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Emerging Tenant Management Issues

THROUGH THE UPTURN OF CO-WORKING SPACE

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Introduction

In the Philippine market, there are three major classifications of flexible workspaces: serviced offices, hosted services firms, and co-working spaces. The entrance of the unique sub-industry of Real Estate and Leased Spaces, Co-working spaces a.k.a shared spaces is brought about by the increasing millennial labor force and their demand for flexible and personalized work environment as startups, freelancers, or online professionals that should be contained in an air conditioned room, with a comfortable workstation, and fast internet.

Co-working spaces are the newest types of flexible workspaces. Apart from the contemporary design that integrates the comfort of home, the ambiance of your neighborhood café, and the functionality of your office, this flexible workspace type differentiates itself by the community it creates. Thus, the shift of Filipinos to a flexible working condition. The transfer is mainly influenced by evident factors such as the excruciating traffic, rise of startups and SMEs, and the influx of multinational companies seeking market penetration in the steady growing economy of the Philippines.

As foreseen by the top Philippine' real estate consultants, co-working space is expected to grow annually. Larger occupants mean larger demands for spaces, however, Property Managers or Landlords may face the consequence for more tenant management issues such as trouble in tracking leases, controlling cost, and drafting contracts.

Our goal in this paper is to focus on the emerging tenant management issues that arises in parallel with the growing market of co-working spaces in the country. Moreover, how a smart property management tool can be employed to address the shift, while tending to the manifesting issues that comes with the increasing demand.

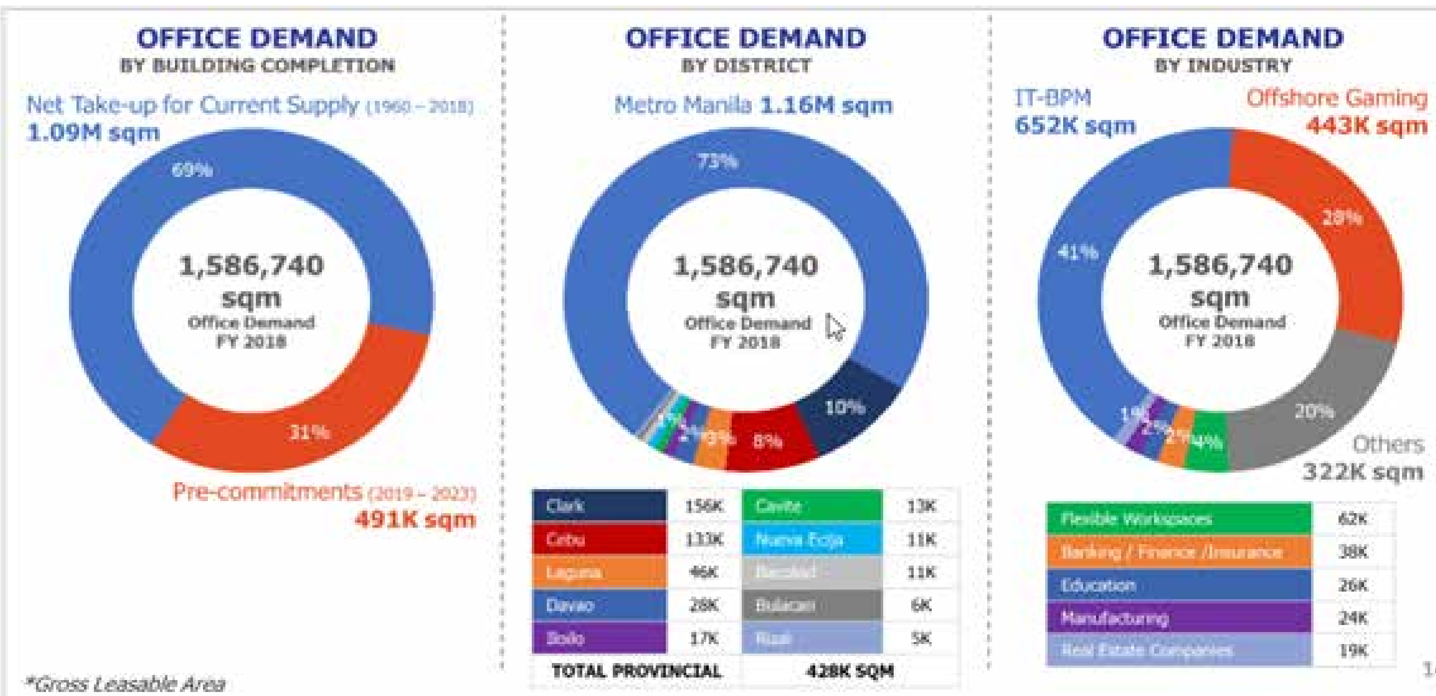
THE PHILIPPINE REAL ESTATE MARKET INSIGHTS:

DEMAND

For year 2018, the Philippine's office demand reached a record-high of 1.5 million sqm, with Metro Manila accounting for 73% or 1.16 million sqm (27% higher from 2017's 910,000 sqm); inclusive of pre-commitment transactions done by tenants for future supply.

Major drivers for office demand includes IT-BPM at 652K sqm, offshore gaming at 443K sqm, flexible workspaces at 62K sqm, banking / finance / insurance at 38K sqm, education at 26K sqm, manufacturing at 24K sqm and real estate companies at 19K sqm. Other industries comprise the 322K sqm of office demand for 2018. Filipino Entrepreneurs and Multinational Companies comprised 322,000 of the office space demand.

When classified by district, Clark recorded the largest office demand outside Metro Manila with 156,000 sqm, the majority of this demand was in Udenna's famed Clark Global City. Cebu, Laguna, Davao and Iloilo follows. Davao regains traction in the 4th quarter generating 28,000 sqm to the 2018 office demand despite Martial Law status.



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SUPPLY & VACANCY

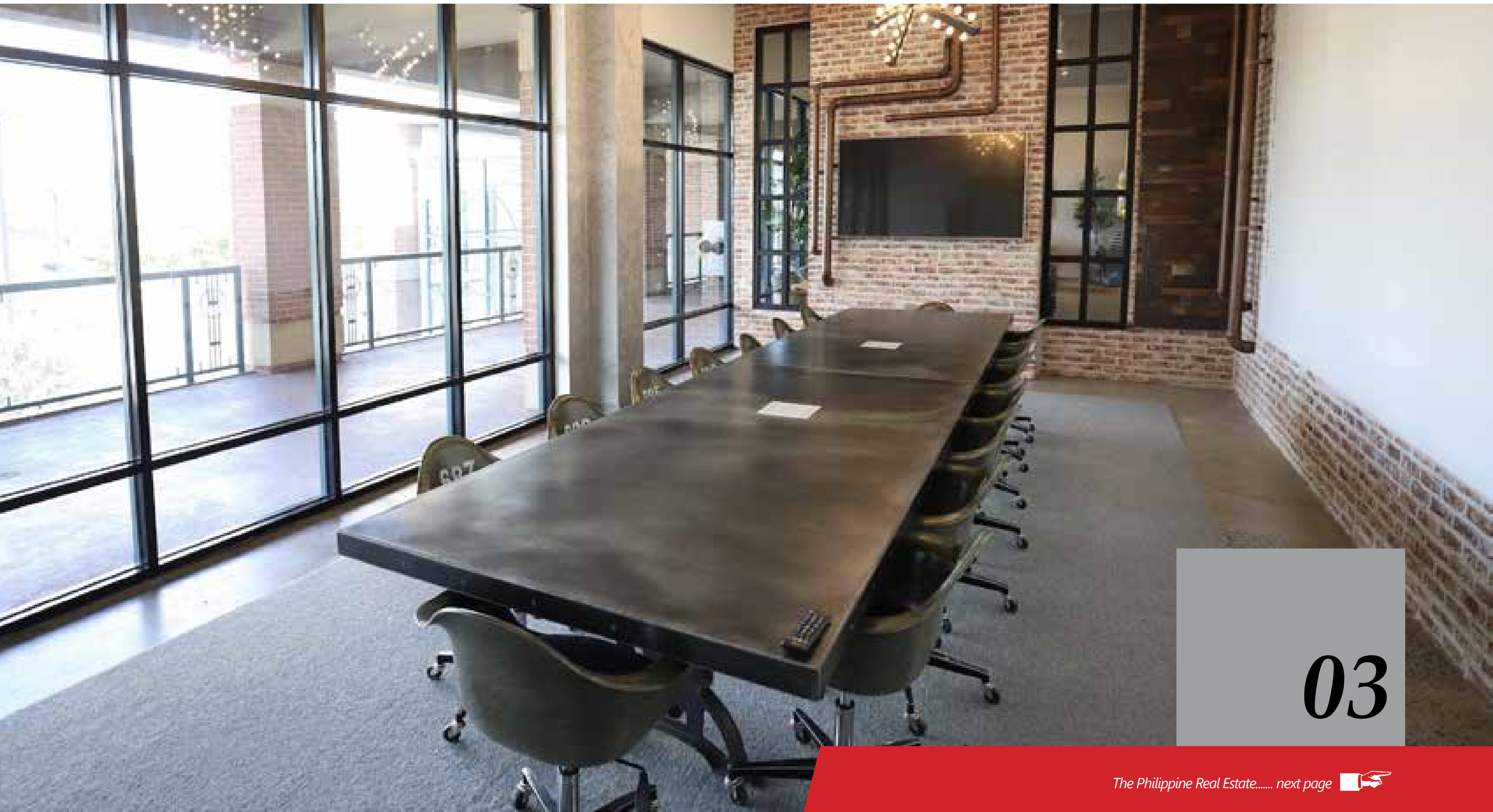
"Metro Manila recorded high levels of pre-commitment in 2018"

In the latest market insights by Lee Chiu Properties, the current vacancy rate across Metro Manila is at 6% while Bay City with 1% and Alabang with 2% record the lowest office vacancy, while Colliers sees vacancy at about 5% from 2019 to 2021.

Collilers International forecasted that Manila Bay Area, Ortigas Center, and Fort Bonifacio covering 53% of the new supply in 2019. Thus, Ortigas Center, Mandaluyong City and Pasig City are projected to be the largest producer of office space in the next 5 years.

KMC Savills Metro Manila Office Briefing for Q3 of 2018 states vacancy in Makati CBD, the premier financial district saw a robust occupier performance dropping to 1.7% of office stock despite the completion of Ayala North Exchange's first tower. BGC saw a rise in vacancies in 3Q/2018 due to the additional 81,200 sq m of new office supply. Ortigas Center has an office pipeline of around 566,500 sq m which should lead to a spike in vacancies to as much as 18.5% by 2020. However, the new stock is expected to improve quality with the new additions, such as the Podium West Tower, GLAS Tower, Jollibee Tower, and Unioil Tower. Although the vacancies may depress rentals in the coming quarters, the improved stock should boost overall rates in the long run. Vacancies rose to 3.8% of the stock in Alabang with the completion of One Griffinstone – a reversal from the very tight conditions recorded in the previous quarter. Without any new office completions, the vacancy rate rose to 8.7% in Quezon City after the expiration of several contracts in the submarket. Market conditions in the Bay Area remain to be very tight as the vacancy rate further declined to 0.3% in 3Q/2018 – despite the addition of 15,600 sq m from Filinvest Cyberzone Pasay Tower D.

Metro Manila recorded high levels of pre-commitment in 2018 with more than 25% of the 2019 stock leased and under negotiations as ITBPM locators struggle to secure PEZA Accredited space in the current stock.
Half of the pipeline supply in Bonifacio Global City is already pre-committed as competition for PEZA accredited space tightens. Century Diamond Tower, due for completion by end of 2019, will be the only PEZA building available in Makati for the next several years.



RENT

From 2018 to 2021, Global Commercial Real Estate Services Organization Colliers, is retaining its projection of an 8.0% annual rise in office rents due to high quality new supply and a tight market during the period.

Despite the rising vacancies, average rents in the capital continued to accelerate registering growth of 4.9% year on year from 4.4% year on year the previous quarter. Tightening conditions in Makati CBD have contributed to this acceleration together with higher closing rates in BGC. The Bay Area remains to be the key outlier with rental growth at 13.9% Year on Year.

Office rents maintained its growth backed by solid demand- despite construction delays and headwinds brought forth by interest hikes, delayed Philippine Economic Zone Authority (PEZA) accreditations on buildings and apprehensions on the Tax Reform for Acceleration and Inclusion (TRAIN) 2 law. Capital values also gained steadily due to the sound business environment which continued to buoy investors' interest.

THE LOCAL CO-WORKING SPACE LANDSCAPE

The growth of the flexible workspace segment in the Philippines has been unquestionable. The estimated total stock of flexible workspaces in Metro Manila has stretched to 228,000 sq m (2.5 million sq ft). Colliers expects this number to grow by 10% annually in the next three years, as demand for co-working spaces is spurred by a millennial-dominated labor force.

Co-working spaces started in 2011 with Co Lab Xchange which started with sites in Ortigas Center and Makati CBD, before consolidating itself in Pasig City with a total of 500 sq m (5,400 sq ft) of space. A-Space followed later in the same year. Since then, other players have emerged. Notably, operators have also started expanding to provincial locations.

Not claimed as the future of office, but the “new way” people work – co-working spaces have evolved the business environment in the Philippines. As companies continue to extend their footprints, and startups are fast rising, they are also in search to propel business growth by top two considerations: Ideal work place to attract more employees efficiently all the more avoiding unnecessary costs. As such, office leases and workspaces have transformed to meet these standards.

The Uprising

CO-WORKING SPACE

What is a Co Working Space?

Co-working space, in the Philippine market setting is classified under flexible workspaces category. Co-working spaces are the newest types of flexible workspaces.

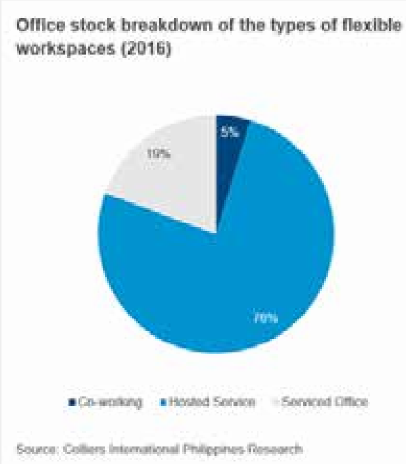
Today's time is not only defined by having adequate workstation and ventilation, but must include spacious work areas to allow maximum productivity. Ambience is also considered a factor today, as it stimulates creativity and promotes work efficiency and collaboration – all of which in a location that is accessible. Thus, it is not surprising to see the increasing popularity of flexible workspaces in recent years.

Co-working operators recruit tenants with the same interests to collaborate in a shared working environment.

The Current State of Co-Working Space

The growth in the flexible workspace segment in the local market has been undeniable. The number of flexible office space operators has reached over 60 as of end 2016. A far cry from the humble industry beginnings of Regus in the late 1990s, with a close to 1,000 sq m of space at The Enterprise Center. Today, the estimated total stock of flexible workspaces in Metro Manila has reached 228,000 sq m (2.5 million sq ft)

During 1999, when flexible spaces market leader Regus entered the market, grade A and premium buildings only comprised 23% of 3.8 million sq m (40.9 million sq ft) of office space. 19 years later, over 3.7 million sq m (39.8 million sq ft) of grade A and premium buildings are now in the market.



Although at a current market share of 5% in the total stock of total flexible workspaces in the country, co-working space have been the fastest growing at 61%.

Co-working spaces started back in 2011, in major central business districts – Ortigas and Makati. Since then, more operators have entered the market. Today, co-working spaces spans across Metro Manila and submarkets. These players started with their expansion in other productive business locations such as Cebu, Iloilo, Bacolod and Davao.

The Growing *Co-Working Space* Industry

Growth factors such as the entrance of multinational companies in the country, continuously rising BPO sector, increasing millennial workforce and emergence of startups and SMEs drive the need for co-working space, which prompted Lee Chiu Properties and Colliers at a projected 10% annual growth of co-working space in the next three years.

The increasing demand for co-working spaces will encourage more foreign flexible space operators to increase their presence in 2019.

The co-working space industry in the country is still in its early stages, despite starting 8 years ago. With the total share in stock of flexible office space only at 5%, there is still room to grow. Today, Major CBDs Makati and Fort Bonifacio rents have reached PHP1,000 per sq m (USD1.86 per sq ft). Alternative locations are also catching up in prices. Understandably, the piece-meal characteristic of co-working spaces has been attractive to various tenants.

Flexible space operators like WeWork and IWG have extended their footprint in the country and are expected to expand in 2019. More local providers of co-working and co-living spaces are also expected to emerge, typically operating in fringe areas. The lower capital costs these types of assets require will spark investor interest.

The potential of flexible workspaces, especially co-working, is irrefutable. The test for both operators and developers is to adjust to the demands of the market to either persist to be economical or partake in this developing segment.

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