KMC MAG Group Research
Metro Manila

KMC MAG Group

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Metro Manila
Midyear Report 2014

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An introduction to KMC MAG Group

KMC MAG Group, Inc. is an award-winning real estate services firm headquartered in Bonifacio Global City, the fastest growing business district in Metro Manila. It is an international associate of Savills, one of the leading real estate firms in the world.

With over 100 employees involved directly in transactions for office, investments, retail, industrial & hotel locaters, as well as residential properties, KMC is a full service real estate firm and is widely recognized as the Best in Class Real Estate Agency in the Philippines by the International Property Awards. With services ranging from tenant representation, investments to property management, KMC MAG Group has successfully become the leading local firm in the Philippine real estate services industry. The firm provides clients with consistent high quality service backed with strong market expertise.

Recently, KMC MAG Group was awarded as the Best Real Estate Agency Philippines by the International Property Awards.

With offices both in Makati and Bonifacio Global City, Philippines, KMC MAG Group's strengths are due to its in-depth market knowledge, high client satisfaction, and nationwide coverage. The company utilizes a process-driven team approach to deliver superior results and value for its clients.

The company's vision is to be the most preferred and leading provider of professional real estate services in the Philippines. Our mission is that we aim to be the only real estate services firm in the Philippines operating with the needs of foreign and local clients in mind, providing high quality services: timely, responsive, and informative – merged with local expertise and passion.

Contents

Greetings from the Managing Director

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The economic environment has provided a strong foundation for the property sector. The current economic boom and stable political atmosphere increased the country's creditability and attracted foreign and local investors. Local developers have poured a significant amount of liquidity with record-breaking capex plans, and overseas interest in the country remains very high. This will lay the groundwork for the country's future real estate markets.

One could say that the Philippine economy is poised at a unique juncture. The expected GDP growth of 6% to 7% in the coming years (6.4% in Q2/2014) amid the slow global recovery makes the country especially attractive. However, the country is moving from an agrarian economy to a service-oriented economy without going through the industrialization process, raising doubts on the sustainability of that growth. The industrial phase the country was forced to skip because of the poor level of infrastructure was replaced by the export of services, specifically through the business process outsourcing (IT-BPO) industry and overseas Filipino workers (OFW).

We are of the opinion that it is sustainable, given that it is highly dependent on internal factors. The real question is whether or not there is enough political will to maintain its current economic status which can be done through reforms and increased public investments. Current efforts of Good Governance and Anti-Corruption as well as Public Private Partnership (PPP) reforms are laying the foundation for future execution of these much needed investments, ensuring the competitiveness and higher productivity later on. Moreover, this newfound political and economic stability has already been emphasized by the recent credit rating upgrades given by international agencies such as Standard and Poor's (now BBB, Stable), which are also expected to have a positive impact on the property market.

Despite the reforms undertaken by the Aquino administration, there is still a long way to go. Constitutional restrictions on foreign ownership limits competition in key areas and results in poor infrastructure. Openness to foreign investments would ensure better funding availability and quality for such sectors, but more importantly, would increase knowledge transfer. As overseas investors actively look for opportunities in the Philippines, foreign equity restrictions hinder potential growth. Investors have now found ways to work around these rules usually through joint ventures and not without significant risk.

> "Meanwhile, property market attention remains mainly in the office sector where BPOs drive the property demand."

Meanwhile, property market attention remains mainly in the office sector where BPOs drive the property demand. The increasing number of occupiers' requirements together with a shortage of office spaces have escalated the rental rates 7.9% YoY, illustrating a current landlord's market. New supply will temporarily ease the chronic lack of supply as 160,000 sqms was introduced within the major CBDs in the first half of the year, with 140,000 sqms to follow in the second.

The popularity of the residential market remains significant among the different price segments. The cooling measures in Hong Kong and Singapore have increased overseas interest in the market's high-end segment while the local market drives demand in other segments. Production is shifting towards the lower segments as developers try to fill the housing backlog there. Even though supply is constantly increasing, a modest market value appreciation is expected to continue as demand stays high.

Nevertheless, strong growth momentum has not had a direct impact on final transaction volume. On the whole, transaction volume in the Philippines is relatively low partly because of the lack of available properties. However, there are currently a couple of interesting assets for sale where transactions will most likely push through. Local property owners may find potential buyers in overseas investors as the fierce competition in gateway markets could cause a trickle down of excess capital into secondary markets such as Manila. The large amount of capital in the financial system has caused some primary markets to become expensive, whereas Manila's high rental yield could provide a good alternative for foreign investors with well-thought-out investment strategies.

In spite of the strong property market growth, Manila still serves as one of the lowest cost destinations in the Asia-Pacific market. We have witnessed some record-breaking deals and are expecting more to transpire. Together with the economic boom, the real estate sector should further improve transparency and emphasize the current state of the investment environment. We at KMC MAG Group continue to do our best to help our clients navigate through these favorable conditions and find a suitable real estate strategy, no matter what the real estate situation is.

Economic Overview

The global economy seems to finally be picking up in 2014. It is expected that the United States will lead global growth as Europe continues to struggle with geopolitical tensions while China leads the emerging markets. Speculation over the US Federal Reserve's (FED) policies, as the stimulus program is about to end and the normalization of interest rates becomes more visible, is keeping the economic spectators alert. In Asia, Japan has been robust but their recovery might reach a critical point as the increase in consumption taxes might slow down domestic demand. However, the upward revisions of growth in China, where the government is looking to rebound the stagnating housing markets through credit easing, is expected to support the region. Amid these circumstances, the Philippines continues to be an outlier.

The Philippines' economic performance continues as it posted a 6.4% GDP growth rate for the 2nd quarter of 2014. The effect of supertyphoon Haiyan's devastation last November 2013, which decreased agricultural production and damaged critical infrastructure in the country, slightly slowed down the economic growth in the first half of the year. However, the economy is expected to benefit from the massive reconstruction plans, amounting to 3% of the country's GDP, by 2014-2015.

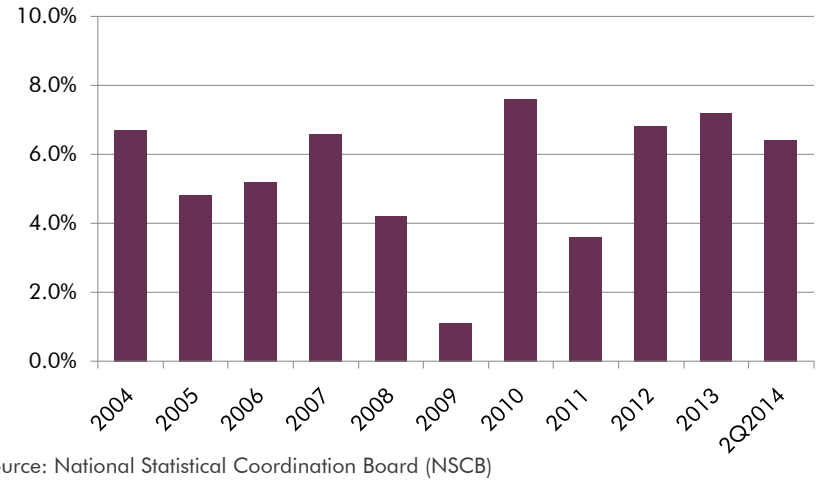
Despite this slight fall in GDP growth, the Philippine economy remains as one of the most promising globally. The economy is mainly driven by its favorable demographics, a continuously growing outsourcing industry, strong private consumption, and high government spending. These fundamentals protect the country from external shocks and cushion the economic influence of the supertyphoon. These are also expected to mitigate the effects of the FED's reductions in quantitative easing, making the Philippines less vulnerable to capital outflows.

"Despite this slight fall in GDP growth, the Philippine economy remains as one of the most promising globally."

According to the National Statistical Coordination Board (NSCB), the majority of GDP growth came from the services and the industry sectors, which grew by 6.0% and 7.8%, respectively. Furthermore, the services sector, led by real estate related services, contributed 3.5% to overall GDP growth while the industry sector, which was led by manufacturing, came in second, contributing 2.6%.

GRAPH 1

GDP Growth



Source: National Statistical Coordination Board (NSCB)

TABLE 1

Key Figures - Philippine Economy %

	2007	2008	2009	2010	2011	2012	2013	2014 Q2
GDP	6.6	4.2	1.1	7.6	3.6	6.8	7.2	6.4
Private consumption	4.6	3.7	2.3	3.4	5.7	6.6	5.7	5.3
Export	6.7	-2.7	-7.8	21.0	-2.8	8.5	-1.1	10.3
Import	1.7	1.6	-8.1	22.5	-1.0	4.9	5.4	1.4
Average inflation rate	2.9	8.3	4.2	3.8	4.6	3.2	3.0	4.4
Unemployment rate	7.3	7.4	7.5	7.4	7.0	7.0	7.1	7.0
T-bill 91-days rates	4.2	5.8	4.3	1.3	1.7	0.5	0.5	1.3
T-bond 10-year rates	6.6	7.4	8.1	6.1	5.4	4.4	3.8	4.2

Sources: NSCB, Banko Sentral ng Pilipinas (BSP), Philippine Dealing and Exchange Corp (PDEX)

On the demand side, the main driver is surging private consumption, posting a 66.1% share of the total GDP. Fuelled by remittances from Overseas Filipino Workers (OFW) and the expanding outsourcing industry, private consumption grew 5.3%, suggesting favorable times for the retail industry. Meanwhile, the trade balance bounced back to positive as exports increased by 10.3%. Moreover, public spending is expected to remain high over the next few years as the government embarks on a PHP 184.2 billion (US$ 4.2 billion) infrastructure program. The program aims to improve basic infrastructure through Public Private Partnerships. Part of this infrastructure-building program is the much-anticipated PHP 65 billion (US$ 1.5 billion) LRT extension project which was awarded to Metro Pacific Investments Corporation and Ayala Corporation in July 2014.

THE PHILIPPINES CONTINUES TO ENJOY POSITIVE GLOBAL PERCEPTION

The efforts of the current administration to clean up the system through structural changes and reforms have produced tangible results and brought a lot of positive attention to the country. The country successfully hosted the World Economic Forum on East Asia that brought influential delegates to witness the current state of the economy. Additionally, the country's ranking in the World Bank Doing Business report recently made a notable improvement by moving 25 places ahead to 108th, which led the WB president to call the Philippines as "the next Asian miracle".

> "Favorable macroeconomic figures, demographic advantage, and stable government committed to economic and political reforms are bound to keep its upswing progress going and attract more investors to the country."

The statement coincided with the WB extending US$ 4 billion to the Philippines for infrastructure and livelihood projects slated for the next four years.

This progress has not escaped international rating agencies' attention as multiple investment rating upgrades kept the limelight on the Philippines. Foreign direct investment (FDI) in the country increased to US$ 1.9 billion in Q1/2014, though it is still relatively low compared to other Asian nations. This is due not only to the overseas ownership restrictions that hinder potential growth, but also due to the less capital intensive services sector where the current structure of economy is shifting. Real estate accounted for US$ 57 million of FDIs; however, more foreign capital takes action through different channels than direct property investments, usually through securities. Foreign portfolio or hot money investments of securities accounted for US$ 10.4 billion inflows in the first half of the year, while net inflows remains at negative US$ 1.4 billion as some of the capital left due to the typhoon by the turn of the year.

On the other hand, credit rating upgrades are still expected to further increase investor optimism and boost foreign investments in the country by the end of the year as the equity market picks up again. Despite the stock index reaching record breaking levels, some small volatility is expected if the global markets, especially in US, will have a correction in the future. However, the moderate development of PSE and the significant amount of liquidity in the global financial system can maintain the current bull market.

Furthermore, the Central Bank reported a 6.2% YoY increase in OFW remittances, another form of capital inflow and a crucial part of the Philippine economy, which reached US$ 12.7 billion in the first half of 2014.

INFLATION PRESSURE STRENGTHENS

Despite the headline inflation being on target at 4.4% in Q2/2014, food and energy prices accelerated the rate due to the effects of the supertyphoon while core inflation remained stable at 3.0%. Despite the Central Bank's confidence in the market's overall performance, accelerating inflation might push the institution to further tighten its monetary

policy in order to stabilize the consumer prices and maintain stable currency. As a preemptive response to inflation pressure, BSP recently increased its key policy rate by 0.25%, now at 3.75% from an all-time low of 3.50%. Low interest rates environment has encouraged various sectors, especially the local real estate market. Real estate loans posted an annual increase of 21.1% in Q1/2014, going up to PHP 866.6 billion and accounting for 17.8% of the banks' total loan portfolio. The increasing credit exposure to real estate has recently raised some issues of an overheated property market, but non-performing loans still remain manageable at 2.8%. Moreover, the Central Bank ordered stress tests as a macro-prudential measure to ensure the banking industry's healthy exposure to real estate lending and to manage credit risk and overheating concerns.

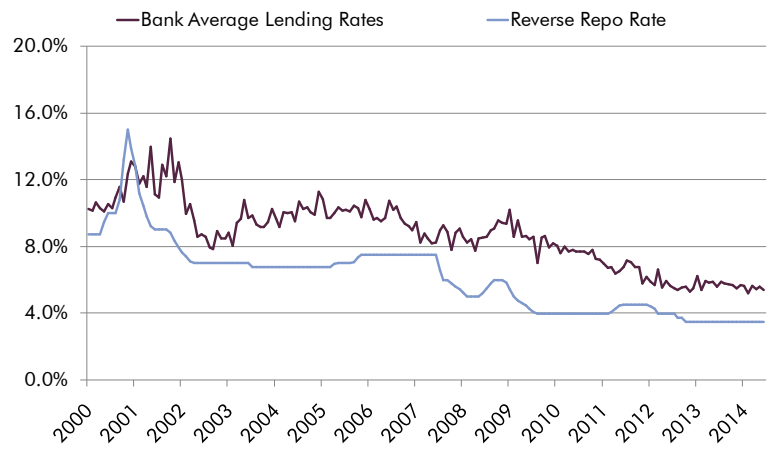
OUTLOOK

Despite some concerns on the Philippine economic growth's sustainability, forecasts for the Philippine economy continue to be generally positive. According to the IMF, the country is expected to be the fastest-growing economy among the ASEAN 5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam) in 2014. The IMF pegged the country's expected output growth at 6.3% which is higher than the forecasted growth rates for Southeast Asia and Asia at 4.9% and 5.4%, respectively. The Asian Development Bank has a similar forecast of 6.4% for the year, and the World Bank projects a 6.6% growth while giving the rest of the world a downgrade from 3.2% to 2.8%.

Moving forward, although there are still a lot of things that the country can do to maintain its current position, its favorable macroeconomic figures, demographic advantage, and stable government committed to economic and political reforms are bound to keep its upswing progress going and attract more investors to the country. The constitutional restraint on foreign ownership, however, results in relatively low FDI; further growth could be achieved by amending these rules and being more open to trade. It would lay the economy on more sustainable ground and result in increased competitiveness.

GRAPH 2

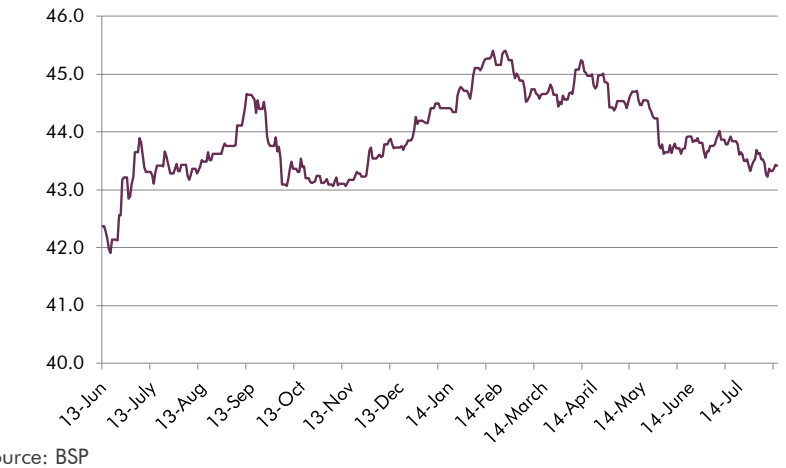
Key Interest Rates



Source: BSP

GRAPH 3

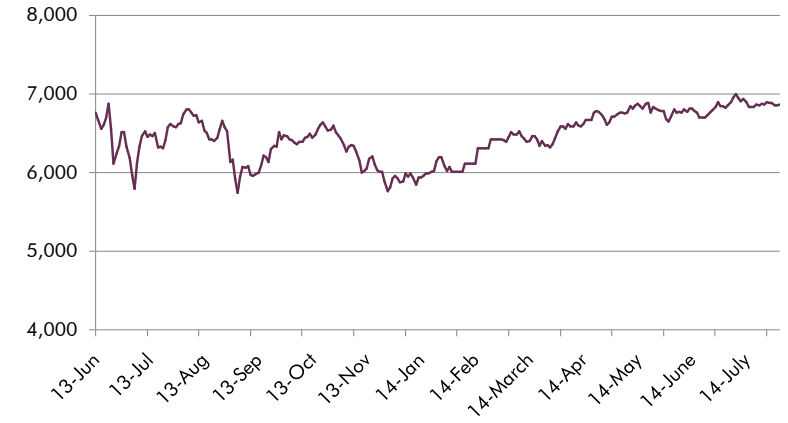
Peso per US Dollar Rates



Source: BSP

GRAPH 4

Philippine Stock Exchange Index



Source: BSP, Philippine Stock Exchange (PSE)

Real Estate Market Overview

The first half of the year ended in a showdown between local players with substantial investment agendas. Despite a slight slowing in economic growth, major developers launched several multibillion dollar expansion programs throughout the country, helping to maintain the bullish outlook and boost positive sentiment in the country's property markets.

At the forefront are the country's biggest developers, Ayala Land and SM Group, who each disclosed PHP 70 billion in (US$ 1.6 billion) capital expenditures plans this year covering the completion of ongoing developments and new launches. Meanwhile, Megaworld has allotted PHP 230 billion (US$ 5.2 billion) to further expand its township projects and to meet its aggressive expansion targets for the next five years. Behind the biggest players are other mainstream developers who are aggressively capitalizing opportunities in the country as they remain confident in the market's performance. Vista Land and Filinvest have each allotted PHP 20 billion (US$ 454 million), while Robinsons Land allotted PHP 16 billion (US$ 363 million) in capital expenditures to pour more liquidity into the local property market.

Besides launching new projects, local developers also underwent major transactions. Last year's biggest transaction took place right at the end of 2013, when SM Group acquired a 90% stake in the Net Group's portfolio. The transaction covered five office buildings from Apollo Global Real Estate worth PHP 18.8 billion (US$ 430 million). This year, one of the busiest players has been Double Dragon (DD), which acquired three commercial properties in Q2/2014 and is currently in talks for a residential development. DD is also in the process of executing an ambitious expansion plan of building 100 community malls by 2020.

International investors were also relatively busy recently as several joint ventures were disclosed. International demand is still concentrated in the capital region, led by Asia-based investors who are by far the most active overseas investors. The biggest property-related transaction in the first half was carried out by Singapore state-owned wealth fund GIC. GIC bought a 14.4% minority stake worth PHP 3.7 billion (US$ 84 million) in a local group that owns eight top hospitals in the country and is looking for options in other health-related businesses. Part of the deal also includes a PHP 6.2 billion (US$ 149 million) convertible bond that can further increase the stake.

Nonetheless, the asset market remains rather challenging for purely investment-minded players as there are only a few assets available on the market. This may force the investors to employ more opportunistic strategies such as investing in project developments.

TABLE 2

Key Office Figures

Location	Grade	Average net rental level Q2/2014	YoY change	Upper net rental level Q2/2014	Vacancy rate	Prime yield
Makati	Premium	1,110.6	7.8%	1,300.0	4.4%	9.9%
	Grade A	786.2		950.0		
BGC	Grade A	800.7	8.3%	950.0	6.9%	7.4%
Ortigas	Grade A	588.3	7.7%	750.0	11.7%	8.6%

*Revised figures
Source: KMC MAG Group Research & Consultancy

TABLE 3

Key Residential Figures

Location	Average net rental level Q2/2014	YoY change	Upper net rental level Q2/2014	Average capital value Q2/2014	YoY change	Prime yield
Makati	764.1	2.5%	1,400.0	128,909.2	3.9%	7.1%
BGC	868.5	2.8%	1,300.0	127,871.1	4.9%	8.2%
Ortigas	689.5	0.5%	1,200.0	93,374.6	3.8%	8.9%

Source: KMC MAG Group Research & Consultancy

OFFICE

The leasing market, driven by the IT-BPO sector, retains a positive atmosphere. The IT-BPO industry is not showing any signs of slowing as the current outsourcing trend has made Manila one of the top IT-BPO destinations in the world. This is because labor and property arbitrage. Demand for office space remain concentrated mainly in the capital region; however, Cebu and other second-wave cities are continuously making themselves more attractive in the office market.

Low vacancy levels remain to be a positive problem for landlords as there is no space to facilitate all the requirements. However, this may soon ease as a total of 300,000 sqms comes into the pipeline this year with approximately 160,000 sqms already being completed. Though the strong economy and a growing BPO sector emphasize the need for new supply. New supply drove the vacancy rate temporarily up to 6.9%. Net take-up was recorded at 100,000 sqms in the major CBDs, which supported the solid market performance in the first half of the year. This is expected to reach 280,000 sqms this year as the market absorbs majority of new supply.

The robust leasing demand continued to push up the rental growth to 7.9% YoY and also kept capital values increasing. KMC MAG Group Capital Values Index, which has shown positive news to investors over the past four years, recorded a 11.1% YoY growth in Q2/2014. Although the additional supply is expected to be absorbed, short-term pressure exists on rental growth and vacancy rate to keep the market balanced.

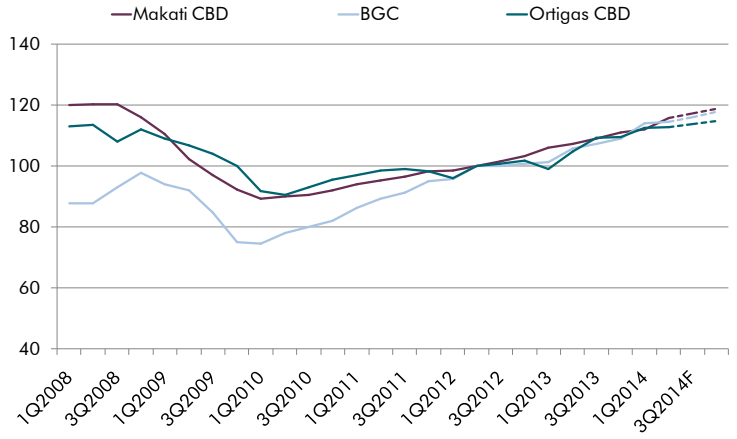
RESIDENTIAL

The residential market continues to grow at a steady rate. Middle-income and low-cost demand in Metro Manila keeps the market demand buoyant and occupancy levels high, while slower growth has been observed in high-end segments. The residential supply will peak this coming year, which increases the pressure, yet the underlying backlog of housing will also keep the market sentiment positive for investors in the low- to mid-range.

As condominium production is shifting towards the middle-income market, the investor profile remains widely varied. Along with end-users, the bulk of

GRAPH 5

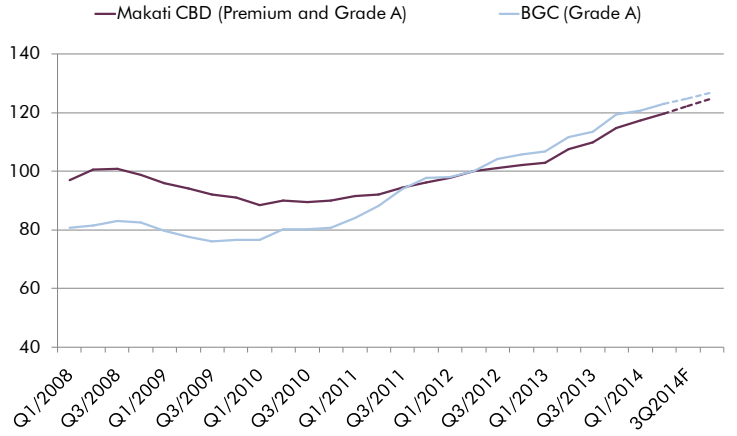
Premium and Grade A Office Rental Indices, 2Q2012=100



Source: KMC MAG Group Research & Consultancy

GRAPH 6

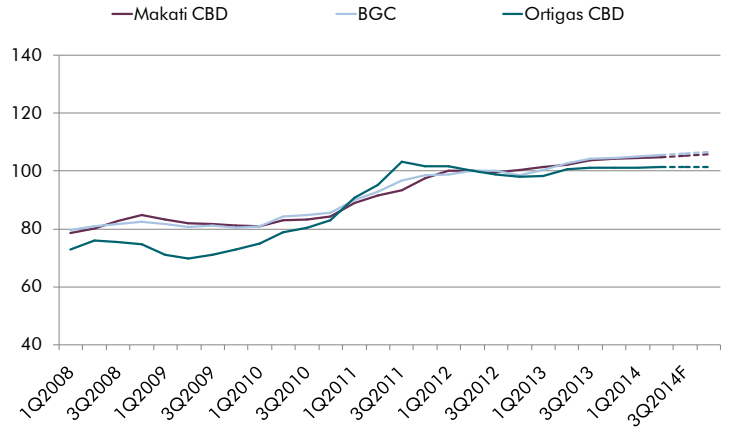
Premium and Grade A Office Capital Values Indices, 2Q2012=100



Source: KMC MAG Group Research & Consultancy

GRAPH 7

Mid-end to Prime Residential Rental Indices, 2Q2012=100



Source: KMC MAG Group Research & Consultancy

buyers for middle-income units consist of wealthy locals and OFWs whose priority now is to invest in their own units. Meanwhile, overseas interest remains strong as Metro Manila offers more attractive yields than other cities in the region. Also, the cooling measures in traditional markets like Hong Kong and Singapore have accelerated the overseas demand into new heights. However, foreign investors still prefer the luxury segments as the prices are relatively low compared to their home countries. These trends pushed the developers to maintain their stock to cater to each segment with their project launches.

Residential yields remained at 7.8% in Q2/2014; however, total return slightly decreased due to slowing value appreciation. According to KMC MAG Group database, the capital values increased 4.3% YoY while rental rates grew 2.3%. This slight slowdown of the market is mainly explained by the supply factors, while residential rates are expected to increase at a moderate rate.

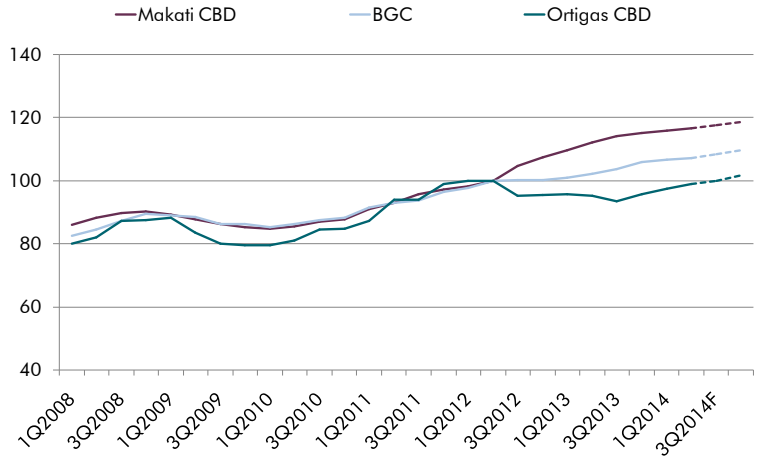
RETAIL

The current positive economic situation, leading to the rise in private domestic spending, is creating an opportune condition for the retail sector. Strong fundamentals–constant OFW remittances, a growing middle-class, and the good employment situation–translate to increased purchasing power. This validates the retail developers' aggressive expansion plans. SM Group, the biggest mall operator in the country, will spearhead this expansion. The firm plans to invest PHP 38.8 billion (US$ 862.7 million) into the retail sector this year, concentrating on areas outside Metro Manila after the expansion of its flagship property, SM Megamall, in Ortigas. By the end of the year, its mall portfolio will amount to 7.5 million sqms, which is equal to approximately half of the total retail space in the country.

The retail sector also remains bullish in modern retail formats such as convenience stores and hypermarkets. Recently, Japanese convenience store giant Lawson Inc. entered into a partnership with the local Puregold brand to tap these favorable conditions. The partnership plans to roll out 500 stores by 2020. Ayala Land, Inc. (ALI) another retail giant, has also seen potential growth in other retail-related ventures, planning to operate 500 convenience stores within the next five years. ALI has

GRAPH 8

Mid-end to Prime Residential Capital Values Indices, 2Q2012=100



Source: KMC MAG Group Research & Consultancy

TABLE 4

Key Retail Figures

	Average gross rental level Q2/2014	Upper gross rental level Q2/2014
Makati	1,850	2,250
BGC	1,900	2,500
Ortigas	1,250	1,800

Source: KMC MAG Group Research & Consultancy

TABLE 5

Key Serviced Office Figures

	Average seat rate Q2/2014	Upper seat rate Q2/2014
Makati	19,250.0	26,400.0
BGC	20,350.0	26,400.0
Ortigas	13,200.0	19,800.0

Source: KMC MAG Group Research & Consultancy

TABLE 6

Key Land Values

	Average capital value Q2/2014	Upper capital value Q2/2014
Makati	355,000.0	379,000.0
BGC	250,000.0	316,000.0
Ortigas	140,000.0	180,000.0
Pasay	130,000.0	130,000.0

Source: KMC MAG Group Research & Consultancy

also recently opened the first Wellworth department store, a joint venture with Rustan's, in the newly completed Fairview Terraces mall.

HOTELS

The boom continues also in the tourism sector. In 2013, foreign tourist arrivals in the Philippines recorded a 9.6% YoY growth with 4.7 million tourists visiting the country. The majority of the arrivals came from Korea accounting to 1.2 million or 24.9% of the total arrivals. Other key source markets include the U.S (14.4%), Japan (9.3%), and China (9.1%). The substantial increase of Chinese visitors (69.9%) was supported by the opening of new regular and chartered air services. In total, Asia remains to be the key source market with 2.8 million (59.6%) arrivals in 2013.

Supported by growing arrivals, the favorable investment climate for the hotel sector remains. A notable hotel transaction came from the Shang Group who recently bought out Alphaland's 20% stake in the Shangri-La Hotel located in Bonifacio Global City. The buyout cost the group PHP 1.7 billion (US$ 38.6 million) and will ensure its presence in the three most important business districts of the country. Earlier this year, Peak Hotels & Resorts Group announced the completion of the portfolio transaction of Aman Resorts. Around PHP 650 million (US$14.5 million) of the joint venture deal was allocated to the island property Amanpulo in Palawan, the country's most prestigious resort with around 40 villas.

Meanwhile, Anchor Land and Accor Group teamed up to redevelop a historic property in old Manila into a five-star boutique hotel. A similar arrangement was agreed upon by Ayala Land and Mandarin Oriental Hotel Group extending its current partnership. Their venture would include the development of a new luxury hotel when the old Mandarin hotel located in Makati CBD closes its doors.

The total number of hotel rooms in Metro Manila is estimated to be at 25,000 with 9,500 more in the pipeline. The majority of the upcoming new supply will be located in the much-anticipated Entertainment City in Manila Bay, accounting for a significant stake of hotel activity in the future. Hyatt is the latest brand landing in Entertainment City, who is expected to open its Hyatt City of Dreams Manila this year. It is set to join Crown Towers and Nobu Hotel in the integrated resort City of Dreams, a venture of Melco Crown Entertainment and SM Group.

SERVICED OFFICE

The serviced office market remains strong as newly opened business centers are being leased out at a very rapid pace. BPO and KPO operations continue to be the main driver of growth in this segment. Small and medium enterprises (SMEs) are also a large customer base for the segment since serviced offices usually serve as incubation centers. The government continues to support the BPO and KPO segment by focusing on the US, European, and Australian market. These markets still have great interest in investing in the country and serviced offices are a great corporate vehicle that allows potential investors to test Philippine waters with low risk and low capital factors. The serviced office concept is seen expanding to other provinces such as Metro Bulacan, Metro Pampanga, Metro Cavite, Metro Laguna, and several more which are tagged as "Next Wave Cities". These cities have become attractive sites due to the government's focus on developing the said cities' talent, infrastructure, policies, and business environment. Serviced offices are, and will remain, attractive over the next few years as prime office supply in CBDs will remain low until 2016/2017.

Makati CBD

Makati City is the country's top financial capital and is the prime central business district in Metro Manila. Makati houses the highest number of industries and globally renowned businesses in the region, having several multinational corporations, locally-based commercial firms, and IT-BPO companies. It is also known for its highly cosmopolitan culture with several commercial establishments.

OFFICE

Because of the shortage of developable land in Makati CBD, there is currently only one office development, Frabelle Business Center. It is slated to add only 8,000 sqms of leasable space once turned over by the end of the year. Recently completed V Corporate Center, on the other hand, added 22,000 sqms to the total stock of Grade A and Premium office space which now stands at 1.1 million sqms.

Driven by strong demand from the outsourcing and offshoring industries, Makati's overall vacancy rate remains low at 4.4% which will remain low as there is no new supply. The majority of the future demand will concentrate on Makati Tower (the latest prime building in Makati CBD) that is soon to be available for leasing.

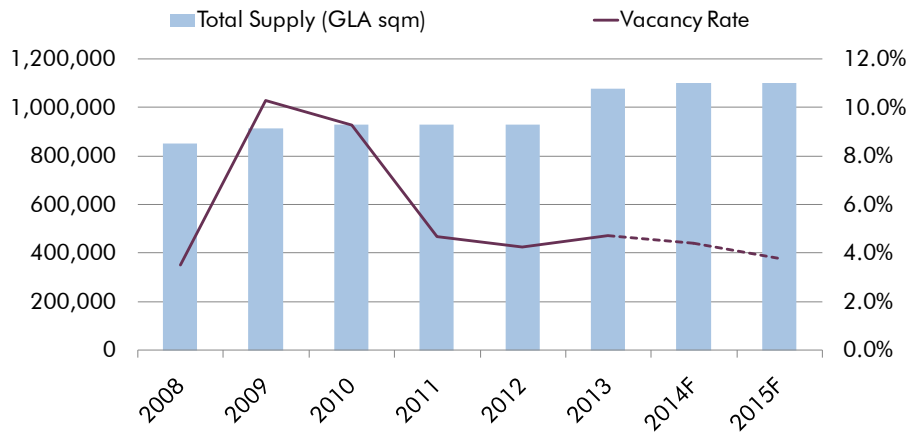
Rental rates and capital values accelerate as companies compete for spaces while supply stagnates. The average per square meter net rent for premium offices increased by 8.1% YoY to PHP 1,110.7, while Grade A offices is at PHP 786.2 per sqm with a YoY increase of 7.3%, and Grade B offices at PHP 572.9 per sqm. Meanwhile, the robust rental increase also accelerated the average capital values to PHP 113,381.6 per sqm for Premium and Grade A office spaces.

RESIDENTIAL

Makati's rental rates largely vary according to building grade and unit size. This quarter, average rental rate across all Makati mid-range and luxury residential properties is at PHP 782.8 per sqm, with a YoY growth of 2.5%. However, this may still go as high as PHP 1,400 per sqm for luxury condominiums in the area.

GRAPH 9

Makati Prime Office Space



Source: KMC MAG Group Research & Consultancy

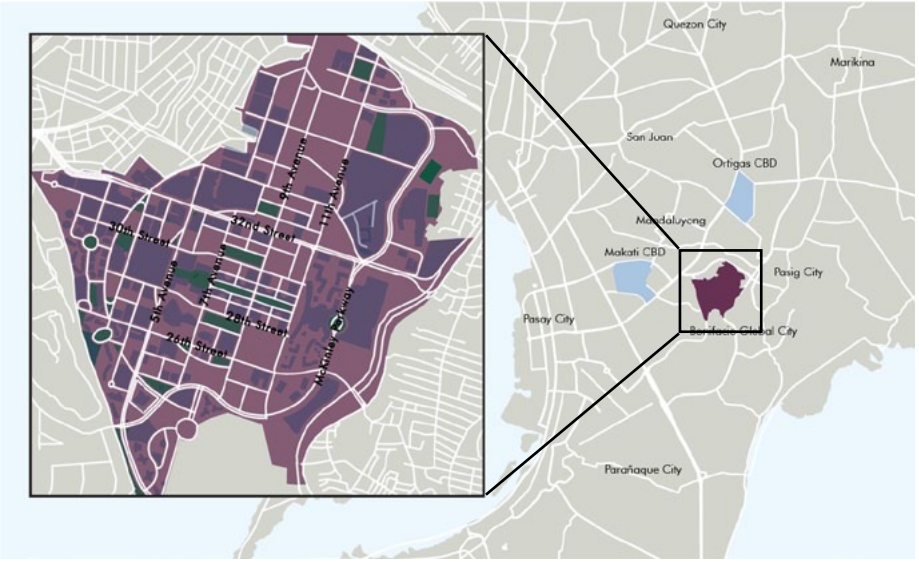
Capital rates for residential properties follow a similar trend; condominium units in luxury buildings may be worth twice as much as below-average spaces. Average capital rate for mid-end to luxury properties is at PHP128,909.2 per sqm, but these rates can go even higher for some luxury properties.

While there are not many office developments ongoing in Makati, the residential sector in the area has some activity particularly in the high-end and luxury residential segments. Makati's luxury inventory will increase upon the turnover of Discovery Primea (90 units) and Shang Salcedo Place (794 units) which are estimated to be completed next year. Ayala Land's multibillion peso projects Park Terraces (370 units) and Garden Towers (340 units) are also expected to be ready for turnover by 2017 and 2019, respectively.

Aside from the CBD, there are several developments ongoing in the fringe areas of Makati. One of the rising districts is Century City which is achieving a lot of international attention. Recently, Century Properties ventured with Hong Kong-based Phoenix Property Investors who will partly finance a 100,000-sqm mixed-use property called The Spire through a US$ 30 million loan. This signals the attractiveness of the local residential market fuelled by the favorable demographics, rapid urbanization, and a growing middle class.

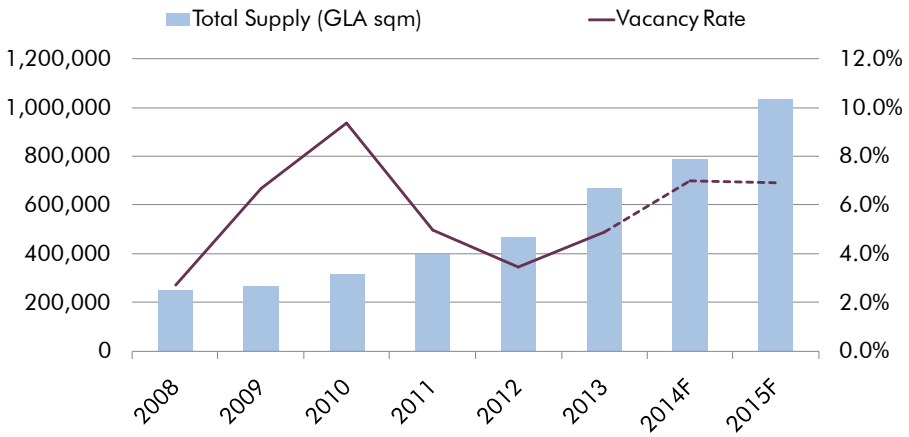
Bonifacio Global City

Bonifacio Global City (BGC), located beside Makati CBD, is the second most important business district in the country. It is a rapidly expanding CBD home to premier residential and office spaces. Good infrastructure development and high-quality office spaces have enticed BPOs, multinational companies, and conglomerates to set up their offices in the area. It also hosts several international schools, museums, public parks, and a premier medical facility catering to its growing cosmopolitan community.



GRAPH 10

BGC Prime Office Space



Source: KMC MAG Group Research & Consultancy

OFFICE

The current stock of Premium and Grade A office space in BGC will soon match Makati CBD's existing stock as there are several new developments in the district. The recently completed Panorama Tower and 11th Corporate Center increased total stock of Grade A office space to 700,000 sqms. This is estimated to increase by 90,000 sqms by the end of the year with the completion of MDi Corporate Center, Uptown Place Tower 1, Twenty-Four Seven McKinley, Orion and Del Rosario Law Building, a headquarter of the Del Rosario Law Firm. Recently, ArthaLand also broke ground for its office debut, planning to bring the first premium address to BGC's office markets with ArthaLand Tower.

New office supply temporarily drove BGC's vacancy rate up to 6.9%, which is expected to slightly increase by the end of the year despite strong demand. With stock throughout the district being fairly new, no significant variation occurs in rental rates. Grade A office spaces in the area have an average rental rate of PHP 800.7 per sqm, growing 8.3% from last year.

RESIDENTIAL

In spite of increasing supply, BGC's take-up has not decreased, signaling the popularity of the area. BGC remains busy especially in the high-end and luxury residential segments with several developments underway. One of the major developments is ArthaLand's Arya Residences, with its first tower turned over early this year and its second tower expected to be completed by early 2016. Ayala Land continues to be active with several developments underway. These developments include the High Street South Block, Two Serendra, and Avida projects in Uptown Bonifacio, all with multiple towers. Meanwhile, the development of Uptown Bonifacio is at full swing led by Ayala, Megaworld, and Federal Land.

GT Capital, Federal Land's parent company, recently disclosed its plan to allocate PHP 4.2-6.2 billion to partially finance the construction of Park West, Central Park West, and Madison Park West in its master plan project, Veritown Fort. The Grand Hyatt Manila Hotel, which will feature Grand Hyatt Residences, is expected to be the first Federal Land project to reach completion, opening by 2015. In addition to Grand Hyatt, BGC's hotel supply will further increase with the completion of Shangri-La and Ascott Residences.

In terms of residential lease rates, the current average rate is at PHP 868.5, increasing 2.8% YoY. BGC is seeing minimal rate fluctuations as most of its inventory is composed of new stock. At PHP 127,871.1 per sqm, BGC's average capital values are almost at par with Makati. As there remains to be a lot of new supply coming online in the succeeding years, the rates are expected to grow at a modest rate as the price development has been positive in the recent years.

Ortigas Center

Ortigas is the country's second largest Central Business District, next to Makati CBD, located at the heart of Metro Manila. It is bordered by three large cities–Pasig, Mandaluyong and Quezon City–and surrounded by major roads and highways. Furthermore, its proximity to the labor force in Pasig, Marikina, Quezon City, Cainta, San Juan, as well as Taguig, Pateros, and Paranaque places it at a geographical advantage as a BPO hub. Ortigas Center is home to local conglomerates such as Jollibee Corporation and San Miguel Corporation, as well as the biggest entertainment complexes and hotels in the country.

OFFICE

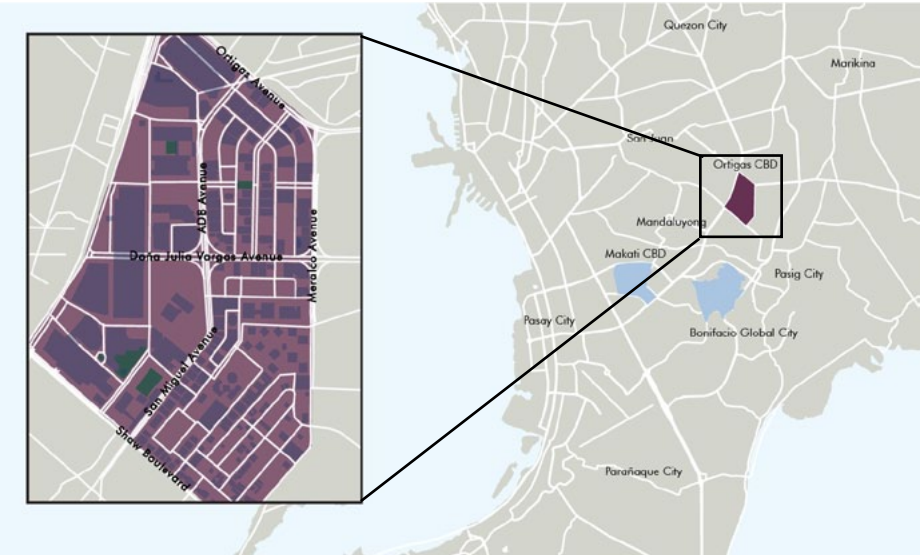
In terms of total square meters, Ortigas is still the second largest CBD in the country; however, its stock is outdated and Grade A office space is only at 568,000 sqms. Earlier this year Ortigas stock experienced a significant increase when new supply was delivered by Robinsons Cyberscape Alpha and Beta, 45 San Miguel Avenue Building, and Marco Polo Ortigas. Pipeline supply for 2014 will include Rockwell Business Center Tower 3 and Estancia at Capitol Commons. The iconic BDO Corporate Center, on the other hand, is expected to be completed by early 2015. These supply additions pulled Grade A office vacancy rate up to 11.8% in Q2/2014. Currently, rental rates have not reflected the added supply growing 7.7% YoY to PHP 588.3; but until the market absorbs this new stock, rental growth is expected to stay modest.

RESIDENTIAL

Residential rates in Ortigas are significantly lower compared to Makati and BGC. These rates have also stayed stable averaging PHP 689.5 per sqm with a growth rate of only 0.5% YoY. Similarly, capital values in the district lags behind the other two CBDs, averaging only PHP 93,374.6 per sqm. However, despite the lower rates, Ortigas offers better gross yield than Makati or BGC with an average of 8.9%.

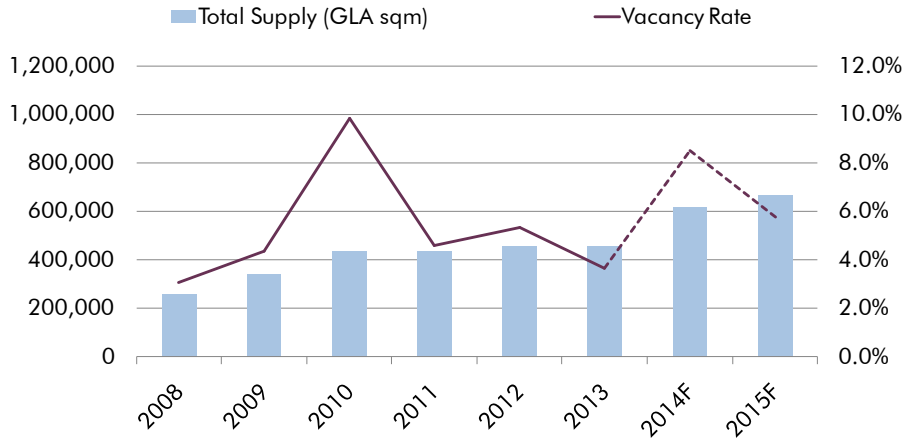
These relatively low average residential rates in the CBD may change soon, as there is currently some activity in the CBD's high-end residential sector. Sonata Private Residences, Robinson's flagship luxury project, recently turned over its second tower while Rockwell Land's The Grove, an emerging 5.4 hectare high-end residential community in vicinity of Ortigas, will complete its second phase by December this year and its third phase is expected to be completed by late 2015. In addition, Shang Properties' luxury two-tower development One Shangri-La Place, projected to add 1,300 units to Ortigas' supply, is expected to be completed late this year. Markets are also waiting for the debut of Mitsubishi and Ayala's partnership, Portico, which will turn 3.6-hectares of land into a mixed-use development with more than 1,000 residential units. Another masterplan project the markets are waiting for is the Capitol Commons, a 10-hectare mixed use complex by Ortigas & Co. Besides the high-end mall and office components, the complex has already launched two luxury residential projects, The Royalton and Imperium. These two towers will add a total of 650 units in 2017 and 2019 respectively, while the company is planning to have five residential towers in Capitol Commons.

Ortigas CBD is also on the map for hotel projects, as Marco Polo and Tune Hotels have recently opened, while Go Hotels by Robinsons Land is expected to open soon to tap the growing business travellers segment within the district. These hotels together with upcoming BGC developments will create much needed alternative destinations to Makati in Metro Manila hotel markets.



GRAPH 11

Ortigas Prime Office Space



Source: KMC MAG Group Research & Consultancy

2014 Outlook

The outlook remains very positive for the Philippines. The economy is expected to grow by 6.0% to 7.0%, outperforming most of Asia. The buoyant investment activity and strong domestic demand are major factors in the positive sentiment for the country amid uncertainties in the global economy.

Investment activity is expected to stay robust especially in the real estate sector. Demand for which will be driven by attractive yields posted across all property types, though the focus of the investors will continue to be in properties within the CBD.

Approximately 140,000 sqms of office space is expected to be completed by the end of 2014. And while BGC and Ortigas have turned their situation around (in 2013, both cities had low supply), Makati's stock is expected to stagnate in the following years.

Looking ahead, the strong leasing demand from the BPO sector will drive the market for the coming years. This is expected to result in higher rental and capital values in all real estate segments. KMC MAG Group also expects the Premium and Grade A office markets to sustain its current pace with rental rates and capital values both expected to increase 7.0% YoY.

> "The buoyant investment activity and strong domestic demand are major factors in the positive sentiment for the country amid uncertainties in the global economy. "

The residential market, meanwhile, is moving in a different direction. It is expected that developers will continue to actively launch their new projects, shifting focus from luxurious developments to lower to mid-end segments. Needless to say, only projects priced at reasonably affordable levels will enjoy higher take-up, as the target buyers are increasingly coming from the middle class. Another expected trend is the projected popularity of small-sized apartments, and large-sized units may become the bane of developers. The high-end residential market will only have a modest growth as a result of a weakening demand from its target market. The rates are forecasted to increase barely over inflation by another 3.0-5.0% YoY, keeping the gross yield within 8.0% to 10.0% spread.

Our positive outlook for the real estate sector, also extends to Manila's retail market. We foresee that retail space in prime malls may hold opportunities for a rise in rental rate, as the larger population catchment will continue to provide strong retail sales. The accelerating inflation might have some downward effects, but increasing purchasing power and private consumption will overwhelm inflation. We believe that the retail market's development is sustainable both in the short- and long-term. This sustainability will justify the rental increase of 7% to 10%, as shopping center landlords are in a strong position to attract both existing retailers and new brands for market entry.

TABLE 7

Metro Manila Forecast

	Rents	Capital Values	Yields	Vacancy	Supply
Office	↗	↗	→	↗	↑
Residential	→	↗	↘	→	↑
Retail	↑	↑	→	→	→

Source: KMC MAG Group Research & Consultancy

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