pulse Economic Insight

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What Is Driving the Manila Office Market?

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The rapid growth of the information technology (IT) and business process outsourcing (BPO) industries has changed the state of the office market in the Philippines in the past two years. Demand for prime office space has already outpaced the available supply since no new office building has entered the market since 2002.

The demand is largely driven by the tremendous growth of the BPO industry. With limited supply and vacancy rate at low levels, rents have been rapidly moving up in the past quarters.

KEY POINTS

- Growth of the BPO industry has boosted the demand of prime office space.
- The Philippines has become a preferred outsourcing destination for MNCs.
- Rental and vacancy rates moving close to pre-Asian crisis levels.

THE CHOICE DESTINATION

The Philippines now ranks second to India as the choice destination for BPO companies. Metro Manila alone has close to a hundred BPO offices. According to the Gartner Group's IT Competitiveness Report on the Philippines, the country possesses a number of advantages over its competitors in the BPO market, namely:

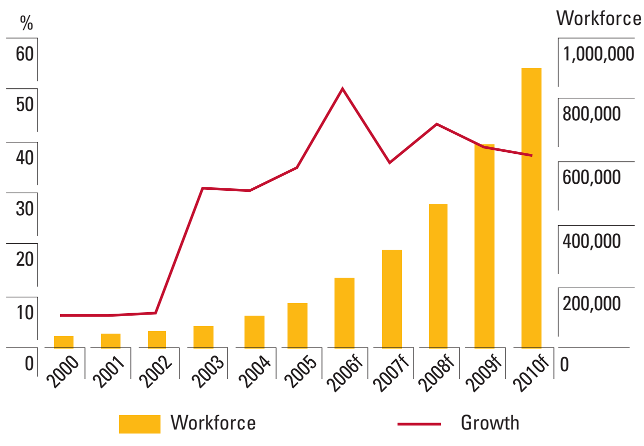
- low-cost labour pool with experience in transaction processing tasks;
- pool of qualified university-graduates;
- accounting system that is modelled after the general accounting procedures in the US;
- capabilities in imaging that can be leveraged for transaction processing engagements;
- local IT service providers that can integrate offshore back-office processing systems with US-based enterprise resource planning (ERP) applications; and
- availability of low-cost facilities in Metro Manila.

Moreover, cultural and historical factors, along with a steady supply of skilled manpower, make the Philippines the top choice for multinational companies such as Convergys, Dell, IBM, Caltex and Shell Shared Services, Procter & Gamble, Accenture and HSBC, to name a few. Multinational companies cite several factors for choosing the Philippines as their contact centre venue, the foremost being the country's customer-oriented and service-driven workforce. Compared with Indians, Chinese and Australians, Filipinos are more receptive and adaptable to Western culture because of their shared history. They also have a higher level of English proficiency, and are able to deliver quality service at a lower cost.

In addition to cost-effective labour, operational costs are relatively low in the Philippines, wherein call centre infrastructures like CRM (customer relationship management) technologies, interactive voice response system (IVR), computer telephony integration technologies (CTI), call management systems, automated quality monitoring and recording systems are highly accessible.

The emergence of the Philippines as an outsourcing destination has immensely boosted the demand for prime office space. This demand is mainly driven by the entry and expansion of call centres and BPO companies. To date, there are approximately 150 BPO companies operating in the country. According to the Board of Investments (BOI), the industry has been growing rapidly at 75-100% annually, surpassing India's 50% growth. Last year, the consolidated revenues of BPOs reached USD 2.4 billion, with industry seats totalling 162,250.

Figure 1: Total Workforce



Source: Business Processing Association of the Philippines

According to the Business Processing Association of the Philippines (BPAP), the industry's workforce is expected to grow by 50.8% in 2006, with 244,675 employees and revenues amounting to USD 3.6 billion. The meteoric growth of the industry is a major contributor to the country's GDP growth. Consequently, the boom in outsourcing is driving growth in other sectors, most notably in the real estate industry (Figures 1 and 2).

A LANDLORD'S MARKET

The rapid and continuous expansion of the outsourcing industry in the Philippines strengthened the demand for office space, bringing the office market into the landlord's favour, following a number of years of being more favourable to occupiers. Rents have increased remarkably and vacancies are now at their lowest level since the Asian financial crisis of the late 1990s.

As the financial centre of the Philippines, Makati has always commanded the highest office rental and capital values in the country. This is also true for residential houses and condominiums. Current asking rents for office space in prime Grade A buildings is now at PHP 750-800 per sqm, almost reaching the highest level attained in 1998 (Figure 3).

Although rents in other CBDs are 30% lower than Makati, they have moved up in the past quarters. For instance, the asking rents in the Ortigas CBD are now at PHP 400-550, Eastwood at PHP 450-550, Northgate Cyberzone in Alabang at PHP 450-500, and Mandaluyong at PHP 500-550 per sqm.

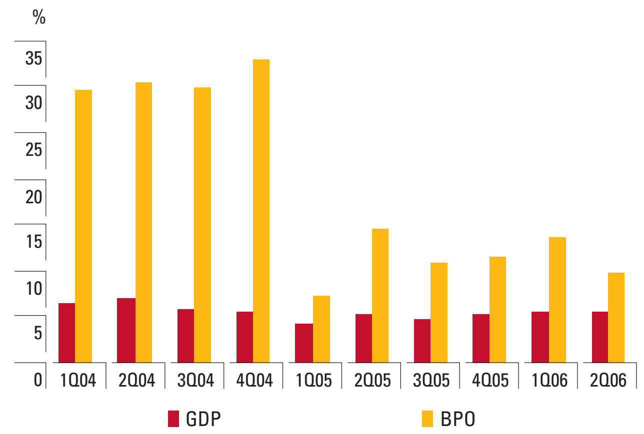
Owing to the huge demand from BPOs, the vacancy rate is now at a single-digit level from experiencing a high of 35% in 2001. In the Makati CBD, for instance, vacancy rate has been sliding down in the past quarters and stood at 7.5% in 2Q06. Prime Grade A buildings like Tower One in Ayala Triangle, Philam Life Tower, RCBC Plaza, GT Tower, and SkyPlaza all enjoy full occupancy (Figure 4).

At present, it is becoming increasingly difficult to find a large floor area in prime office buildings located in the CBDs. Although prime office buildings are approaching full occupancy, the take-up of space in older buildings remains unmoved, primarily because these buildings lack the infrastructure that meets the requirements of the BPO companies.

These BPOs, call centres in particular, are large-space users. They require contiguous floor areas of more than 1,000 sqm immediately. They usually have aggressive expansion plans, thereby requiring expansion options. At the same time, they want to locate and occupy Grade A locations and premises.

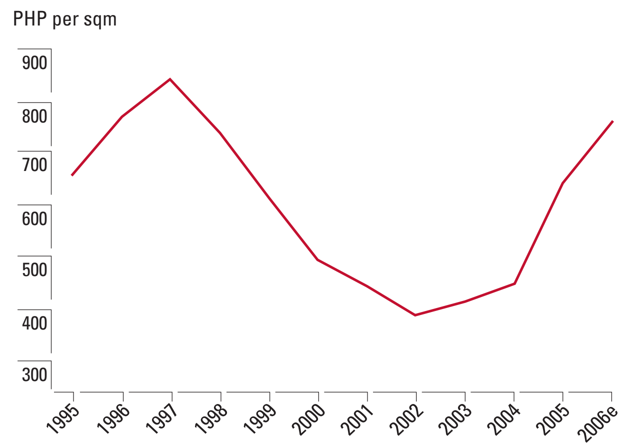
In spite of the improved market sentiment and robust demand, developers are still wary of constructing traditional office buildings. On the other hand, many developers are open to build-to-suit projects with long-term leases. Ayala Land, for instance, agreed to build stand-alone structures for PeopleSupport (15,800 sqm) and Convergys (14,400 sqm) in the Makati CBD, HSBC (12,900 sqm) in Bonifacio Global City and InfoNXX Building (5,600 sqm) in Sta. Rosa, Laguna.

Figure 2: GDP and BPO Services Growth



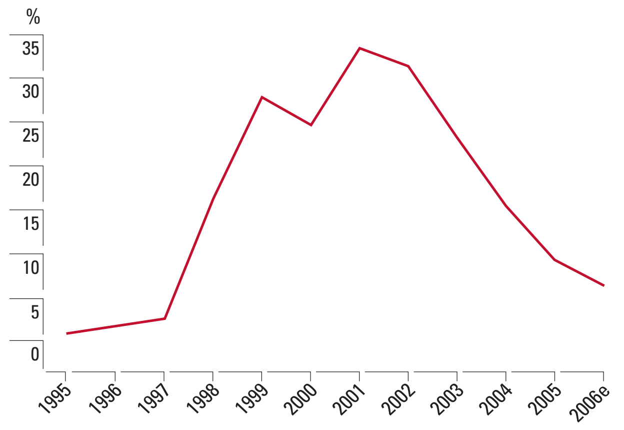
Source: National Statistical Coordination Board

Figure 3: Office Rent



Source: Jones Lang LaSalle

Figure 4: Vacancy Rate



Source: Jones Lang LaSalle

As a result of the dearth in office supply, the BPO firms are increasingly looking for alternative sites outside Metro Manila for set-up, expansion or relocation.

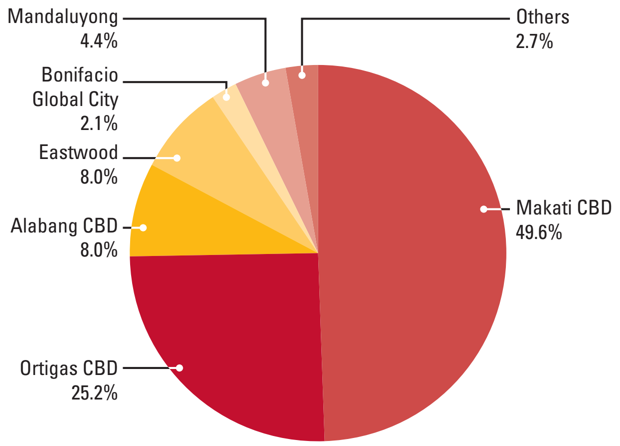
Likewise, some developers ventured into constructing structures specifically catering to BPO needs. Some of these developments are Robinsons Land's Cybergate Towers 1 and 2, SM Development's One e-Com Centre, Filinvest Land's Northgate Cyberzone, Greenfield Development Corporation's Edsa Central IT Park and Megaworld's Eastwood City Cyberpark.

OUTLOOK

With no traditional office buildings scheduled for completion in the near term, tight supply, coupled with strong demand, will continue to push rents and vacancy rates close to pre-Asian financial crisis levels. The existing and planned supply in the pipeline will not meet the estimated strong demand for office space from the BPOs. At present, the Makati CBD has the most number of office stock at 1.2 million sqm. It is followed by Ortigas Centre with 636,186 sqm. The Alabang CBD and Eastwood have almost the same number of office stock at 201,781 sqm and 201,500 sqm, respectively (Figure 5).

This year alone, with the anticipated 82,425 new jobs, an aggregate demand of 576,975 sqm of office space would be needed (assuming that each workstation has an area of 7 sqm). However, only three office buildings are scheduled to be completed in 2006 with a total leasable area of 63,473 sqm, these are Net Square, 1800 Eastwood and Plaza@A and not one of these is located in the Makati CBD.

Figure 5: Distribution of Key Office Locations in Metro Manila



Source: Jones Lang LaSalle

Manpower and real estate expenses are the main cost drivers in establishing and operating a BPO firm. These BPOs usually locate in cities where there is a large educated labour pool. The build-to-suit option is also expected to gain popularity amongst BPO firms as it offers a separate identity and, at the same time, has the option for easy expansion.

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Tess heads the Research and Consultancy Unit of the Manila office, overseeing its daily management and operations. She provides subject matter expertise on all issues concerning the Philippine economy and the real estate market. Before joining Jones Lang LaSalle, Tess was a consultant for various multinational and local companies, wherein she conducted qualitative and quantitative research for possible business and investment ventures. Tess has also served in strategic planning capacity and had worked as an analyst at various financial institutions.