COVID-19 Impact to Property Sector

April 23, 2020

Outline

- Impact to Economy
- Office Sector
- Retail Sector
- Residential Sector
- Hospitality Sector
- Industrial and Logistics Sector
- Outlook and the New Normal

Impact and Risks to the Economy

The Global Impact of COVID-19 and Policy Responses

Situational Threat Report* | **Macro Conditions**

We are here as of Apr 13 → 7

		Macro Conditions
Highest	10	Severe global recessionary conditions lasting for a prolonged period
	9	Widespread cascading business failures imminent or ongoing
	8	Solvency risk broadly spreading across economies
	7	Severe multiquarter economic impacts in multiple markets likely
	6	Markets and public in multiple major nations reacting strongly
	5	Sustained transmission likely in multiple transmission
	4	Sustained transmission occurring in multiple areas in country of origin
	3	Sporadic cases appearing outside of region of origin
	2	Large-scale epidemic in single region
	1	Identified contagion, local origin, little information known
All Clear	0	Threat is negligible or has passed

Impact

- ✓ 1.3M cases, 63K deaths
- ✓ Global GDP growth from 2.9% to 2.4%
- ✓ Worst case, full year GDP growth could fall to zero
- ✓ FDI flows could fall 5% to 15% to their lowest levels since the 2008-2009 global financial crisis
- ✓ Global carriers to lose $63B to $113B in 2020 revenue
- ✓ International indices nearing bear market territory
- ✓ Risk of layoffs, consolidation, and bankruptcy looms

Government Response

- ✓ China announced billions in special purpose loans
- ✓ Federal Reserve cut the policy rate
- ✓ Other major economies announced financial measures (Japan $9.6B, South Korea $9.2B, Italy $4.1B)
- ✓ IMF and World Bank announced availability of $50B and $12B in financing

Source: Bain's Macro Trends Group, WHO, CSIS

NEDA estimates up to 1.8M job losses due to COVID-19

429B to 1,355B

Foregone GVA (current prices)

-0.6% to 4.3%

GDP Growth

116K to 1,800K

Employment Losses

1M

Displaced workers in the **formal sector** as of April 11

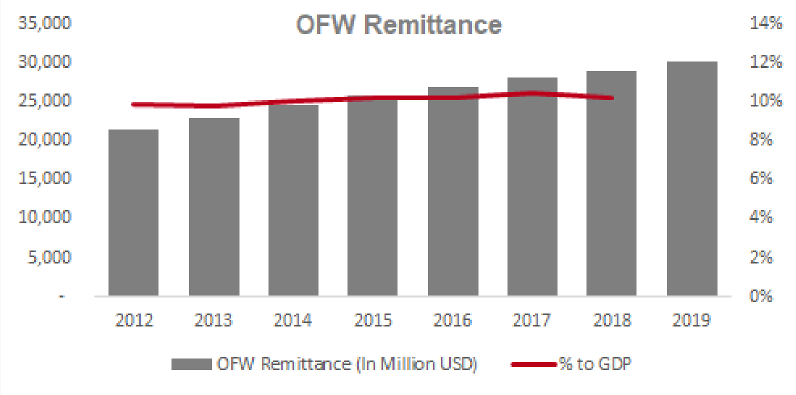
Majority belong to manufacturing, hotel, restaurants, tourism-related, and education

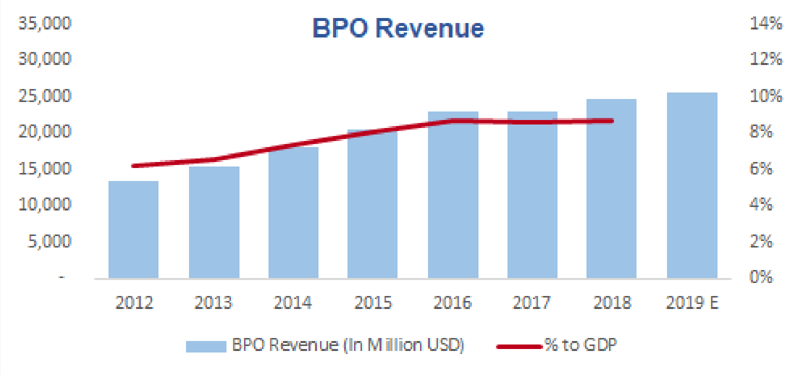
~250K

Needing assistance in the informal sector

Source: NEDA, DOLE

3 Pillars of PH Economy stand to lose billions of pesos

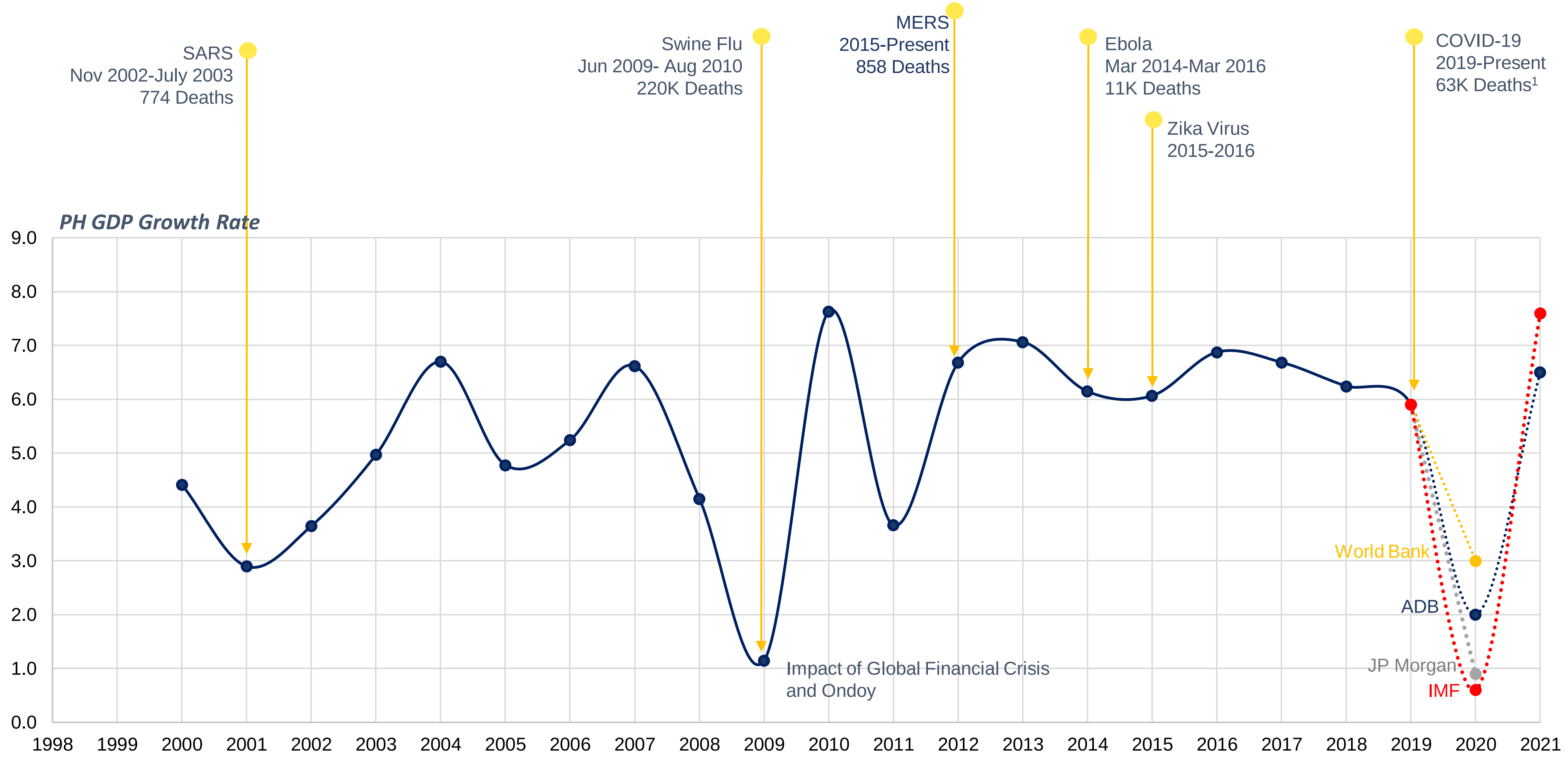




- NEDA estimates Php 76 to 157B GVA losses in tourism
- While ACTS-OFW expects PH to lose Php 228B in OFW remittances

Source: NEDA, PSA, BSP, Philippine Star

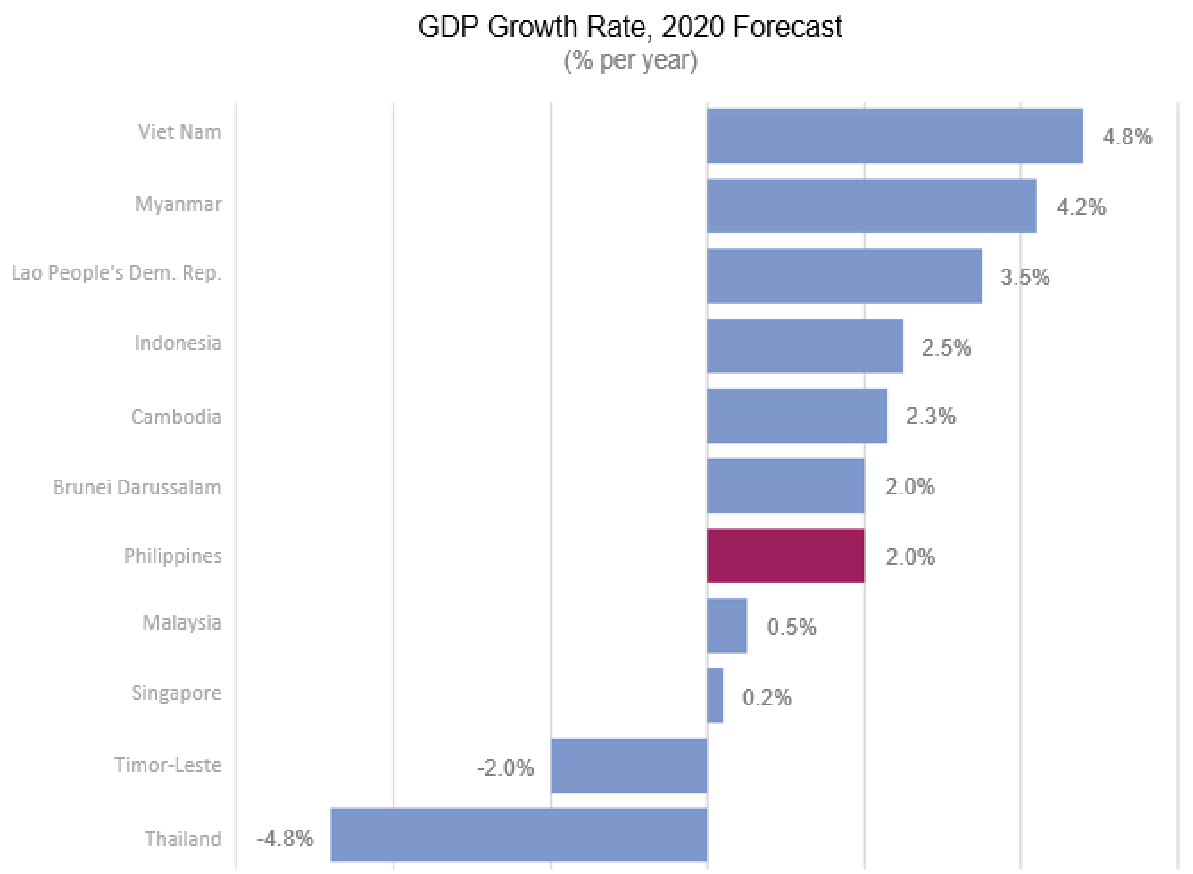
PH GDP expected to slide to 0.6-3% but will have a strong rebound due to expansionary monetary policies

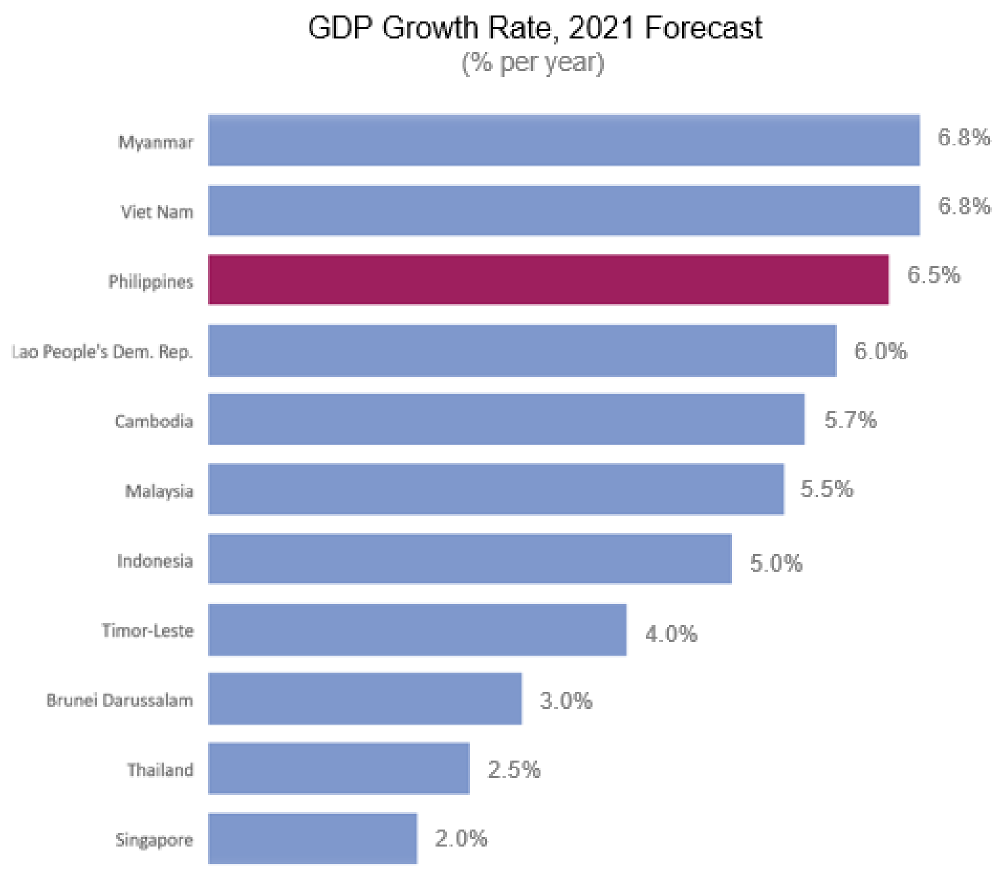


[1] Deaths due to Covid-19 as of April 5

Source: CDC, WHO, PSA, CNBC, Inquirer

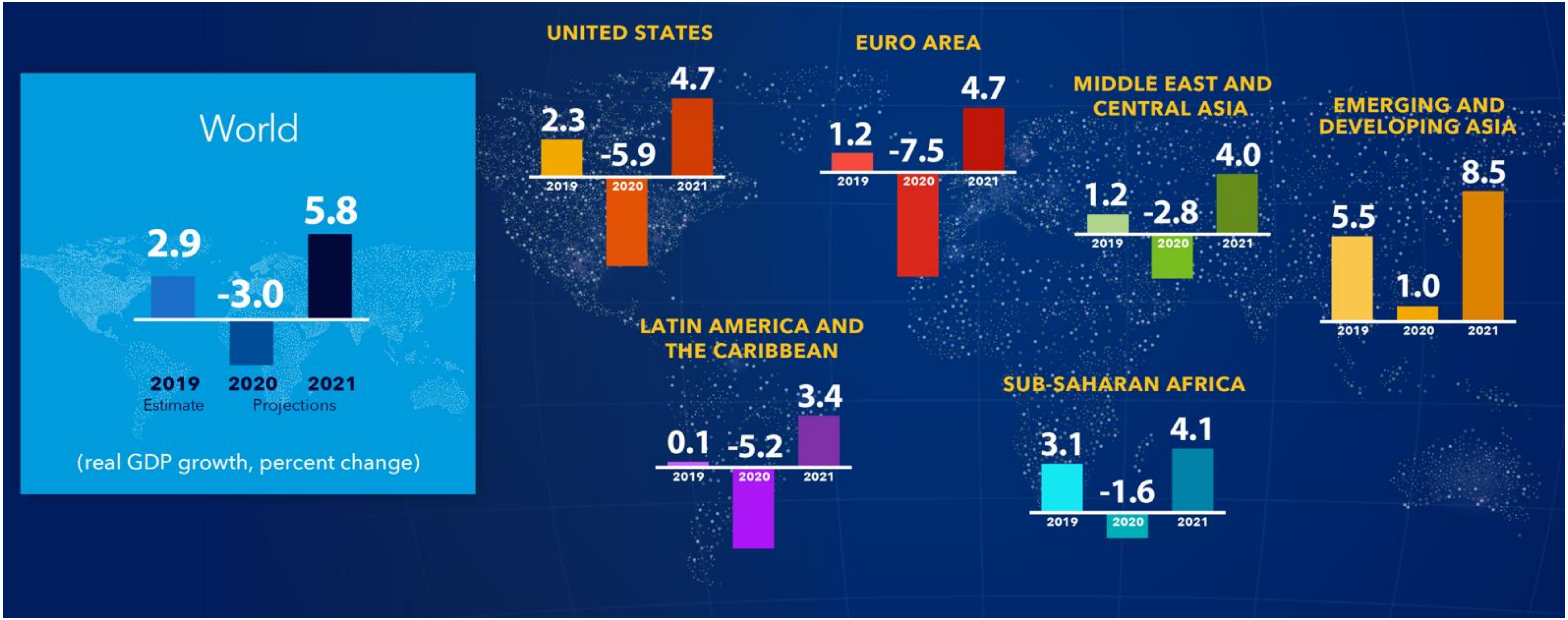
Despite a gloomy outlook in 2020, PH is expected to be one of the growth leaders as emerging Asia rebounds in 2021





Source: Asian Development Bank

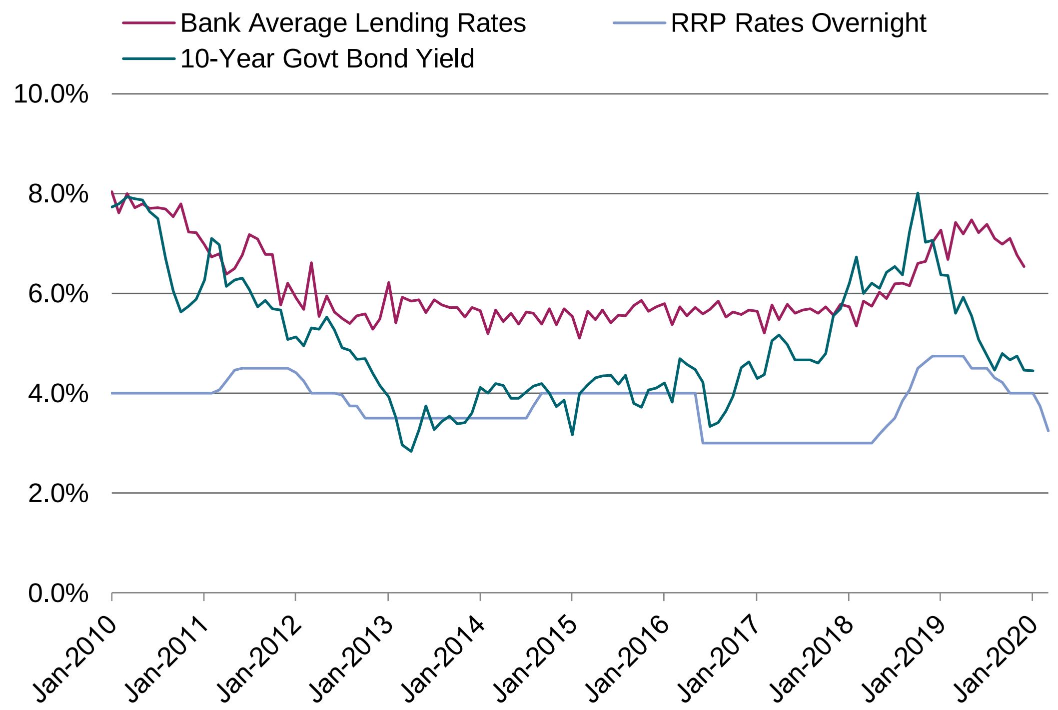
Latest World Economic Outlook growth projections

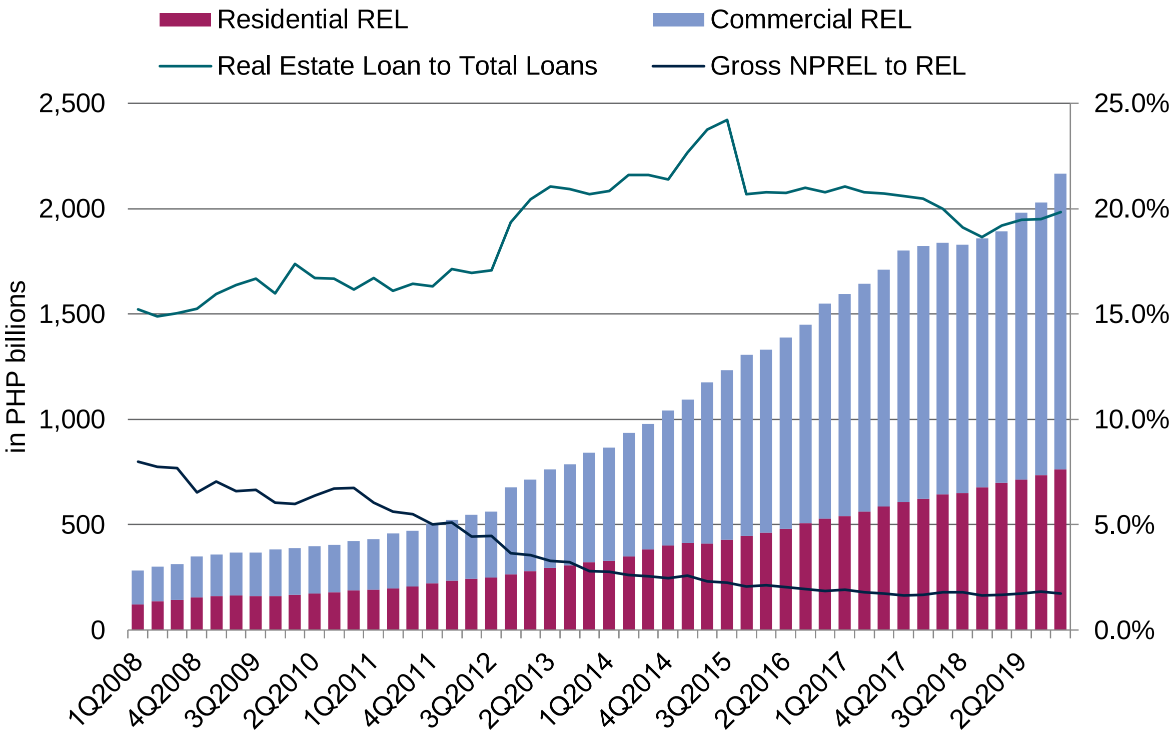


YoY change

Source: IMF (World Economic Outlook, April 2020)

Central bank actions reduced default risk and protected overall real estate sector





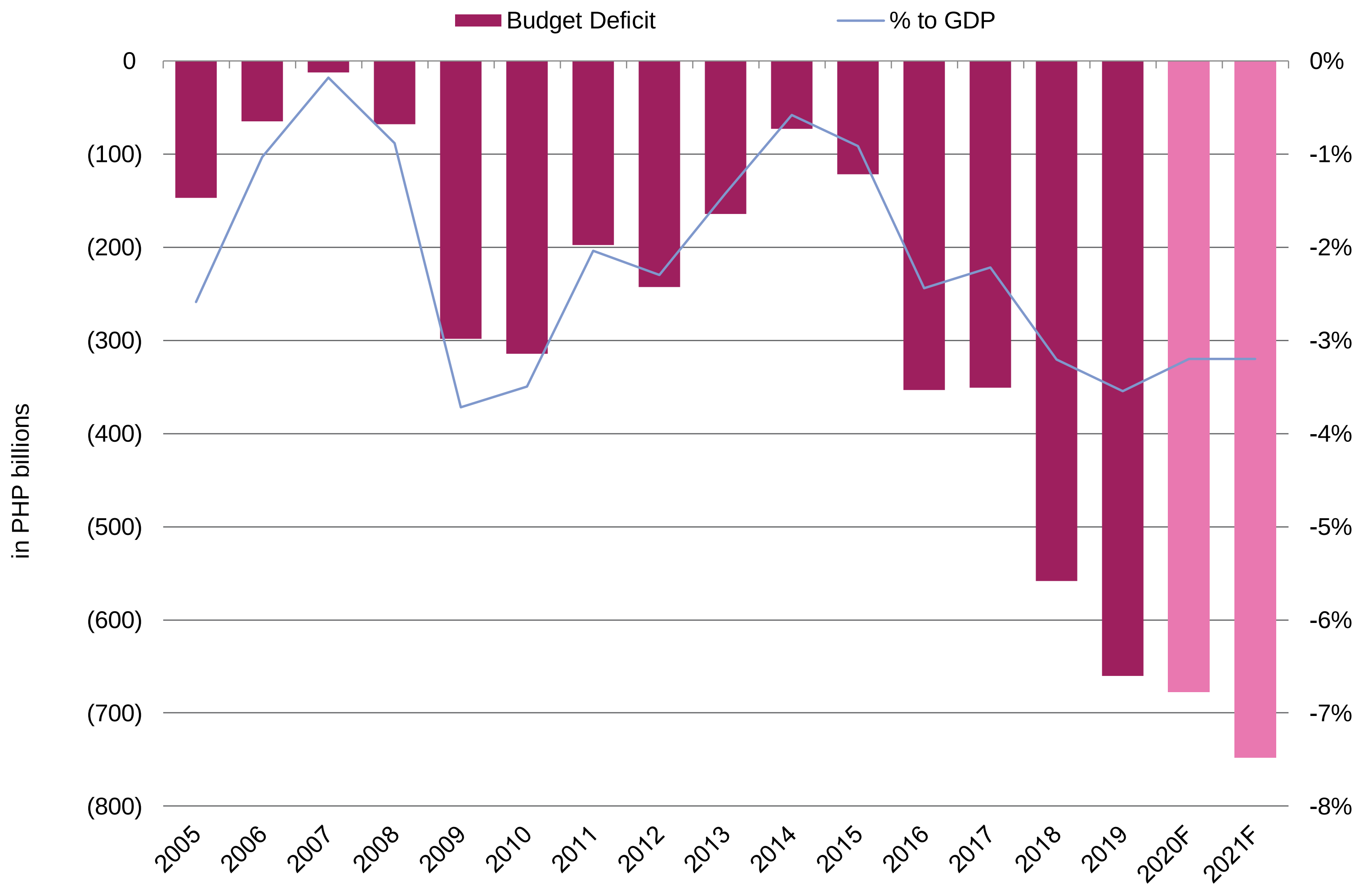
- The Bangko Sentral ng Pilipinas (BSP) has cut interest rates to its lowest level since 2018 and is still expected to cut rates further. It has also reduced the reserve requirement ratio by 200 bps with potentially another 200-bps reduction within this year.
- The central bank has also implemented its own form of quantitative easing with a programmed purchase of up to PHP 300 billion in government debt.
- These moves should assist fiscal measures currently in place and reduce default risk during this ECQ. Real estate loans in the banking sector amount to more than PHP 2.1 trillion with non-performing loans at 1.7% end 2019.

Source: BSP, KMC Savills Research

Budget deficit to further increase as government grapples to contain the pandemic

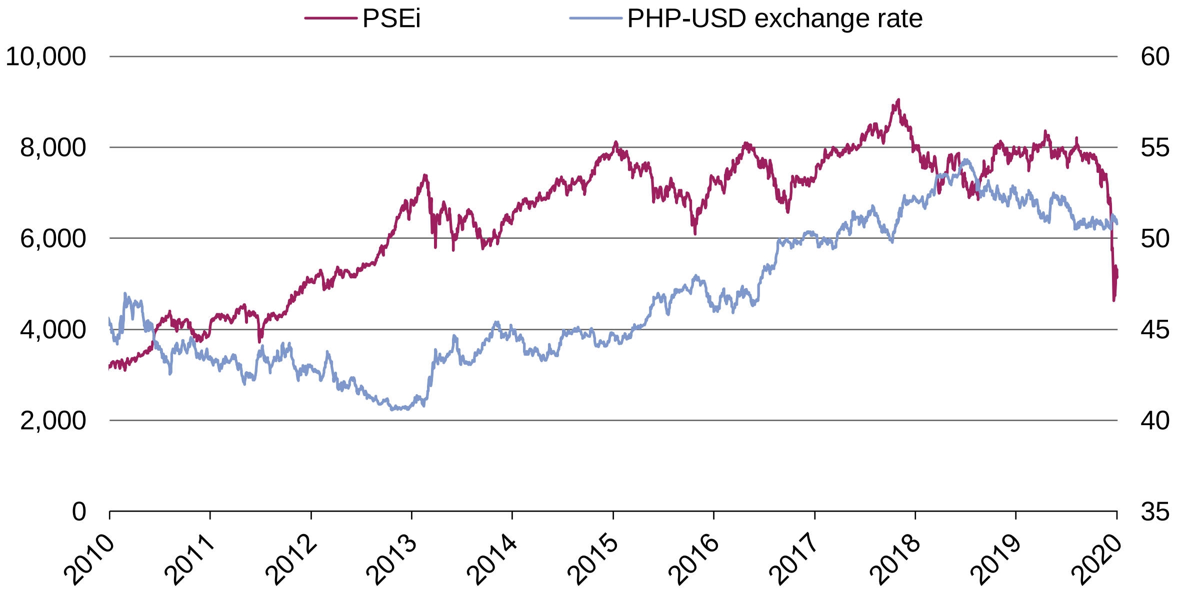
- The budget deficit has continuously increased since 2016 as the government boosted public spending.
- However, expectations see this deficit to grow as the government fuels spending to contain the pandemic.
- From 3.2% of GDP, the country's budget deficit may increase to 5% by the end of the year.
- Although this may be alarming, current economic conditions warrant these movements in fiscal policy.
- The key here is to gradually decrease spending when the overall situation improves in order to reduce the risk of high inflation.

Budget Deficit (2005-2021F)

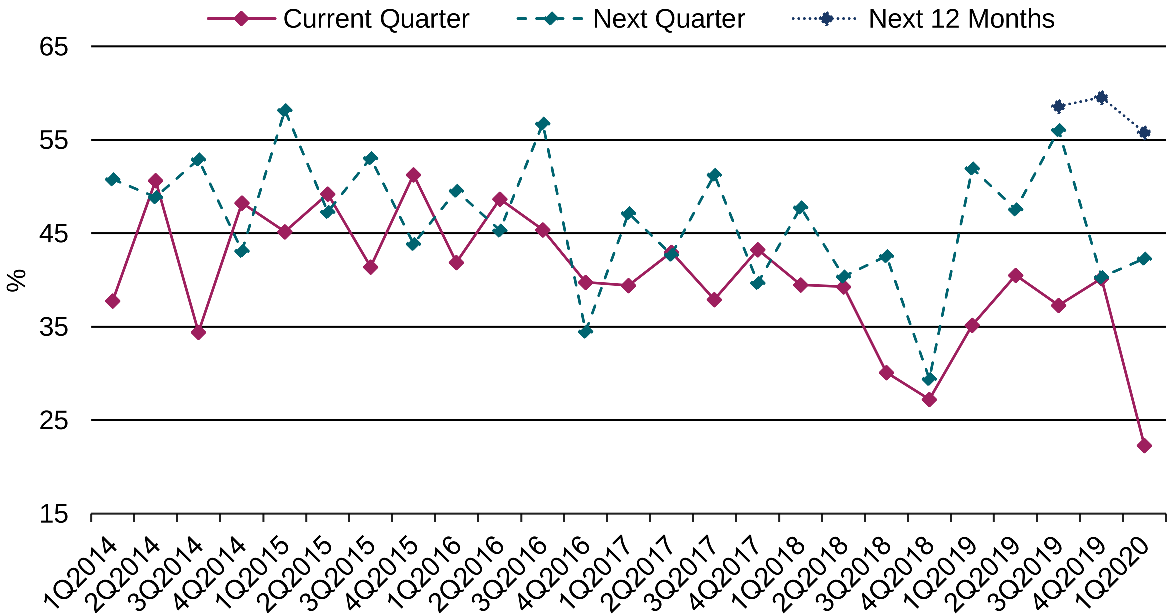


Economic contagion persists

PSE Index vs PHP-USD exchange rate (2010-2020)



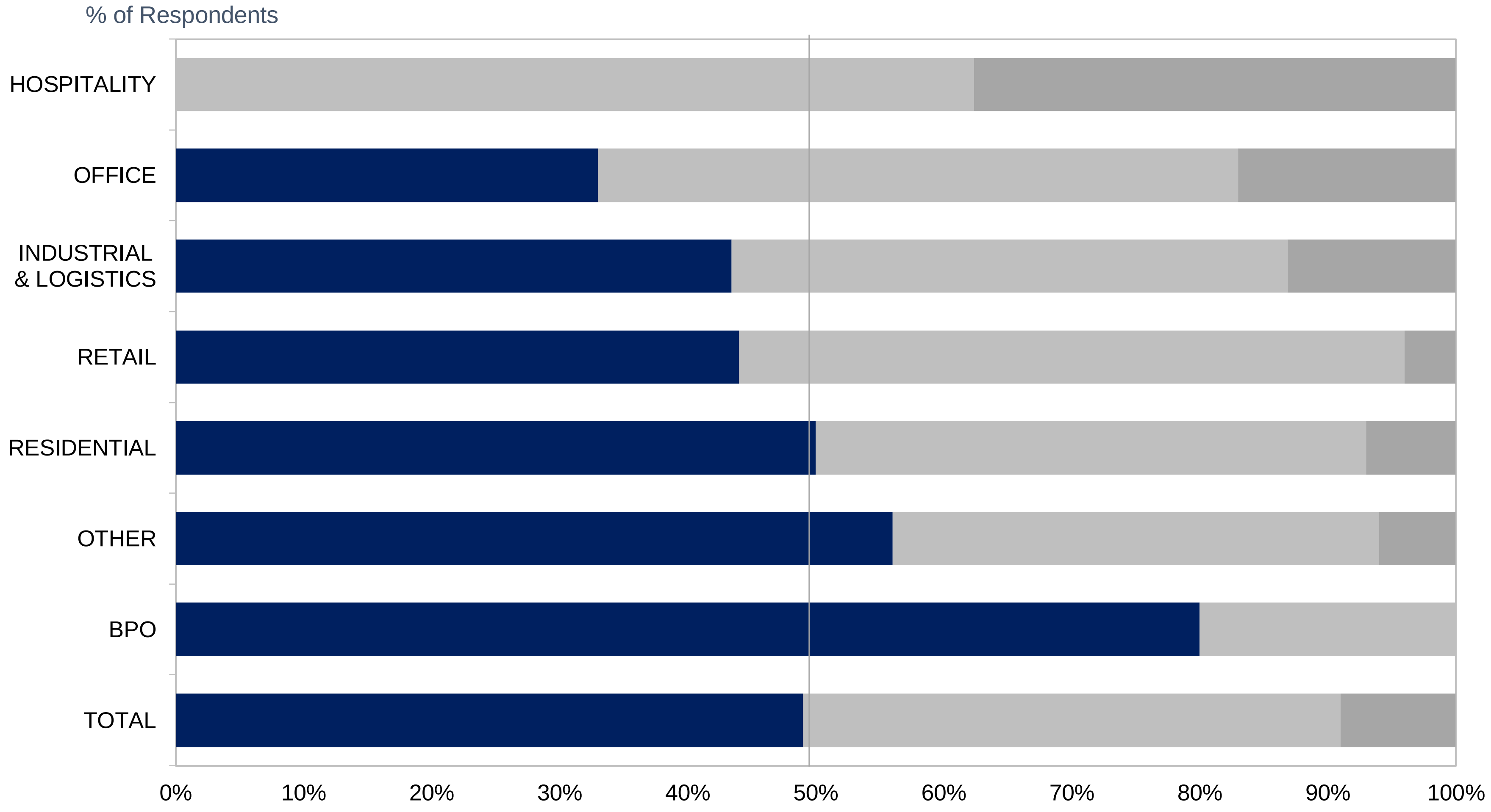
Business Confidence Index)



- The ongoing shocks to the supply and demand brought by the pandemic did not spare the financial and capital markets, as equity prices, oil and bond yields have fallen sharply.
- Although market reaction was naturally out of fear, the PSE index has dropped by 31.9% YTD. The BSP is already taking the necessary measures to calm markets. Meanwhile, the peso against the greenback remains resilient amid shifts in risk sentiment.
- Business Confidence Index plunged to 22.3% in 1Q/2020 as sentiment across all sectors (except construction) turned sour with businesses anticipating more uncertainties and materialization of substantial disruptions to economic activity.

Source: Philippine Stock Exchange, Bangko Sentral ng Piipinas

Business sentiment: Most industries are optimistic that recovery will be within 6 to 12 months; The hospitality sector is less optimistic due to cautious travelers and the emerging use of virtual platforms for meetings and events



Optimistic

The industry will bounce back within 2-3 months and will become strong or stronger than before

Unsure

The industry will be impacted for 6 months to 12 month or longer and will decline or flourish eventually

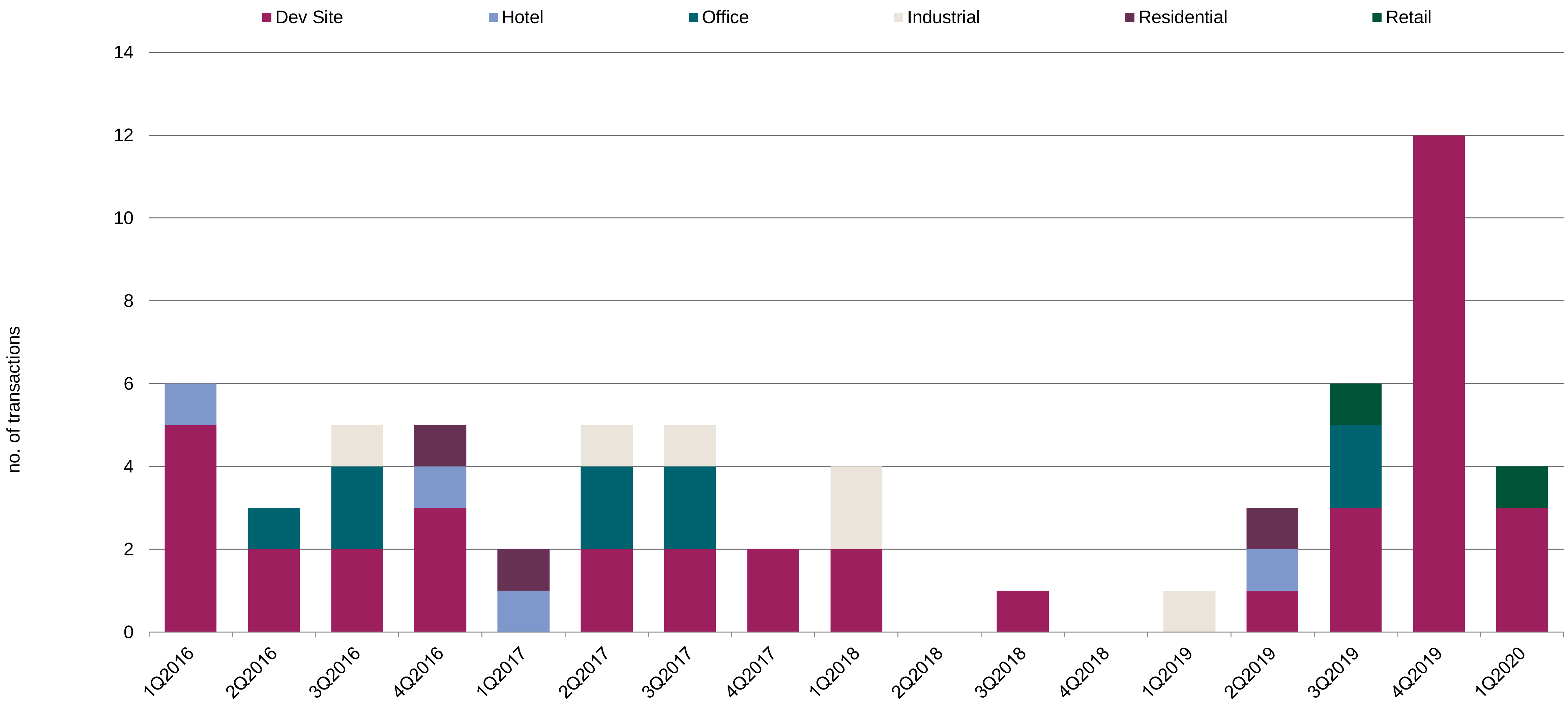
Pessimistic

The industry will be greatly affected and will have a long- lasting impact which may lead to regression or worse, recession

Total Respondents: 145
Respondents are developers, landlords, tenants, and employees from different industries
Survey Conducted From March 30, 2020 to April 3, 2020
Hospitality should be read with caution due to low base (8)
Total Sentiment is Unweighted
Questionnaire is patterned after Mckinsey's Consumer Optimism Survey

Source: KMC Savills Research

Transactions eased at the latter end of 1Q/2020



Office Sector

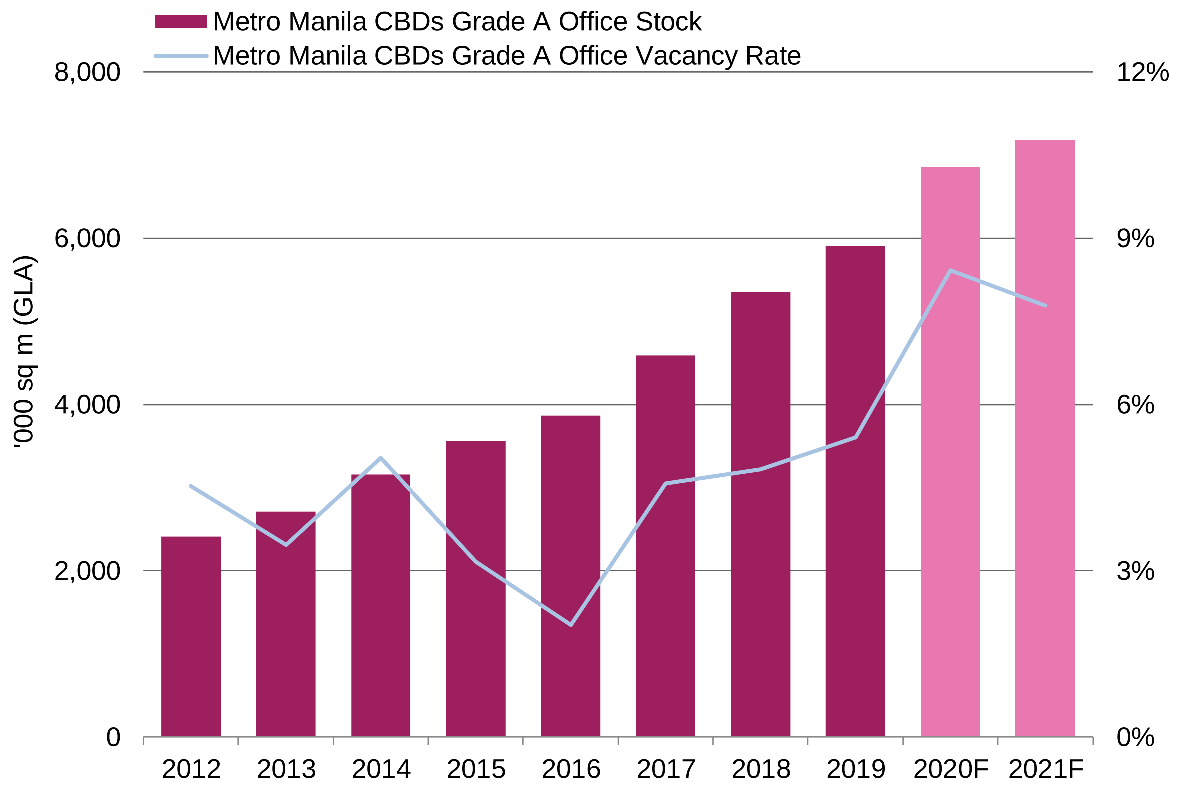
Uncertainties may lead to hedging structures in leases

▼ Impact

- The office sector should experience a demand disruption post-COVID as telecommuting (working from home) becomes the new norm.
- Cash management should be prioritized by traditional occupiers while they delve into rental abatement strategies and review business continuity policies.
- Landlords are preparing for possible cash shortfalls due to an anticipated increase in non-payments; landlords with exposure to short-term leases are worst affected.
- Flexible office providers face a higher risk with demand expected to drop and with possible contract pre-terminations.

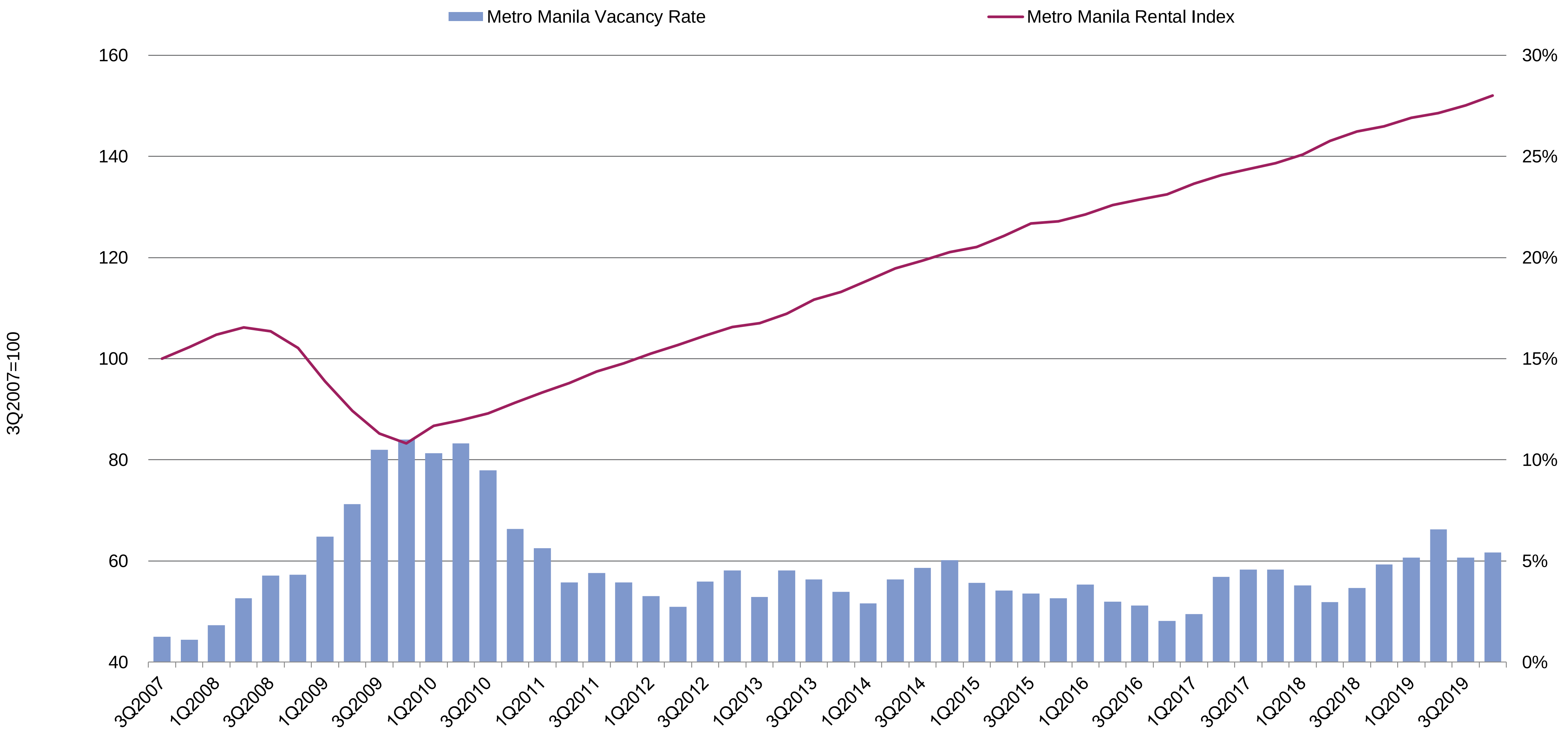
▼ Outlook

- Subdued demand and a potential rise in vacancies should place significant pressure on market pricing in the near term.
- Occupiers will likely reassess long-term leases and concessions in order to hedge against future downward pricing adjustments yet to be realized across the broader market.
- As occupiers come to terms with remote work, demand for office space may weaken in the long term.
- We should expect more companies to use flexible office solutions in the future as part of their business continuity plans (BCP)..



data as of 4Q/2019

Vacancy pressure on rents not yet on the horizon



Impact on Occupier Mindset

	Measures	Outlook
	Review **cost**, cash-flows and financial projections for the rest of the year. Follow global and local market forecasts closely.	✓ Pause in take-up until occupiers gain stability on finances and operations ✓ Lease structures will be further scrutinized and could result to different ways on how occupiers will negotiate corporate real estate requirements in the future ✓ More interest in provincial sites and new sites with proximity to residential areas with a rich labor pool
	Review and examination of **portfolio** across locations. Review vacancies, space utilization and design efficiency	✓ Potential lease disposal for affected businesses ✓ Shift to more flexible and shorter-term commitment ✓ Consolidation of old, fully depreciated facilities that can eliminate overlap of spaces in split locations ✓ Density, space design and workplace strategy will be examined closely
	Occupiers will review and incorporate **Work-From-Home Set-up** and **Remote Work Arrangement** in their BCP and employment policies.	✓ Such policies will be incorporated in customer and/or employment contracts ✓ More robust and cost efficient BCP strategies are more likely to secure approval for expansion and win client contracts (for O&O industry).
	Occupiers will look closely into the different **technology platforms** available in the workplace they occupy	✓ Rise of tech providers that can provide such solutions. ✓ Developers to be more conscious of adopting smart building features ✓ Focus on workspaces technology will not just revolve around security, connectivity and energy savings but also sanitation, air quality and no touch sensors
	Review of Occupiers' facility **occupational health and safety** policies.	✓ Upgrade in taking employee health and safety will be taken seriously and shall be top priority ✓ Requirement for LEED and WELL buildings to rise ✓ LEED and WELL compliant offices will rise ✓ Shift of facilities team strategy to be more health and people centric rather than space centric.

A more sophisticated Outlook on Business Continuity

	Overall effectivity of BCP requirements involve 5 main occupier considerations apart from location proximity		Overall effectivity of Work From Home Occupiers should address
	Infrastructure and Equipment ✓ Readiness to operate in case BCP is triggered ✓ Redundancy of power on site ✓ Information on location of power grids ✓ Infra provider track-record in the location		Availability of Technology Platforms that can track attendance and/or hours of work
	Connectivity ✓ Availability of telco providers ✓ Redundancy of risers ✓ Are servers connected to main sites		Clear KPIs, availability of technology and tools to measure employee productivity or output during WFH.
	Transportation ✓ Accessibility to talent pool through commute ✓ Full information of transportation availability to employees		Leadership training and accessibility to tools to keep teams engaged
	Housing ✓ Immediate housing options available ✓ Proximity to talent pool demographics of the occupier ✓ Availability of partners that can provide temporary housing		Platform and tools to mitigate any possible compromise on data security
	Food ✓ Availability of 24/7 food options ✓ Are they Affordable food options		Internet stability

Residential Sector

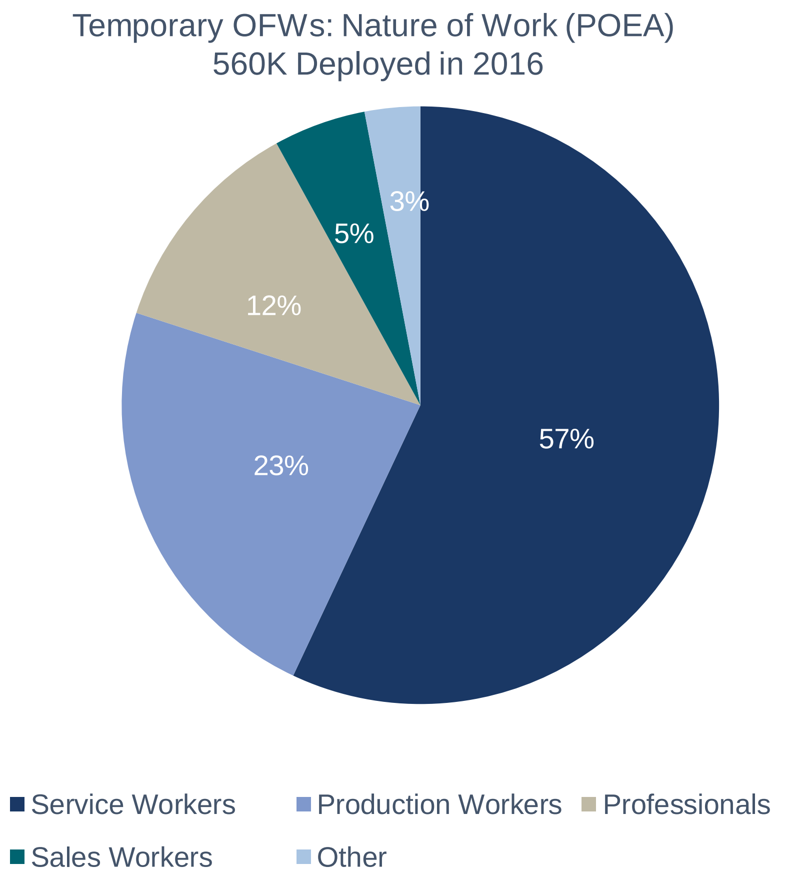
Fewer project launches as developers slash their capex and adjust their cash flow strategies

Impact

- Low transaction volume across the buyer spectrum (I.e. local and foreign investors, OFWs, end-user buyers), as most try to conserve cash and assess the situation.

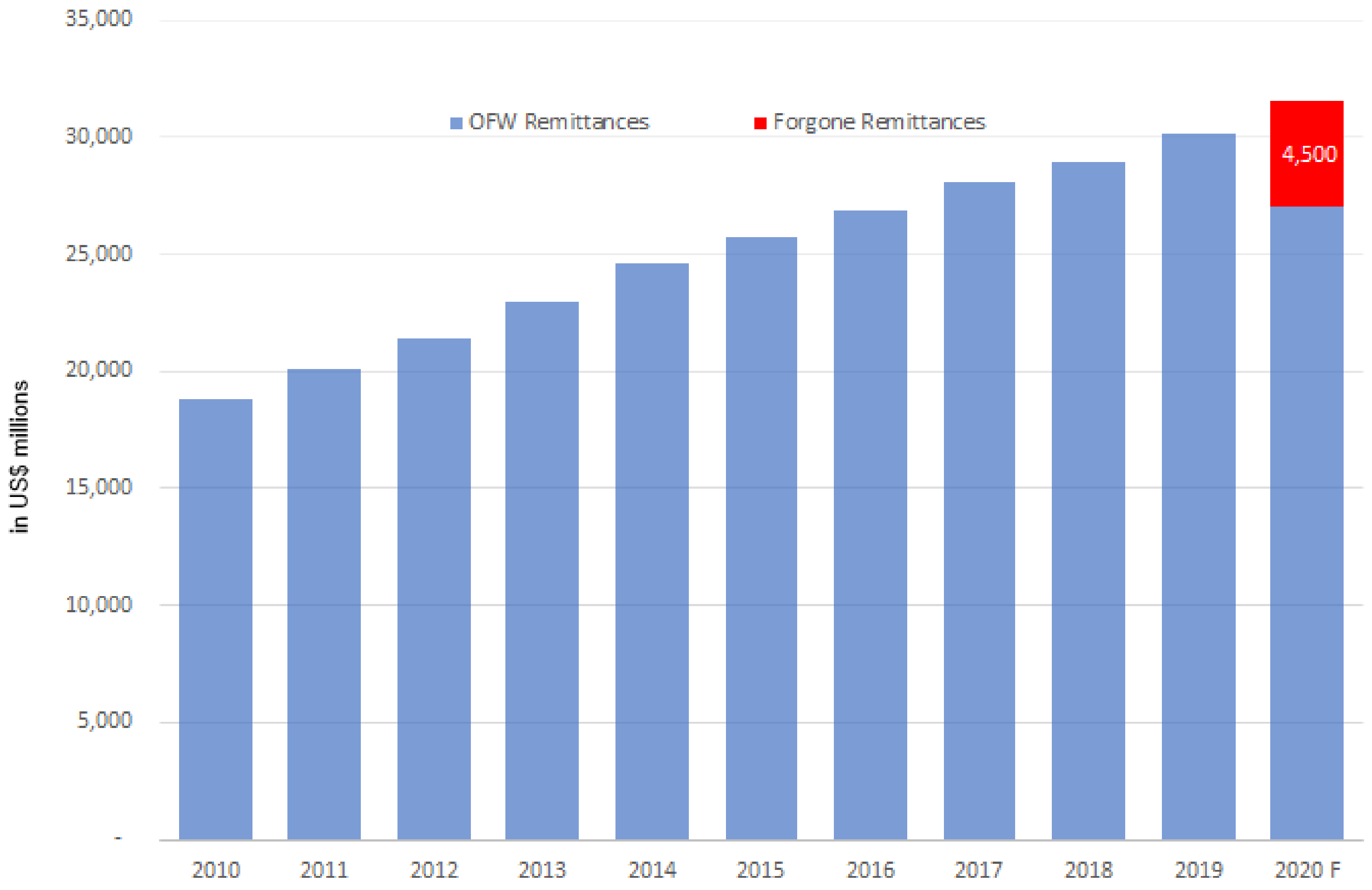
Outlook

- Fewer project launches as developers slash their capex and adjust their cash flow strategies.
- Delays in project construction due to supply chain bottlenecks (e.g. steel, glass) and lack of labor due to ECQ
- Income disruption from job losses may be largely felt in the low-income bracket. We expect this to result into receivable losses in the socialized and economic housing segments.
- The mid-market segment may still have a steady stream of cash from receivables during this period, and sales is expected to be sustained post-COVID.
- We expect high-end and luxury buyers to be opportunistic during this period as they observe any price changes in the secondary market. On the flip side, if owner cash positions are threatened, assets may be liquidated.
- Businesses will evolve to capitalize on technology, e.g, virtual tour and online payment platforms, to ensure business continuity and mitigate the impact of the pandemic stigma.
- Slower take-up from the OFW market due to job losses and uncertainties abroad.



- Temporary or Contractual OFWs working in the service sector such as hotel receptionist, food service attendant, and housekeeping attendant have higher risks of being laid off.

OFW remittances, a driver of residential demand, might lose $4.5B but will see an upside in the demand for healthcare workers



- ACTS-OFW Coalition of Organizations estimates that the national government stands to lose $4.5B in remittances under a "best-case scenario"
- While there were lay-offs in tourism, travel, hotel, accommodation, and retail, one possible upside is the deployment of more OFWs working in essential sectors like healthcare.

Source: BSP, Philippine Star

Retail Sector

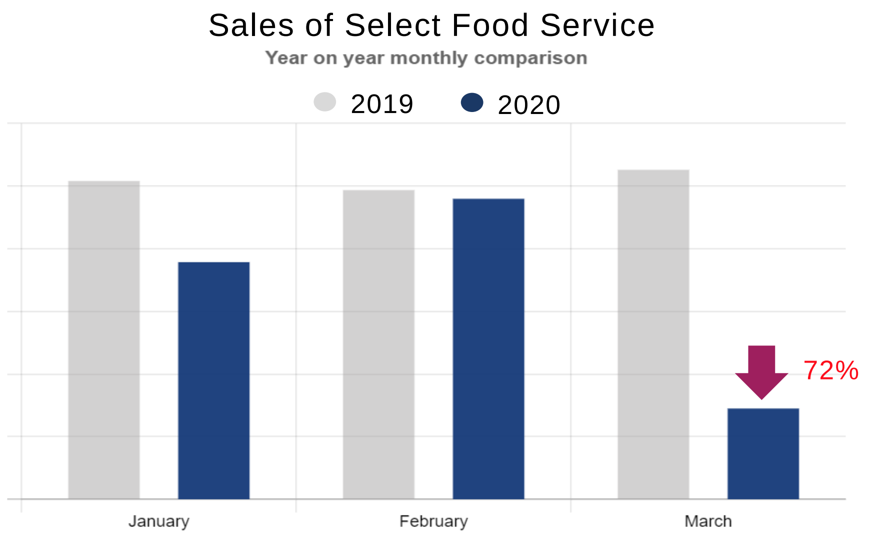
Retailers will fast track e-commerce platforms to continue operating amidst the outbreak while minimizing losses

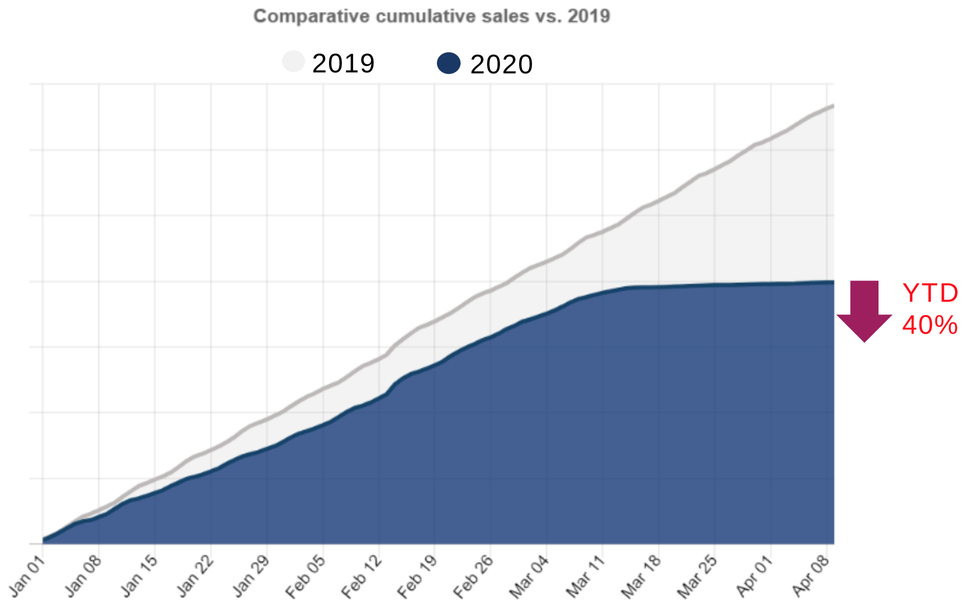
Impact

- Grocers experienced waves of stockpiling and hoarding of daily essentials, especially long shelf-life items, and hygiene products while discretionary spending was deprioritized
- Grocers experienced insufficient shelf inventory due to mass buying
- Food Service suffered a rapid slowdown, with sales down by 72% in March versus the same period last year, as people observed social distancing measure to minimize risk of infection.
- Retailers could experience low cash-flow due to reduced demand; non-essential goods retailers may seek rent reliefs from landlords
- Essential goods retailers with the infrastructure to respond to online orders and home delivery are beneficiaries of social distancing
- Due to fear and long service time in the stores, online channels experienced high volume of transactions causing longer lead time or delays in delivery

Outlook

- Retailers will fast track implementation of e-commerce platforms to minimize impact of the disruption caused by the pandemic – threatening mall developers in the long-term.
- Some retailers may continue to experience critically-low inventory levels post-COVID because of the disruption of the entire value chain.
- Given this, they will require a stronger relationship with suppliers and may even consider alternative sources





Hospitality Sector

Slow recovery seen in the hospitality industry due to weakened demand for travel

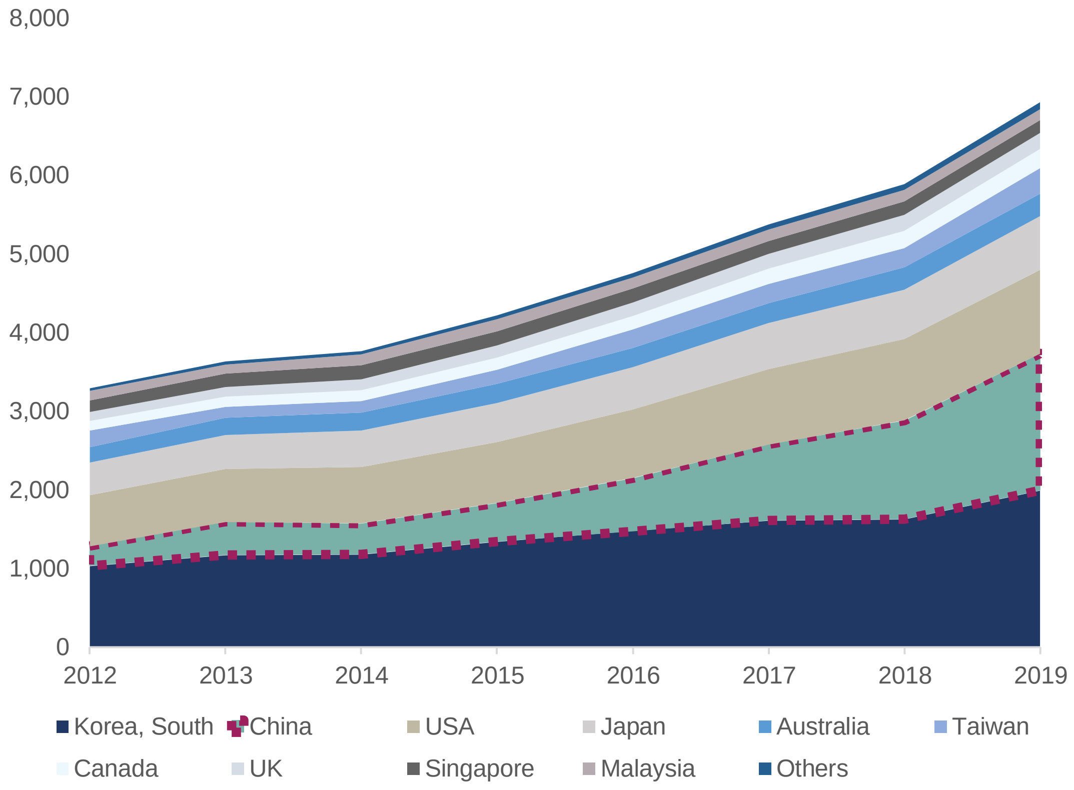
Impact

- As of February 2020, hotel and resort occupancy rates in the country's top-visited destinations experience massive drops – by 40% in Boracay, by 27% in Cebu, and by 40% in Bohol
- Prior the quarantine, hotels and resorts started lowering published room rates by as much as 70%
- The International Air Transport Association (IATA) estimates a 36% reduction in passenger demand for 2020 equivalent to $3.5B loss among carriers (if restrictions are lifted after 3 months)

Outlook

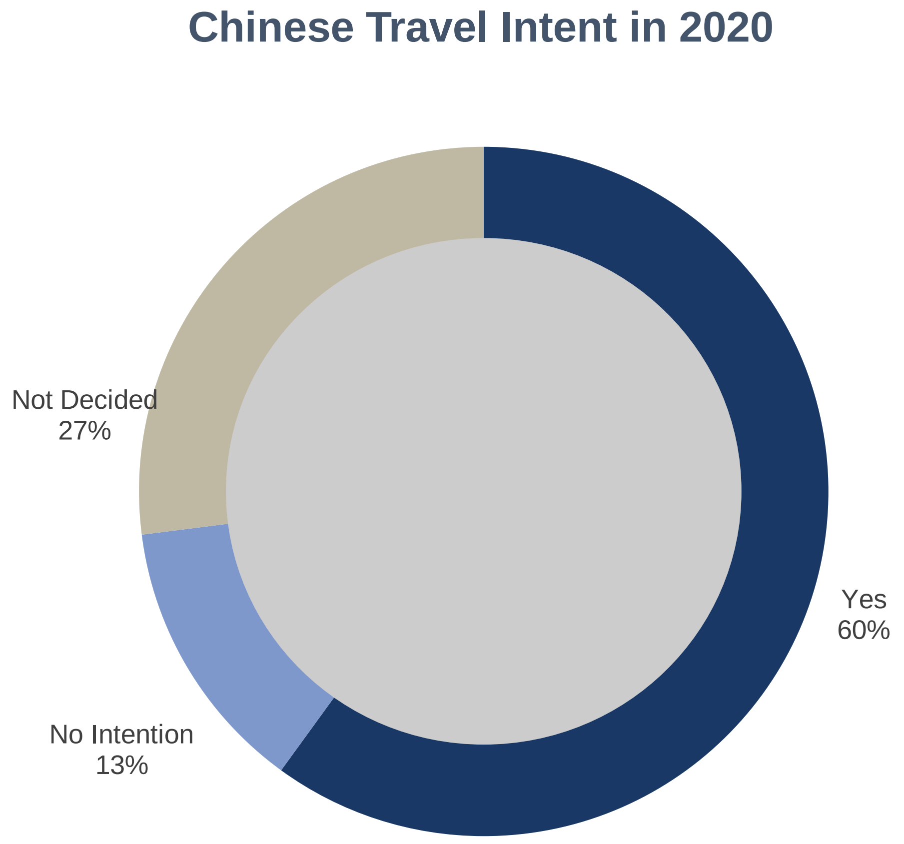
- Large hotels which tend to host conventions are forecasted to slowly recover due to limited meetings and events as businesses shift to virtual platforms.
- Air travel demand post-COVID will be weakened with the impact of a global recession on jobs and confidence.
- Domestic tourism likely to recover first on pent-up demand and people going back to their hometowns to spend the holidays by year end.

International Tourist Arrivals in PH (in thousands)



Tourism was 12.7% of GDP in 2018;
Chinese tourists grew 39% in 2019

Post-COVID overseas travel intent among Chinese is deterred by health, safety, and discrimination issues



Factors Deterring Travel Intent

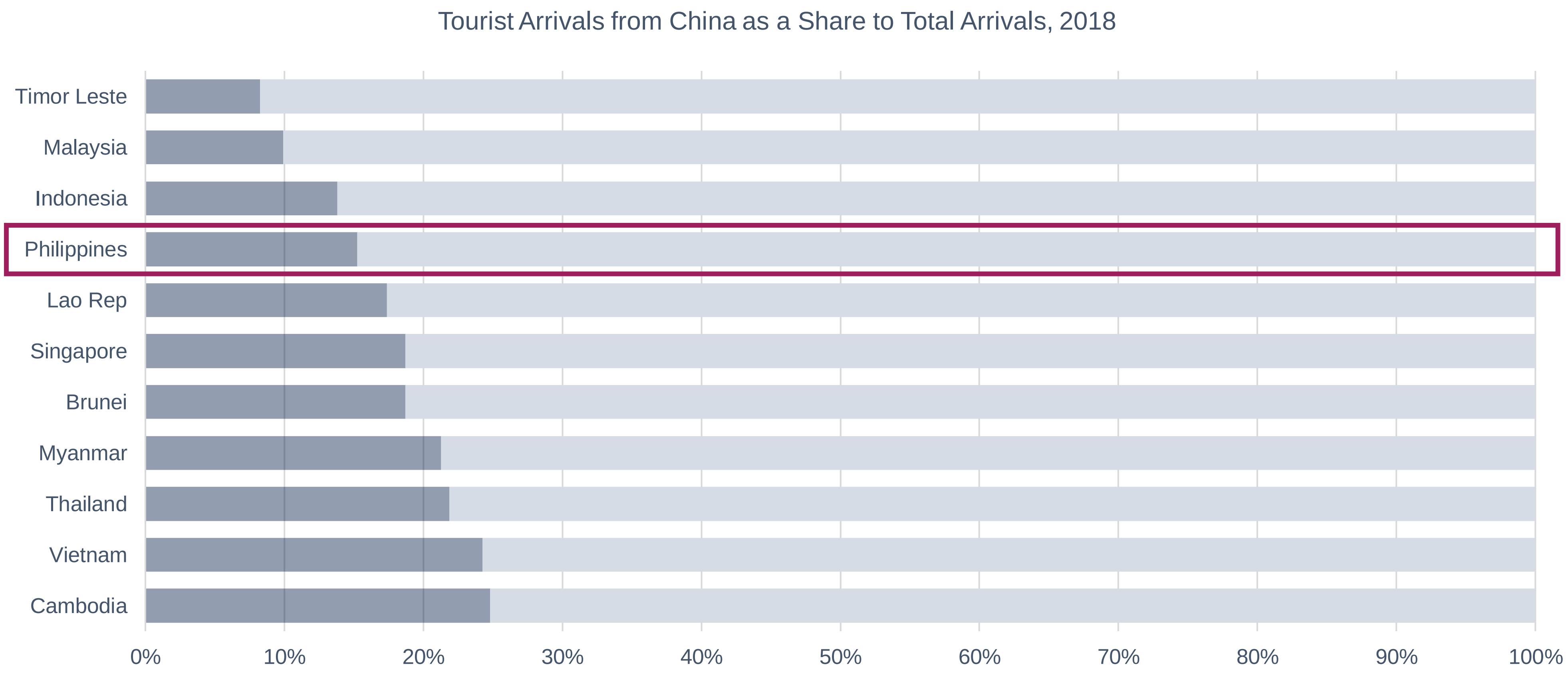
%	Factors
67%	Worries about health and safety issues, better wait and see
44%	Worry that the epidemic will spread again
32%	May have less income this year, saving money
29%	Worries about discrimination against Chinese tourist due to the epidemic

Preference on Destinations

%	Destination
56%	Travel to other domestic cities or scenic places
45%	Travel overseas
22%	Travel around the place of residence
15%	Not decided

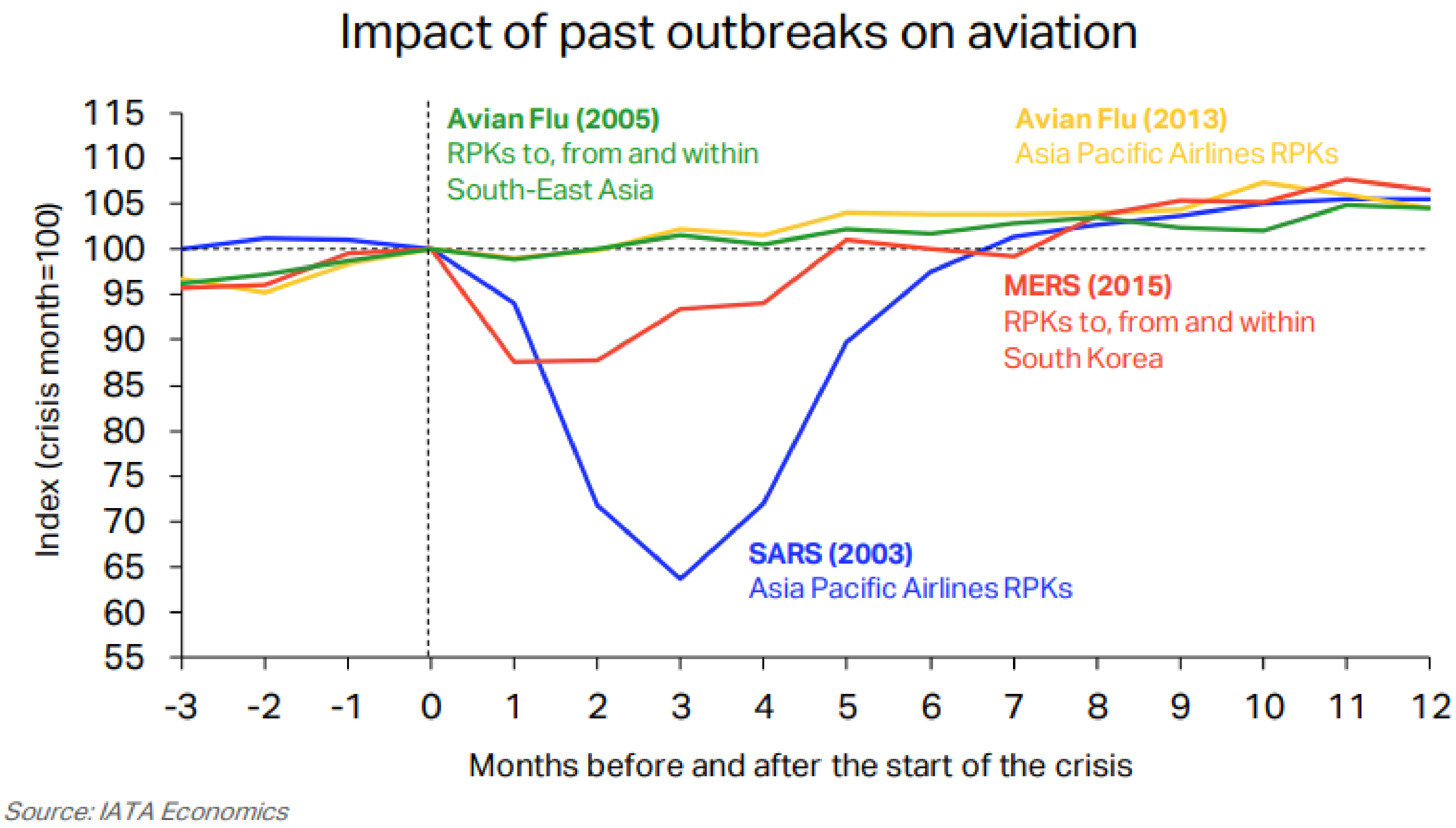
Source: *Survey Report on Chinese Tourists' Travel Intent After The End of Covid-19 epidemic (Alliance, Ivy Aliiance, CCT, PATA)*

The Philippine tourism exposure to China is relatively small compared to other ASEAN countries



Source: ADB: The Economic Impact of the Covid-19 Outbreak on Developing Asia

The far-reaching impact of COVID will set the recovery of the hospitality sector beyond what was experienced in past outbreaks



Previous disease outbreaks have peaked after 1-3 months and recovered pre-outbreak levels in 6-7 months.

Industrial and Logistics Sector

Manufacturing companies will look for alternative sources other than China

Impact

- Manufacturing in emerging markets rapidly slowed down reflecting drops both in external and domestic demand.
- International shipping lines cut the number of seaborne vessels disrupting the global supply chain.
- Skeletal staffing slowed down the process resulting to slow pull out and cargo congestion

Outlook

- Given the disruption of the global supply chain, we expect a concerted effort to relocate most manufacturing capacity outside of China. We believe this could benefit the ASEAN nations – including the Philippines.
- If the country transitions to a Modified Community Quarantine (MCQ), the logistics sector may have a head start to recovery. We also expect more demand for third party logistics as retailers explore e-commerce platforms.
- There will be massive shift in labor requirement. While Hospitality will have cuts and restructuring, Logistics will be needing more manpower to address significant movement of goods post-COVID and retailers exploring e-commerce platforms.

Purchasing Managers Index (PMI)

Source: Haver Analytics

PMI is a lead measure of demand. An index of >50% means increase in output which reflects growing demand, while an index of <50 means that there is declining demand.

Outlook

What's next?

The question remains in the real estate sector: will this drastic change in business and consumer behavior stabilize once we flatten the curve, or is this our new normal?

Work from home mode

Office Sector

- Adoption of telecommute policies could likely reduce office space demand in the long run
- O&O sector may still come on top. Cost-savings will become key business priorities
- BCP is expected to fuel the demand of flexible office, and this segment may become a predominant occupier in the years post-COVID-19.

Shoppers buying online

Retail Sector

- Quicker shift to e-commerce from traditional brick and mortar stores
- Mall developers may address the rise of e-commerce by adjusting their tenant mix to compensate for the loss of foot traffic from merchants affected
- Food and beverage should stay as a key component in that mix but expect changes on how these merchants are positioned throughout the mall

From physical to digital

Hospitality Sector

- We expect tourism activity to start later next year when the government adopts looser travel restrictions
- The heightened awareness of social interaction will lead to changes in the frequency and nature of both physical and digital interactions
- Business travel may be hit substantially. As such, business trips may be unnecessarily scrutinized if firms have invested heavily on their digital infrastructure.

Disruption in operations

Industrial Sector

- Transitioning to a Modified Community Quarantine (MCQ) may give the logistics sector a head start as new policies are introduced to jumpstart the supply chain
- With the pandemic exposing the vulnerability of the global supply chain's dependence to China, some countries grant incentives to relocate their production outside of China

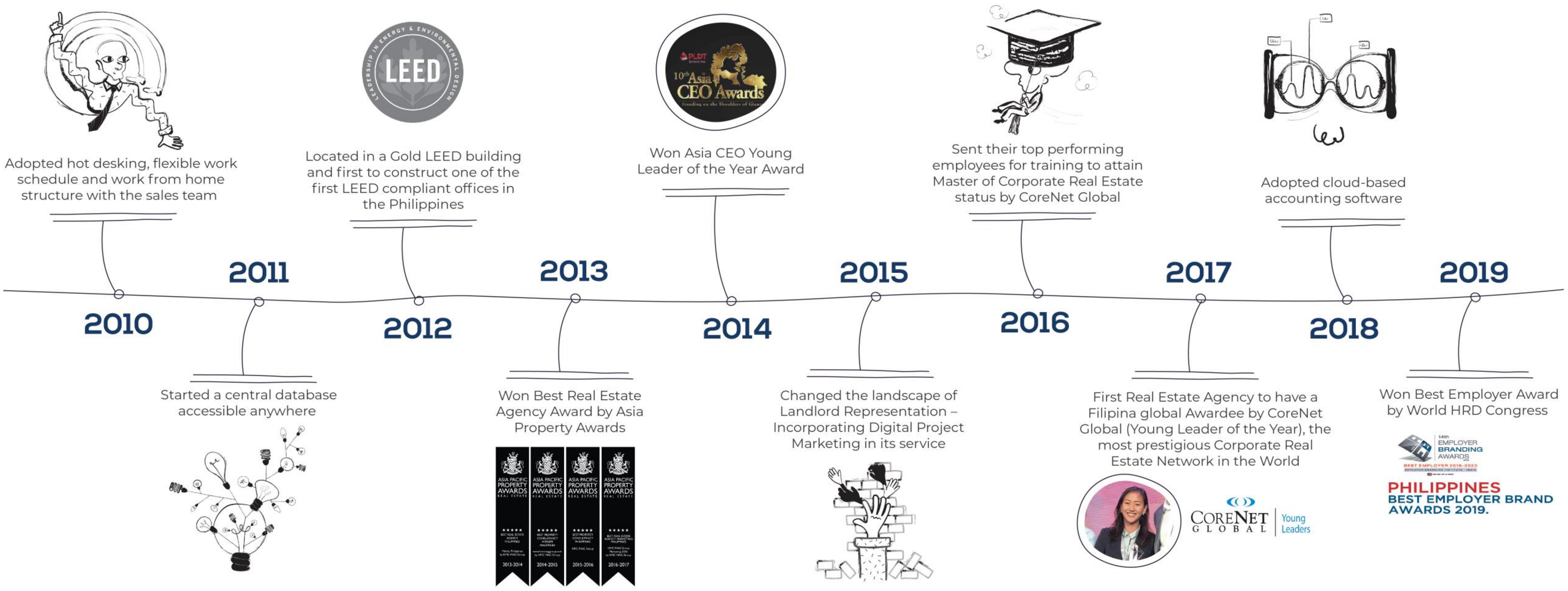
Slower launches and pre-selling

Residential Sector

- Tenants and end-user buyers may prefer residential project which have larger unit sizes and lower unit densities per floor
- Our key concern is in the Economic and Low-End segments wherein buyers' incomes are more susceptible to economic disruption
- Once the pandemic hits the real economy, demand for new residential projects may diminish as unemployment rises and wage growth falters
- We do not discount the possibility that prices may correct itself after a prolonged ECQ. It is also possible that prices will begin correcting themselves once an MCQ takes place as owners reassess their cash position

We practice what we preach – KMC Milestones over the years

KMC has been a pivotal force in the Philippines for more than a decade now as we continue to build forward-looking initiatives and innovations in the real estate industry.



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