JONES LANG LASALLE

Real value in a changing world

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Americas Research

Panama

Office Report

Mid-Year 2013

Economic Outlook

Panama experienced a slowdown in GDP from year-end 2012 of 10.1% to 7.7% by mid-year 2013. This was due primarily to a decrease in containerized cargo passing through the Panama Canal, as well as to issues with the Colón Free Trade Zone's two main customers, Venezuela and Colombia. Venezuelan businesses have amassed ~US $900 million in debt to Colón FTZ businesses, an amount that is difficult to export due to Venezuela's capital controls. Colombia also recently upped its import tariffs on Colón FTZ goods, particularly textiles, prompting Panama to file a dispute with the WTO. Negotiations with both countries are currently underway. A slowdown in cargo passage could be attributed to a general decrease in global demand, particularly from developed countries for the time being.

Inflation decreased to 4.9% from 5.7% six months ago, due to lower-than-expected inflationary pressures. However, that figure is still considered high by local standards. A reduction in transportation costs along the food chain, as well as three recently signed FTA's with the US, EU, and Canada, should help a bit; however, the bilateral trade gains of the agreements are still yet to be fully understood.

With the 2014 elections nearing, President Martinelli's government is focused heavily on speeding up the country's multitude of public works projects. These include the Panama Canal expansion, the Metro transit system, roads and bridges, power generation and sanitation facilities, the airport expansion, and more. A recently proposed USD $40+ billion Super Post-Panamax Nicaragua Canal raises important questions about how Panama should position its Canal to remain competitive in the long run. Both the pending US Foreign Trade Compliance Act (FATCA) and also calls to eliminate anonymous bearer shares in Panamanian companies threaten Panama's reputation as a safe haven for international capital.

Economic Data	
Country Population (Millions)	3.56
Panama City Population (Thousands)	880
Unemployment Rate (%)	4.2%
GDP (US$ B)	41.6
GDP Growth Rate (forecasted)	7.7%
GDP per capita (US$) – PPP	10,775
Annual Inflation (%)	4.9%
Source: IHS Global Insight (2013)	

Challenges persist, but significant opportunities also abound in Panama. The logistics lobby continues to support the repositioning of Panama as a global logistics hub at the crossroads of world trade. At least three new ports are planned as well as an expansion of Tocumen International Airport. SEM Law No. 41, which grants special tax and immigration incentives to multinational companies, has already attracted over 90 corporations to Panama, with more on the way. Oil was recently discovered in the Darien and the government plans to award concessions for its exploration by the end of 2013. The mining industry is seeking to exploit significant copper and gold deposits; the Cobre Panama mine contains the world's second-largest copper reserve. Significant opposition to these projects exists, especially from local indigenous groups and increasingly from the general population.

Panama's GDP per capita is high by regional standards, but the country also ranks second in Latin America in terms of income inequality. Education availability and quality and access to social services remain concerns, as well as a lack of professional, skilled labor. Indigenous groups are particularly affected by a lack of access to these services as well as recent infrastructure and tourism projects in the interior of the country. Crime remains low, however, and Operation Martillo – a counter-narcotics initiative by the US and Panamanian governments - is currently being conducted. Another area of concern is money laundering. Global Financial Integrity, an international non-profit advocacy group aimed at curtailing international financial flows, estimated that the movement of illicit capital may account for more than 10% of Panama's GDP. Solutions to infrastructure development issues, upgrades to information technology across all sectors, bureaucratic red tape, and official corruption are needed if Panama is to continue its positive narrative of economic transformation.

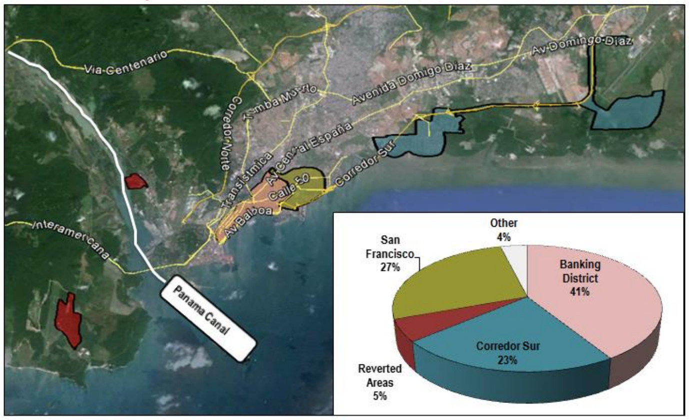
Market Summary

Panama is in the midst of an unprecedented office construction boom. Approximately 220,000 m^2 of office space will be delivered in 2013, followed by 150,000 m^2 in 2014 and 230,000 m^2 in 2015. About 41% of prime office stock today can be found in the Banking District. San Francisco boasts 27% of the stock, Corredor Sur – which includes everything East of San Francisco - has 23%, and the Reverted Areas have 5%. Over the next couple of years, the majority of development will be concentrated in the Banking District (about 270,000 m^2 of production), and Corredor Sur (about 120,000 m^2).

Author's Note: As JLL continues to improve its market tracking capacity, we have made some improvements in our methodology. This has resulted in vastly different estimates for vacancy and absorption from our previous reports. Please also note that we have consolidated "Obarrio" and "Avenida Balboa" into the submarket of "Banking District," and "Panama Pacifico" is now included as part of the "Reverted Areas," to allow for a broader classification of buildings located near the Panama Canal.

The potential for high vacancy and a drop in absorption over the next few years should place downward pressure on rents, providing tenants with added leverage in negotiations. Office seekers can expect monthly rental rates between USD$ 21 - 26/m²/month for Class A space and between USD$ 14 – 25/m²/month for Class AB space. Sale prices are between USD$ 1,800 – 3,600/m² for Class A space and USD$ 1,000 – 3,600/m² for Class AB space, depending on submarket.

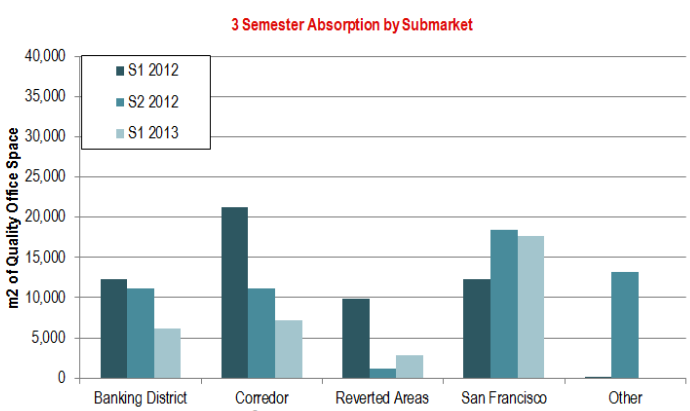
Panama City Location Map



Demand

Demand in Panama for Class A and AB office space is driven by a diversified and professional services-oriented economy. According to the Panamanian government's Minister of Economy and Finance, ~25% of economic activity in the country can be attributed to Transportation and Communications, ~15% to Property and Professional Services, ~13% to Import/Export, and ~9% to Banking. Panama's largest users of prime office space are the banking industry - which is mostly situated in the Banking District - and other multinational corporations, which tend to be drawn to Costa del Este (a subsector of Corredor Sur) and the Reverted Areas.

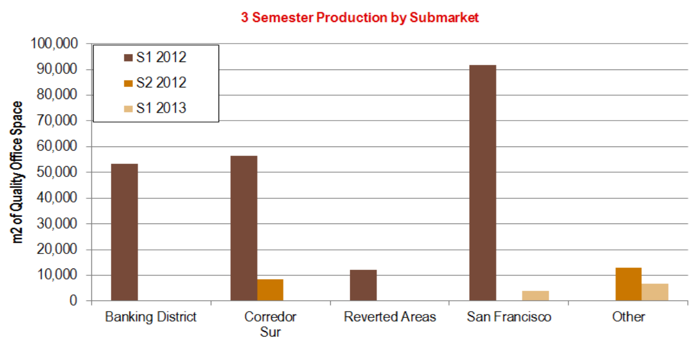
Office demand has remained far below production over the past year. Net absorption was highest in 2013 in San Francisco, while in 2012 the most active submarkets were the Banking District and Corredor Sur. Overall absorption in 2012 in Panama City barely topped 100,000 m², yet production in 2012 stood at nearly 235,000 m². In 2013, absorption is projected to more than double, to about 200,000 m², yet production should still top out at more than 220,000 m².



Panama's growth prospects remain strong, and should be buoyed in the next few years by the Canal expansion and major public infrastructure projects. Proinvex, an agency established by the Ministry of Commerce and Industries (MICI) to attract foreign investment and promote local exports, projects that more multinationals will move to Panama over the next few years, which will support office demand.

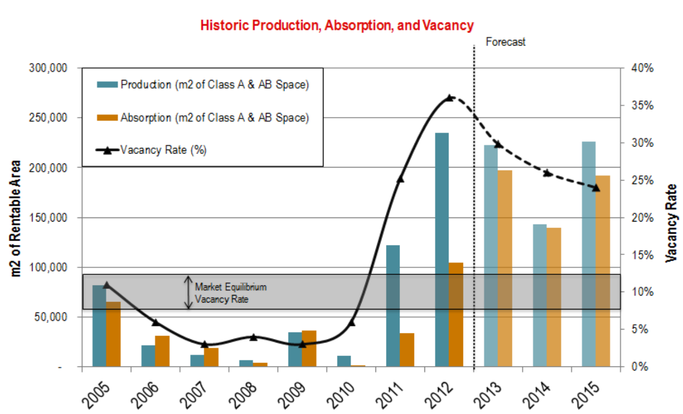
Supply

The first half of 2013 saw less than 10,000 m² of prime office product enter the market, although this number is projected to rise to 220,000 m² by the end of the year. The reason for this is that several office projects have a Q3 or Q4 2013 target completion date. In 2012, the majority of the 235,000 m² of production occurred in San Francisco, followed by Corredor Sur and the Banking District. Approximately 600,000 m² of production will arrive to the market over the next three years, an amount that is nearly double the production Panama experienced over the past three years.



Vacancy

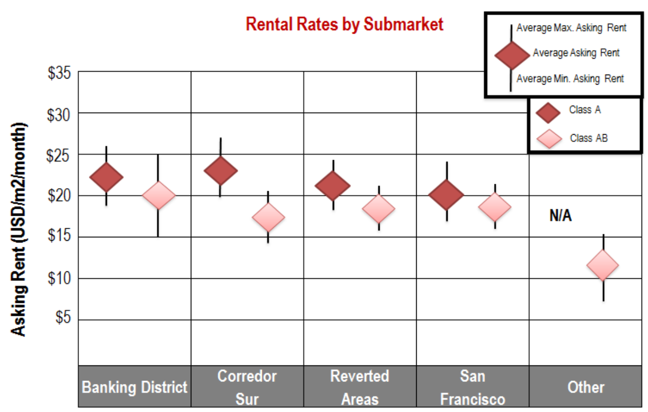
We project that vacancy could lower a bit from 30% this year to 25% by 2015; however, this would be predicated on the market's ability to absorb the historic boom in supply. San Francisco leads Class A submarket vacancy at around 47%. This is followed by the Banking District at 43%, the Reverted Areas at 27%, and Corredor Sur at 25%. Corredor Sur is showing the highest vacancy rate for Class AB, at around 36%. The Banking District follows this at 24%, the Reverted Areas at 17%, and San Francisco at 14%. This shows that higher vacancy in the market exists for new Class A than for older Class AB offices.



The question on everyone's mind seems to be how the recent international pressures on Panama will affect the local economy. Which multinationals will expand their operations in Panama, who will be the new arrivals, and how many of them will come? Also, how will the opening of the Panama Canal's Third Set of Locks in 2015 impact the office market?

Rental Rates

Asking rates for new Class A commercial office space are highest in Corredor Sur, with an average of USD $23/m²/month. This can be explained by Costa del Este's particular appeal to multinational companies, as well as to a glut of new Class A buildings that is keeping prices stagnant. The average asking rate for Class A in the Banking District is ~$22/m²/month.. In the Reverted Areas, new Class A space in Panama Pacifico is being offered competitively at around $21/m²/month. The Panama Pacifico development has also positioned itself as a particularly attractive hub for multinationals, owing to its Special Economic Zone status and master-planned community amenities.



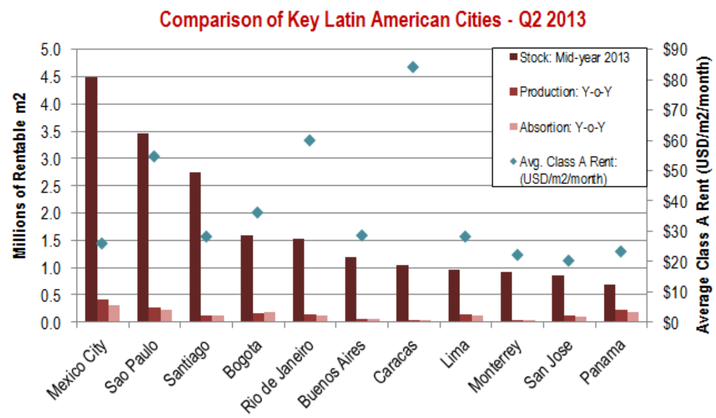
Office Market Statistics

	YE 2012	YE 2013 (Estimated)	Trend (next 12 months)
Class A Rent (US$ /m² /mo.)	22-30	18-26	↘
Class AB Rent (US$ /m² /mo.)	16-25	14-25	↘
Service Charges (US$ /m² /mo.)	2-3	2-3	→
Total Costs Class A (US$ /m² /mo.)	24-33	20-29	↘
Total Costs Class AB (US$ /m² /mo.)	18-28	16-28	↘
Stock (m²)	687,000	880,000	↗
Vacancy Rate (%)	34%	30%	↘
Production (m²)	235,000*	220,000**	↘
Absorption (m²)	120,000*	200,000**	↗
Future Stock (Q4 2015)	86 Buildings	1.3 million m²	↗

***2012 Total**
****2013 Annual Forecast**
Source: Jones Lang LaSalle research (2013)

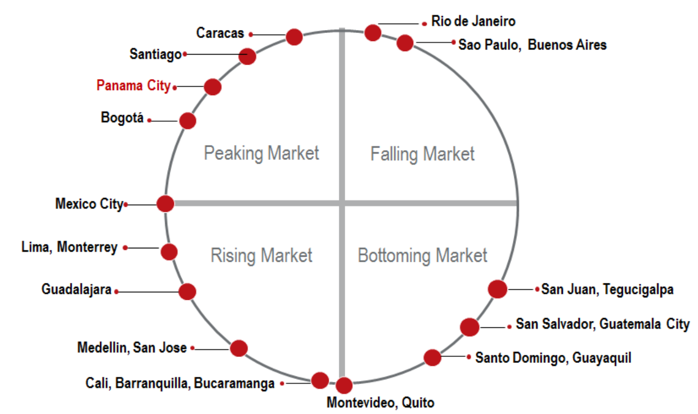
Market Outlook

Panama is expected to continue its pattern of strong economic growth in the coming years. This month, the S&P reaffirmed its BBB long-term credit rating for Panama. The announcement cited a rosy outlook for Panamanian growth prospects, particularly owing to the government's dedication to investment. This, however, is balanced by what the ratings agency described as, "a small, open economy that is vulnerable to swings in global economic conditions, underdeveloped but growing capital market, and developing political institutions."



Office Market Clock: Latin America

This indicator is elaborated by Jones Lang LaSalle, and allows markets to be classified according to their positions in the rent cycle.



Panama is positioned just at 10:30, categorizing it firmly as a peaking market. Government spending on infrastructure and increased economic diversification should keep office demand high in the short-term. However, with so much new supply in the market, it is likely that prices will stagnate or fall in the medium-term, and keep the market firmly in tenant-favorable territory for the foreseeable future.

Typical Leasing Practices

Standard Unit of Measurement	
Unit of Measurement	Square Meters (m^2)

Lease Contracts	
Rent	Quoted in US$/m²/Month
Typical Lease Term	3-5 years
Frequency of Rent Payment	Monthly
Rental Deposit	Case-by-case, insurance policy covering the contract is typical
Security of Tenure	Only for the duration of the tenancy, no guarantee beyond the original lease term
Statutory Right to Renew	No (unless an option to renew is agreed at the outset and specified in the lease)
Basis of Rent Increases or Rent Review	Case-by-case basis, CPI (Typically indexed as a percentage of local CPI, but this can vary)
Frequency of Rent Increases or Rent Review	Depends on contract

Transaction Fees	
Agency Fees	2 months rent
Agency Fees (payable by Landlord / Tenant)	Landlord/Tenant
Legal Fees (payable by Landlord / Tenant)	Each part responsible for its own legal costs

Incentives	
Rent Free Period	Case-by-case basis, 1-3 months

The rent free period is not standardized in the local market, however typically occurs. The length of this period is negotiated between the parties and is also a factor of how much (if any) tenant improvement allowance is provided.

Service Charges, Repairs and Insurance	
Service Charges/Managements Fees	Additional to the rental charge and payable monthly in advance
Utilities (Sometimes separately metered, sometimes paid as a percentage of occupation)	Electricity, telephone, AC, etc. paid by tenant according to consumption
Car Parking	1 space per 50 m² included in the lease contract; newer class A buildings will offer more spaces for additional fee
Internal (Tenant Space)	Tenant
Common Areas (reception, lift, stairs, etc.)	Landlord (charged back via service charge)
External / Structural	Landlord
Building Insurance	Landlord

Taxes	
Building Insurance	50% / 50%
Local Property Taxes	Landlord, annually
VAT on Rent & Service Charge (Payable by Tenant)	7% (ITBMS)

Disposal of Leases	
Sub-Letting & Assignment	Normally yes (subject to landlord approval)
Early Termination	Unless otherwise stipulated in the rental contract, tenant is responsible for paying the entirety of the contractual obligation
Tenant's Building Reinstatement Responsibilities at Lease End	Original condition, allowing for normal wear and tear.

Purchasing Properties	
Foreign Ownership	No restrictions
Strata Title (Partial ownership of the building)	Strata title ownership is quite common
Security Deposit	Equal to 1 month of rent (last month of contract) payable to Panama Ministry of Housing (MIVI). Required by law.
Agency Fees	3% - 5% of the sale value paid by seller and split between the two brokers
Legal Fees	Each part responsible for its own legal costs
Stamp Duty	50% / 50% 0.1% of sale price
Other Transaction Costs	Property Sales Tax of 5%

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