COLLIERS OUTLOOK

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INDIA MARKET OUTLOOK 2021

Year of Consolidation for Occupiers and Investors

Insights and Recommendations

COVID-19 will likely continue to influence India's economy at the start of 2021. We expect a gradual recovery of demand from H2 2021, backed by an improving economy and the rollout of the COVID-19 vaccines in H2.

> **Office**: In 2021 occupiers should enter flexible leases to allow them to operate in a hybrid work-from-home model and keep their capital expenditure low.

> **Industrial**: Electronics & hardware, pharmaceuticals & medical equipment, textiles, and auto industries will drive demand for manufacturing facilities.

> **Logistics**: E-commerce, third-party logistics groups (3PLs) and cold storage operators will make up the bulk of demand.

> **Investment**: Investors should buy in 2021, before prices rebound from 2022 onwards.

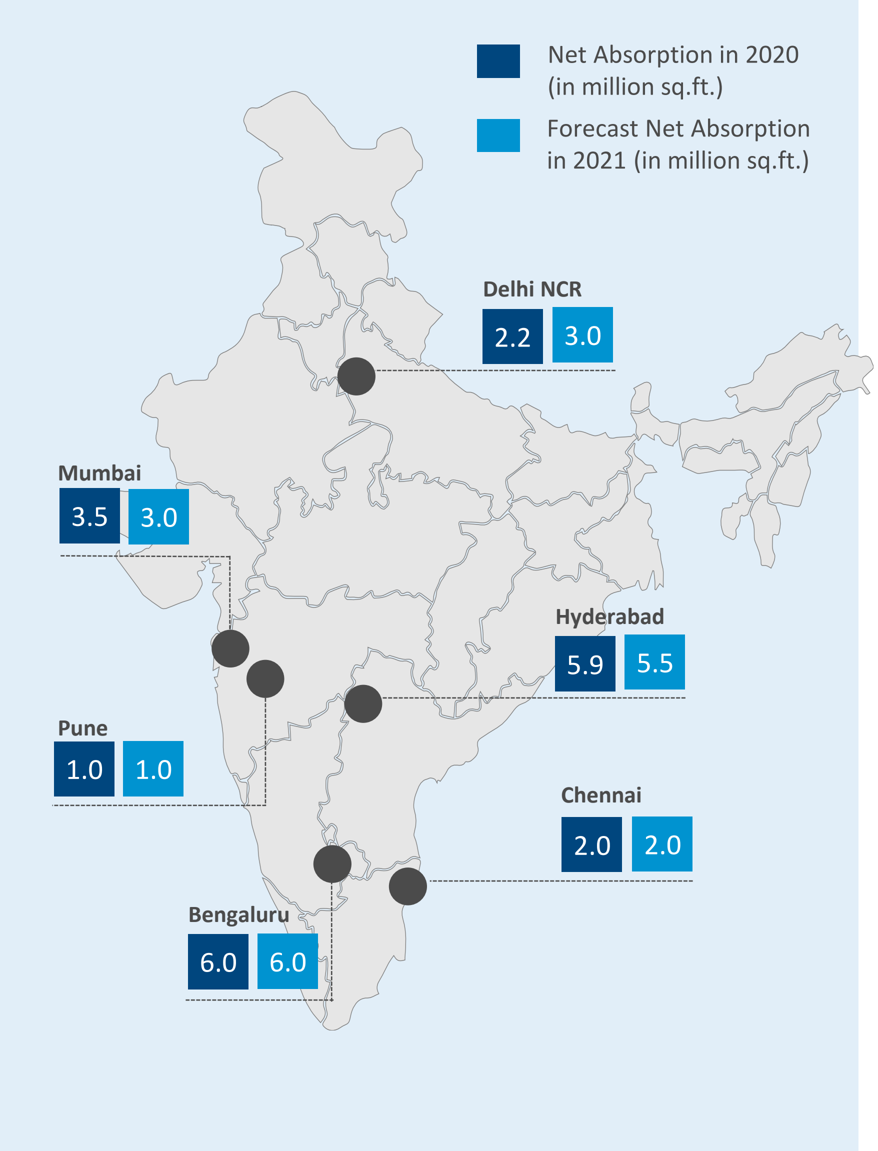
		Net Absorption	Vacancy	Rental Value
Office	With new demand likely remaining slow in H1, we expect Grade A office rents to decline in 2021, with overall rents dropping by 3.7% this year and showing improvements from 2023 onwards.	0.0%	1.7pp	-3.7%
Industrial	In 2021, we expect demand for manufacturing facilities to remain strong driven by the high-quality assets that established developers are providing.	Increasing	Decreasing	Stable
Logistics	In 2021, we expect demand for logistics warehouses to remain strong due to the improving domestic demand that is driving demand for e-commerce and 3PL providers.	Increasing	Decreasing	Stable

		Investment Volume	Yield
Investment Sales	We expect to see investment transaction volumes increase in 2021 given that investors remain positive on the long-term growth prospects of the Indian economy, and that the markets are moving towards institutional ownership.	14.6%	Stable

		Interest Rates	GDP
Economic Indicators	Oxford Economics forecasts India's 2021 GDP to rebound by 8.8% YOY, after it was down 7.4% YOY in 2020. Concurrently, we expect interest rates will remain stable as both the Indian government and the Reserve Bank of India are focused on economic growth.	Stable	8.8%

Source: Colliers International, Oxford Economics.

India: New demand in 2020 and 2021



Source: Colliers International

COMMERCIAL OFFICE SECTOR

During 2020, leasing activity remained sluggish as the uncertain economic environment and business conditions brought on by COVID-19 nudged occupiers to postpone their decisions and reassess their real estate portfolios. Net absorption across major markets in India was 20.6 million square feet (1.9 million sq meters), a decline of 42.8% YOY. Occupiers focused on portfolio optimization by relocating, consolidating and downsizing. About 45% of the demand was led by technology firms with larger companies still considering expansion in recently completed projects with better wellness and hygiene standards. As the pandemic drags into 2021, we expect transaction volumes to remain subdued over the first half. We expect technology firms to continue to lead office space demand in Bengaluru, Hyderabad, Pune, Gurgaon and Noida, where some firms have announced plans to ramp up the hiring process.

Demand from flexible workspace providers remained subdued in FY 2020 due to stringent lockdowns and social distancing protocols. We saw a few flexible workspace operators reduce their space or cancel the LOIs as demand remained muted across major markets. However, we expect a pick-up in demand in FY 2021 as several large corporates and startups are in the process of reviewing their real estate portfolios and may consider flexible workspace to meet their needs through 2022.

Despite concerns about potential oversupply in select micro-markets and muted demand, we saw new supply in 2020 of 38.1 million square feet (3.5 million sq meters), a 2.4% decline YOY. Bengaluru , Hyderabad and Delhi NCR drove the bulk of new supply.

Muted demand prompted developers to adopt a more accommodative stance when negotiating lease terms as they focused on occupancy levels.

During 2021, Colliers forecasts net absorption of about 20 million sq feet (1.9 million sq meters, similar to 2020. We expect that most occupiers will continue to operate low headcount offices as they follow a hybrid model of allowing employees to work both from home and the office.

COMMERCIAL OFFICE SECTOR OUTLOOK (AGGREGATE)

		2020	2021	Annual Avg 2021–25
Demand*	We expect net absorption to remain largely stable over 2021 as occupiers in India are still evaluating growth plans. We believe that demand will mainly be derived from technology companies, engineering and manufacturing sector.	20.6mn sq ft	20.0mn sq ft	28.5mn sq ft
Supply	Indian cities are witnessing projects at different stages of construction. However, we expect developers to pare supply to match actual demand, and not build too much speculatively. Hence, we project that supply during 2021 will also remain steady from 2020.	38.1mn sq ft	38.0mn sq ft	39.3mn sq ft

		YOY/ End 2020	YOY/ End 2021	Annual Avg 2020–25 / End 2025
Rent	Although headline rents remained steady in Q4 2020, effective rents decreased as landlords continued to offer more incentives. Over the next five years, we expect effective rents to increase by 1.0% per annum, with rents turning positive by 2023.	-9.4% / INR97	-3.7% / INR93.0	0.2% / INR98.0
Vacancy	We expect vacancy to increase in 2021 led by higher supply and occupiers' portfolio optimization strategies. However, we expect overall vacancy to remain within comfort zones for most landlords and investors who remain positive about the prospects for commercial offices in India.	3.3pp / 14.3%	1.7pp / 16.0%	3.0pp / 17.3%

Source: Colliers International
*Represents net absorption.

PORTFOLIO OPTIMISATION

A key theme in 2021

After seeing a 41% decline in demand in 2020, we believe that in keeping with global trends, occupiers will optimise their portfolios in 2021 and 2022. Employers' priority is their employees' safety and convenience. The complete roll-out of the vaccine will likely take until Q3 2021 at the earliest, and most occupiers are not planning for a full headcount in their offices before then. This, at the same time occupiers are anecdotally reporting that they are focussing on reducing their occupancy costs to help them add 6-7% to their margins.

Some occupier strategies under consideration:

> Occupiers approaching lease expiration are undertaking portfolio optimization efforts by relocating to cheaper and/or smaller offices. For perspective, in 2021, leases expiring total about 81 million sq feet (7.5 million sq meters), with 65% of these being smaller than 10,000 sq feet (929 sq meters). We note that Delhi-NCR, especially, is witnessing this trend with occupiers moving to locations such as Golf Course Extension Road in Gurugram.

> Occupiers undertaking a hybrid work-from-home model need less office space. This should focus their requirements on space for ideation, group discussions, social interactions, developing cultural bonds and cohesiveness, knowledge transfer and mentoring.

> A hub-and-spoke model of offices with one main office in the CBD and multiple smaller offices near residential locations. We believe this is especially viable in larger cities like Mumbai, Delhi-NCR, and Bengaluru, which often require long employee commutes.

> Large occupiers are also looking at taking space with flexible workspace operators in order to provide their employees with access close to their homes.

However, we do expect that new demand will emanate from new businesses set-ups as well as those seeing growth since last year.

Source: Colliers International

Newer avenues of demand?

	IT-BPM	Engineering & Manufacturing	BFSI
	2019 - 35% 2020 - 45%	2019 - 10% 2020 - 14%	2019 - 12% 2020 - 12%
2021 Outlook	Stable	Increasing	Decreasing

> Technology companies are expanding and are likely to fuel demand for office space over the next two years.

> Over the next three years, technology companies dealing with digitization, artificial intelligence, machine learning and robotics ought to expand led by increasing demand for such services.

> Smaller multinational firms following in the footsteps of the global MNC giants in setting up global-in house centers.

> *China Plus One* strategies, as multinational companies diversify out of China. India is poised to benefit, and we recommend companies scout for research and development centers in Bengaluru, Hyderabad and Pune.

> India's fast growing e-commerce industry, which has seen the pandemic further increase demand. We believe that e-commerce companies in India will lease more office space as they continue to expand.

> We also expect demand from local start-ups and small and medium enterprises to increase. During 2020, the Ministry of Corporate Affairs reported that number of companies registered rose 10% YOY.

> Developers and landlords are pursuing customized data centers, which should drive demand in 2021.

New IT Policy to herald growth in smaller towns

In November 2020, the government eased[1] rules regarding registration, submission of bank guarantees, remote working, and other norms for other service providers (OSP) involved in the IT and business process outsourcing (BPO) sectors. Removal and easing of restrictions ought to increase the ease of doing business and increase the competitiveness of Indian IT-BPO firms. We envisage this move boosting the start-up culture in the absence of red tape that cost time and money.

With work from anywhere (WFA) increasingly becoming a reality, firms can set up offices in Tier II and Tier III cities and hire locally, driven by the diverse talent pool and top-notch educational institutions. We believe that setting up firms in Tier II and Tier III cities ought to spur the following:

> Reduce attrition rates and a captive talent pool.

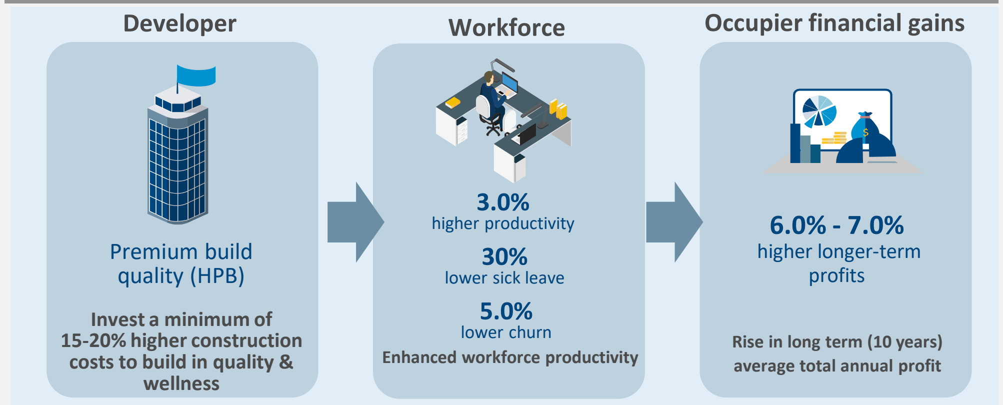
> Growth of small and medium enterprises supporting core IT firms.

> Development of better-quality office spaces at reasonable rents.

> Improved infrastructure for education, healthcare and recreation.

We believe that this initiative, if sustained over the next decade, has the potential to decongest India's top cities, leading to more uniform urbanization. Established developers should develop physical infrastructure to boost the services sector in newer markets.

Benefits to occupiers from high performance buildings



Source: *The financial case for high performance buildings*, Colliers International.

[1]https://www.pib.gov.in/PressReleasePage.aspx?PRID=1670405

Flexible workspace operators are expecting renewed growth

During 2020, flexible workspace operators leased about 3.0 million sq feet (278,707 square meters) of space, accounting for 9% of the total leasing. The operators are expecting greater traction in demand for their centers as occupiers look at stop-gap arrangements while optimizing their portfolio. We expect that occupiers are implementing hub-and-spoke models with space closer to residential areas, and flexible workspace can help meet this need. Across Asia, we also expect to see partnerships between occupiers and operators as the former begin to reduce excess space from their portfolios. Consequently, flexible space operators lease new spaces as they become more confident about the demand from their clients.

Greater focus on health and wellness by developers and occupiers

In view of the COVID-19 pandemic, landlords ought to become increasingly focused on health and wellness. As seen above, developers that invest in well-being and health will likely see better returns. This, we note, underpins the importance of a high-performance building (HPB) with focus on sustainability and wellness.

> Grade A HPB buildings, replete with wellness and energy saving measures offer enhanced value to tenants, while commanding a rental premium.

> In the backdrop of COVID-19, we believe that commercial assets that focus on health and wellness elements, ought to be a priority for institutional investors in the next three to five years.

INDUSTRIAL AND LOGISTICS SECTORS

Industrial leasing to become more robust

COVID-19 influenced and the China/United States trade war exacerbated the challenges and uncertainty experienced by global manufacturing firms and logistics players in 2020 prompting many global corporations to diversify their production base across countries. Indian government initiatives like Make in India, Atmanirbhar Bharat (Self-reliant India), production linked incentive (PLI) scheme, 100% FDI allowance for manufacturing firms and corporate tax reforms have attracted many electronics and hardware manufacturing firms to set up a base in India. Homegrown device makers like Dixon Technologies and global contract manufacturers such as Foxconn and Pegatron are in the process of ramping up their production capabilities in India. Similarly, many textile, pharmaceutical and medical equipment manufacturers are preparing to expand their production capabilities in India. Leveraging its key position in India’s pharmaceutical sector, Hyderabad has been able to attract further investments in biotech, generic-drug and medical devices manufacturing in the past few months. The Indian automobile industry is also optimistic as demand for personal vehicles, especially electric vehicles, is seeing a return to pre-COVID-19 levels.

With a just-in-time (JIT) production model and linear supply chains causing significant disruption to the supply chain, firms are switching to multi-sourcing and overhauling their existing warehouses and order management systems. This should increase demand for resilient supply chains offering more visibility and automation across the entire supply chain.

Bolstered by increased demand from e-commerce players and third-party logistics (3PL) providers, several institutional players such as Blackstone, Logos, GIC, and CapitaLand have formed joint ventures with local developers to set up and buy industrial parks and fulfilment centres in Tier I and II locations. We expect demand for core assets located in strategic locations like the the Chakan-Talegaon cluster in Pune, Neelamangala – Doddaballapur in Bengaluru, and in clusters along NH 16 in Chennai, NH 48 in Gurugram,and NH 19 in Kolkata that enjoy easy connectivity to ports, national highways and airports to remain strong.

Logistics to gain even more traction

Warehousing deal activity continued to grow in 2020 supported by strong demand from e-commerce players, consumer electronics, pharmaceutical sector and 3PL providers.

We are seeing healthy growth from 3PLs and local transportation businesses serving the population base in Tier II and Tier III cities.

Development activity continued to expand in Tier I and II cities with several large developers and institutional players announcing new projects and acquiring land to develop logistics parks.

Heading into 2021, we expect the following key trends to shape the logistics market:

- Demand for advanced warehouses that cater to regulatory compliance, security and quality checks will gain traction as shoppers continue to embrace grocery e-commerce.
- Many occupiers are looking for short-term leases and on-demand warehousing. This should augment demand for co-warehousing/flexible warehousing space, resulting in increased utilization in existing warehouses. Landlords can take this opportunity to sublease unutilized space.
- To ensure cost optimization and increase competitiveness in the industry, warehouse operators are increasingly adopting IT-driven solutions including Internet of Things (IoT) and Warehouse Management Systems (WMS) to track inventory and adopt an analytical approach to forecasting demand to avoid depletion of stock.
- As efficient in-city distribution increases, demand for modern Grade A warehousing continues to grow in urban cores. Landlords should redevelop or upgrade their existing facilities, incorporating multi-level racking and sustainable solutions.
- As competition in e-commerce increases, sellers want logistics service providers to deploy predictive analytics to create visibility in seasonal demand-supply fluctuations and solve the reverse logistics problem while improving inventory management.

CAPITAL MARKETS

Institutional investments in Indian real estate assets

USD**6.2** bn
2019

USD**4.8** bn
2020

USD**5.5** bn
2021F

Despite a lull in activity during Q2 2020, INR346 billion (USD4.8 billion) of institutional investments in real estate assets were recorded during 2020, witnessing a drop of 23% from 2019. Investors continue to be bullish on the Indian real estate sector and asset classes such as offices, data centers and warehouses are receiving increasing interest. During 2021, we predict about 15% higher inflows YOY, as investors are looking to deploy their existing dry powder. Moreover, we are also witnessing increased fund raising with some investment firms floating new investments funds. For instance, firms such as Kotak Realty Fund, Motilal Oswal Financial Services are floating new funds for Indian real estate.

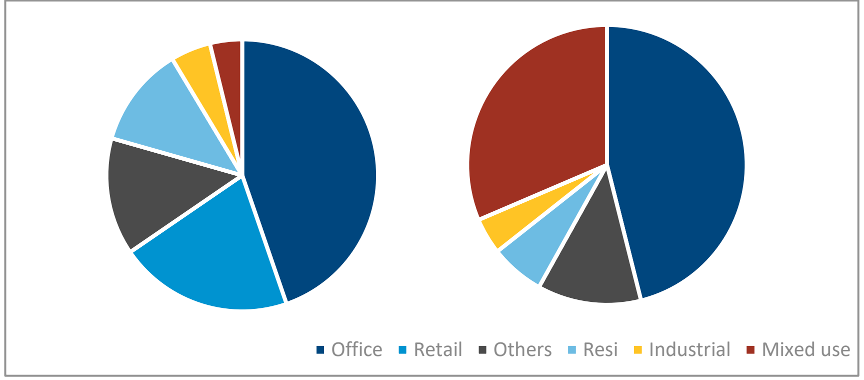
On the REITs front, after Mindspace Business Parks REIT's listing in August last year, February 2021 also saw the listing of Brookfield India REIT. Given the strong investment sentiments, we will likely see one or two more listings in the second half of this year.

As several developers continue to face cash-flow problems, we foresee more equity-led deals in the office sector as prices are quite attractive. These can then be bundled with other assets into a REIT listing in the future.

Investors to increasingly look at developmental position in office assets

Commercial office assets accounted for over 55% of total Indian real estate inflows between 2018 and 2020, showing the higher appetite of investors. However, there is now limited availability of investible office stock. Between 2018 and 2020, an average annual supply of over 35 million square feet (3.3 million square meters) entered the top six Indian cities, with the majority being snapped up by institutional investors. Even though a similar level of supply is set to enter the market, some investment firms are increasingly looking towards developing their own greenfield office assets. Investors remain bullish on the long-term prospects even as they target an internal rate of return (IRR) of about 17-18%.

Investment inflows: 2019 & 2020



Opportunities for investors

- The continuing low interest rates in India make office assets attractive. Investors are increasingly looking for an equity stake in development projects or looking to develop their own greenfield assets.
- Strong demand from the e-commerce sector is making warehouse space attractive.
- Demand for data centers is strong as they offer net yields of about 17% per annum.
- Now is an opportune time for funds to invest in the residential sector as pricing is attractive, consolidation is set to increase and developers with good track records and strong balance sheets are looking at growth.
- Distressed asset funding or acquisition including portfolio buyouts of lenders offers attractive valuations.

Opportunity for funds as NBFC crisis leaves a vacuum in housing projects

We believe that this is an opportune time for funds to enter the market, at a time when non-banking financial companies (NBFCs) are either withdrawing from the housing sector or not deploying any more capital. We recommend that funds explore last-mile funding for projects in the residential sector. We note that funds such as SSG Capital, Oaktree Capital, and Apollo Global Management are investing in the development stage of residential projects.

As the residential sector undergoes consolidation, we expect investors will increasingly invest in companies directly, as opposed to the structured debt route at a project level that investors largely used in the last decade. As per Colliers' data, during 2016 and 2017, debt deals accounted for about 40% of the total inflows into the sector. However, in 2018 and 2019, the share of debt deals fell to about 12% of the total quantum of inflows, indicating the shift towards equity and entity-led deals.

The residential sector is slowly witnessing an improvement in sentiment led by decadal-low mortgage rates and rebates offered by developers. We believe that demand in the residential sector ought to turn the corner as the economy rebounds.

Data centers in the spotlight

India has about 1.2 megawatt (MW) per user of co-location data center (DC) capacity when compared to Europe's 19.1 MW per user DC capacity, providing a huge opportunity for DC operators. To give a boost to DCs, the government for the financial year 2020-2021, had proposed a INR800 million (USD1.1 billion) fund to setup DCs and IT parks across the nation. In addition, the government's Personal Data Protection Bill, 2019, mandates that an individual's data should be stored locally, encouraging firms to set up DCs in India. We expect two private-equity deals in data centers should close in 2021, apart from large investments in new data centers from Indian corporate groups.

[2] Tier 3 DC has multiple paths for power and cooling and systems in place to update and maintain it without taking it offline. It has an expected uptime of 99.982%
[3] Tier 4 DC is built to be completely fault tolerant and has redundancy for every component. It has an expected uptime of 99.995%

Since DC are capital intensive, we recommend that investors with a long-term horizon scout for greenfield DC assets which yield more attractive returns than brownfield assets. We estimate that Tier 3[2] and Tier 4[3] DC asset class can provide a net yield per annum of about 16%-18%, making them attractive for institutional investors. Over the next decade, we also believe that a developer's strong DC portfolio can also be converted into a REIT, led by a strong appetite for income-yielding assets. DC REITs have been popular with investors in developed markets such as the US, China, Singapore and Australia and interest in them is increasing.

Data Centers Investment Opportunities

Average investment needed
USD4.0 - USD5.0 million per MW

Time taken to break-even
~6 years

Net yield per annum
16% to 18%

High customer stickiness
14-20 years

Source: Colliers International

Industrial sector gaining ground

India's industrial sector is garnering significant interest from institutional investors. The interest is being driven by the implementation of the Goods and Services Tax (GST) regime, accordance of *infrastructure* status to the sector, the creation of a logistics park policy and the development of multi-modal infrastructure. Moreover, India's e-commerce sector is one of the fastest-growing in the world, fueling demand for warehouses. Led by robust demand from e-commerce and other consumer-led occupiers, we expect the industrial and logistics sector to stronger demand than other asset classes.

In 2020, sovereign wealth fund GIC formed a USD750 million joint venture with ESR Cayman to develop and buy industrial and logistics assets in India. Over the last two years, foreign investors such as the Abu Dhabi Investment Authority (ADIA), Canada Pension Plan Investment Board (CPPIB), Ivanhoe Cambridge, Ascendas, Blackstone, have also invested into the sector. During 2021, we expect increased formation of joint ventures between developers and investment funds to expand and develop industrial parks, in keeping up with the demand.

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