion agency, Philippine Economic Zone Authority (PEZA), released guidelines for doing business in sectors where operations are gradually being opened. Other business guidelines are regulated by the Inter-Agency Task Force (IATF) for COVID response.

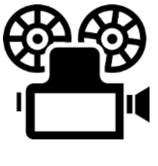
DOLE and PEZA allows extended implementation of work-from-home set up until September 12, 2021.



Operations in the public transportation sector is still limited with curfew hours from 12mn until 4am in some areas. Capacity is also limited to 30% of a vehicle's maximum capacity.



Many government offices remained open despite on a skeletal structure setting, meaning only those whose line of work is essential to the continuity of businesses and addressing business concerns are allowed to work in the offices.



The IATF continues to send signals in favor of opening some sectors to allow resumption more business operations in the entertainment and gaming industry, including movie houses and arcades.

TAKEAWAYS

- ✓ Restrictive quarantine measures imposed by the government since March 2020 resulted to increased vacancy figures in major CBDs as companies and enterprises transitioned to work-from-home set-up while others suspended operations entirely.
- ✓ Delayed completion of office projects from 2020 will add 476,000 sqm of new supply in 2021.
- ✓ The prolonged effects of the pandemic will have a continued negative impact on the pace of expected building completions. The Philippine government's procurement of COVID-19 vaccines in early 2021 might possibly ease tensions among developers and pull up building construction confidence
- ✓ There are at least 21,000 available seats of flexible workspaces as of Q1 2021 with Makati, BGC, and Ortigas offering the greatest number of available workspaces.
- ✓ The TRO on 5% franchise tax for POGO operators is expected to save roughly 200,000 sqm in office space from the industry from completely emptying out.
- ✓ The Philippine government remains vigilant but is leaning towards opening more sectors to increase economic activities in the country towards end of 2021.
- ✓ As the COVID vaccination program is being rolled out, the government is expecting industries to continue to observe precautionary protocols in operations for companies back in their physical offices. Companies are allowed to continue operations on a work from home set-up at least until September 2021, pending further announcement on its extension or not.
- ✓ Additional incentives that were not available pre-pandemic are now available to tenants that will be relocating or expanding in 2021, but this window will close late this year as vaccine roll out continues, and the demand picks up again.

PLEASE CONTACT US FOR FURTHER INFORMATION

Tan, Frankum & Associates (TFA) is a full-service, advisory-based, corporate real estate brokerage and consultancy firm established in the Philippines in 2011 that combines in-depth market knowledge and a vast network of relationships to produce value-driven results. The firm is dedicated to providing its clients with exceptional and personalized service in all aspects of commercial real estate brokerage, research and consultancy services, industrial sales and acquisitions, and client support services. Our extensive experience in handling the full spectrum of corporate real estate requirements will ensure that your company's interest and objectives are met with professionalism.

contact@tfa.ph

(+632) 8553-2995

Tfa.ph