

# India Office Market

The commercial office sector has consolidated itself and is entering into the growth phase in 2011, due to good response from occupiers. Despite a rise in absorption levels and stabilization of rents, construction delays have resulted in the deferment of supply of office projects across Indian cities. However, upbeat over the tremendous response in the residential sector, developers are increasingly focusing their energies on execution and delivery of office space, rather than launching new ones. Most of the markets are stable, with prime micro-markets increasing rents. Prime markets of Bangalore, Mumbai and NCR-Delhi have witnessed an increase in rental values. The implications of the proposed Revised Direct Tax Code (DTC) will be significant on the IT & IT SEZ supply expected to become operational, as it impacts the earnings of landlords as well as tenants. The first quarter of 2011 has seen an increase in investment sales of office space, particularly in stable income yielding assets by private equity funds.

## 61.1 million sq ft of office space to become operational in 2011

The first quarter of 2011 witnessed the completion of 41 office projects encompassing 14.2 million sq ft of office space, taking India's total operational stock to 279.4 million sq ft. 17 IT projects, 11 IT SEZ projects and 13 Non IT projects became operational with a medium average occupancy of 41.4%.

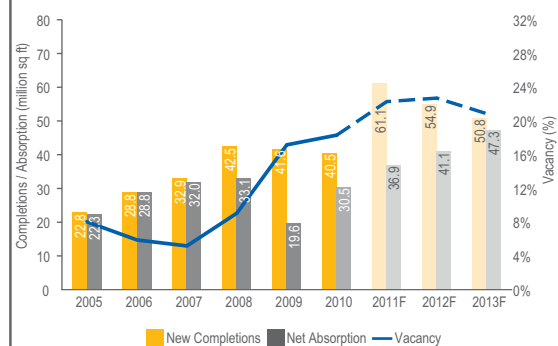
Mumbai led the completions in 1Q11, witnessing an addition of 4.9 million sq ft of office space across 19 projects including Mindspace 1 Building 4 & 7 (IT SEZ) and Reliable Tech Park Phase 1. Other two prominent IT SEZ projects that became operational were Global Axis Phase 2 in Bangalore and DLF IT Park Building 4 in Pune.

Construction delays in the past few months have pushed nearly 5 million sq ft of office space to become operational in 2012 as opposed to the planned completion year of 2011. As against an expected supply of 66.1 million sq ft as per the 2010 estimates, only 61.1 million sq ft of office space is expected to become operational in 2011. Against this supply, net absorption of 36.9 million sq ft is expected during the year, registering a y-o-y growth of 20.9% over net absorption recorded in 2010 (Figure 7).

A total of 152.7 million sq ft of office space is expected to become operational in the next eleven quarters till end-2013. While Mumbai and NCR-Delhi are expected to witness a supply of around 40-42 million sq ft each during 2011-13, Chennai, Pune, Kolkata and Hyderabad expect 14-17 million sq ft each. On the other hand, Bangalore is expected to

add 23 million sq ft against this supply, while NCR-Delhi and Bangalore are expected to absorb 20-22 million sq ft each during the same period, Chennai, Pune, Kolkata and Hyderabad should absorb 10-15 million sq ft each. Mumbai however, is expected to lead with almost 33 million sq ft of absorption. Since 73% of the future supply till 2012 is being developed for IT or IT SEZ occupiers, the forecasted growth trajectory of IT/ITES sector remains critical for office real estate in India.

**Figure 7: Supply Overhang to Remain Despite Recovery of Demand during 2011-2013**



Note: Figures are representative of India's seven metropolitan cities - NCR-Delhi, Mumbai, Bangalore, Chennai, Hyderabad, Kolkata and Pune  
Source: Real Estate Intelligence Service (JLL), 1Q11



Over 75% of the supply expected to become operational in 2011, is under advanced stages of construction, in either 'Ready for Fit-Outs' or '50-100% Structure Ready' stages (Figure 8). A degree of construction uncertainty looms over the 25% of office space expected to become operational in 2012 as they are in preliminary stages of construction, either under 'Excavation / Upto Plinth' or 'Proposed' stages. While select projects in the near term have good pre-commitment levels depending on their stage of construction, location and flexibility to negotiate rentals, several projects in long term supply are either stalled or have yet to begin construction.

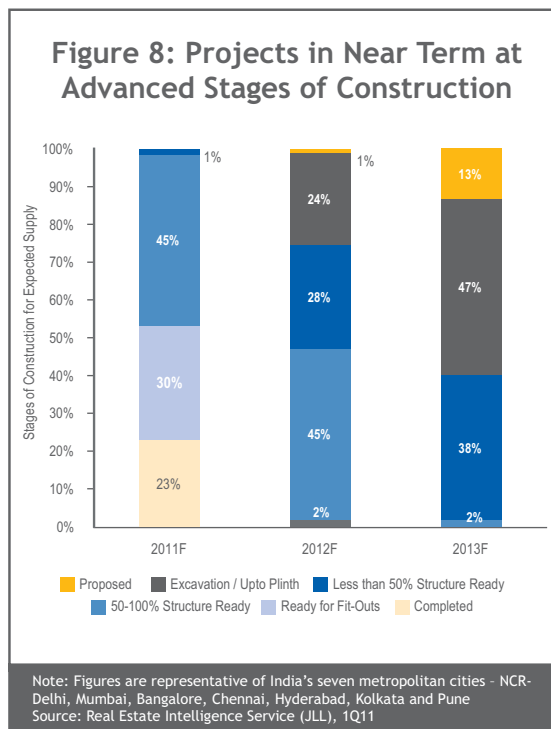
**Net absorption was recorded at 9.3 million sq ft in 1Q11 compared to 10.7 million sq ft recorded in 4Q10**

While Mumbai led leasing activity in 1Q11 with a phenomenal 3.5 million sq ft of absorption on the back of healthy pre-commitments by IT majors in the suburban precincts, NCR-Delhi witnessed a very high absorption level at nearly 1.6 million sq ft. Bangalore, Chennai and Hyderabad saw a net absorption of about 1 million sq ft each.

A larger share of transactions happened in operational vacant stock rather than under construction projects, contrary to the trend observed during 2007 & 2008, when options in operational office space weren't available to tenants in the same measure. However, a portion of transactions are pre-committed in buildings that were under construction. They are expected to get absorbed in the near term as those buildings become operational.

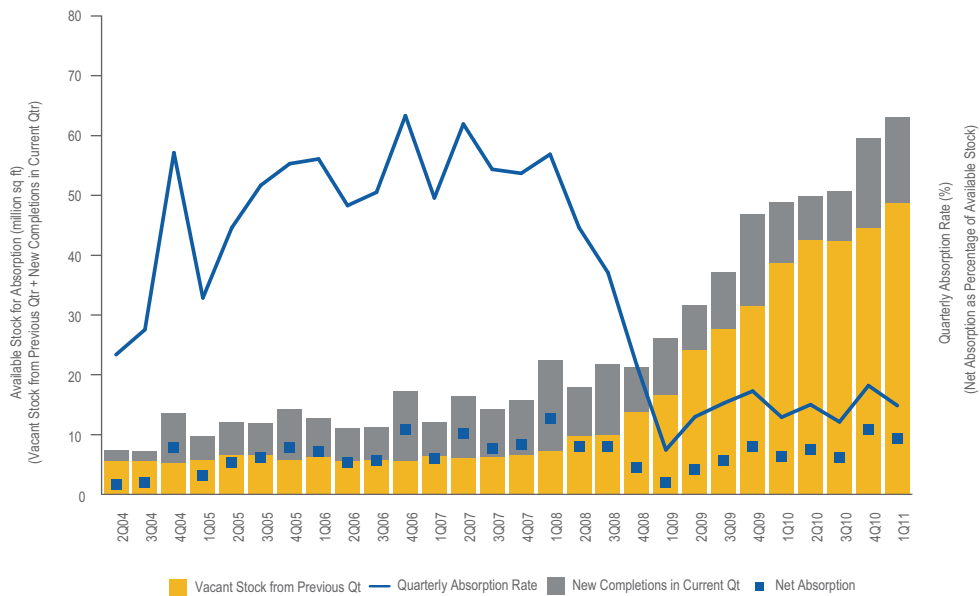
Demand for IT SEZs has witnessed traction in select markets due to the benefits on STPI properties coming to end in March 2011. However, a majority of the SEZ projects have yet to become operational and are under various stages of construction. The implications of the proposed Revised Direct Tax Code (DTC) will be significant on the IT & IT SEZ supply expected to become operational, as it impacts the earnings of landlords as well as tenants.

Among the Indian cities, Pune, Hyderabad, Chennai and Kolkata have a balanced supply of IT and IT SEZ projects. Mumbai, Bangalore and NCR-Delhi have a larger supply of IT projects and relatively fewer IT SEZ projects in pipeline.



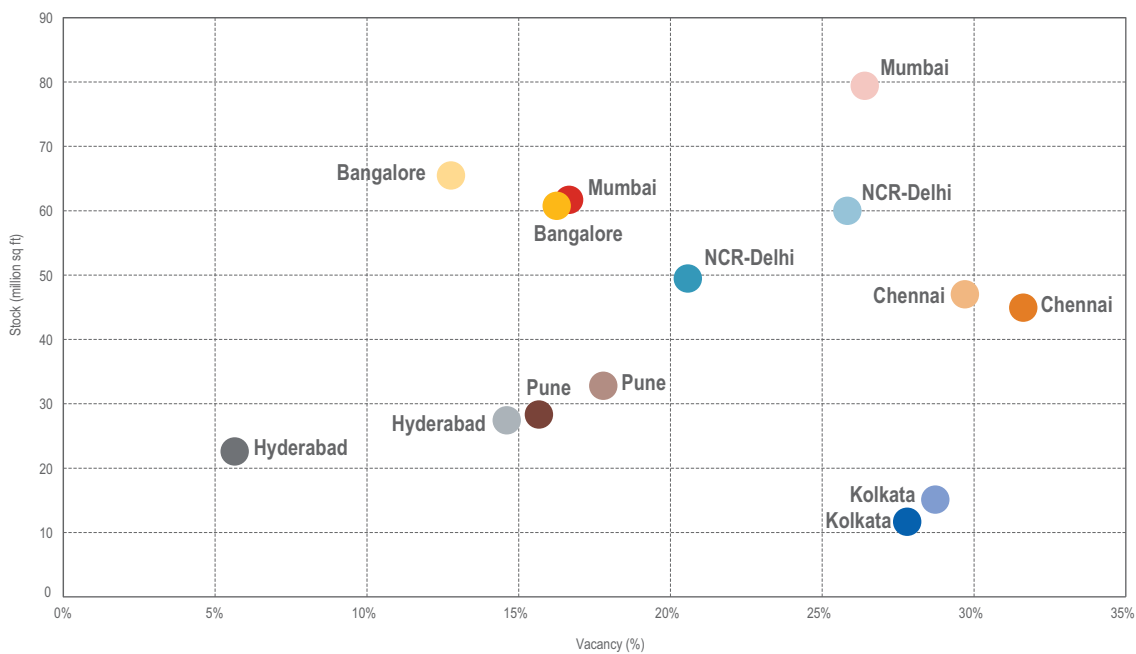


**Figure 9: Absorption Rate of Office Space**



Note: Figures are representative of India's seven metropolitan cities - NCR-Delhi, Mumbai, Bangalore, Chennai, Hyderabad, Kolkata and Pune  
 Source: Real Estate Intelligence Service (JLL), 1Q11

**Figure 10: Stock-Vacancy in Various Cities (1Q11 vs 4Q11F)**



Note: Darker circles indicate stock-vacancy position at end-1Q11 and lighter circles indicate positions per forecast at end-4Q11F  
 Source: Real Estate Intelligence Service (JLL), 1Q11





### Vacancy has increased by 80 bps from 18.3% in 4Q10 to 19.1% in 1Q11

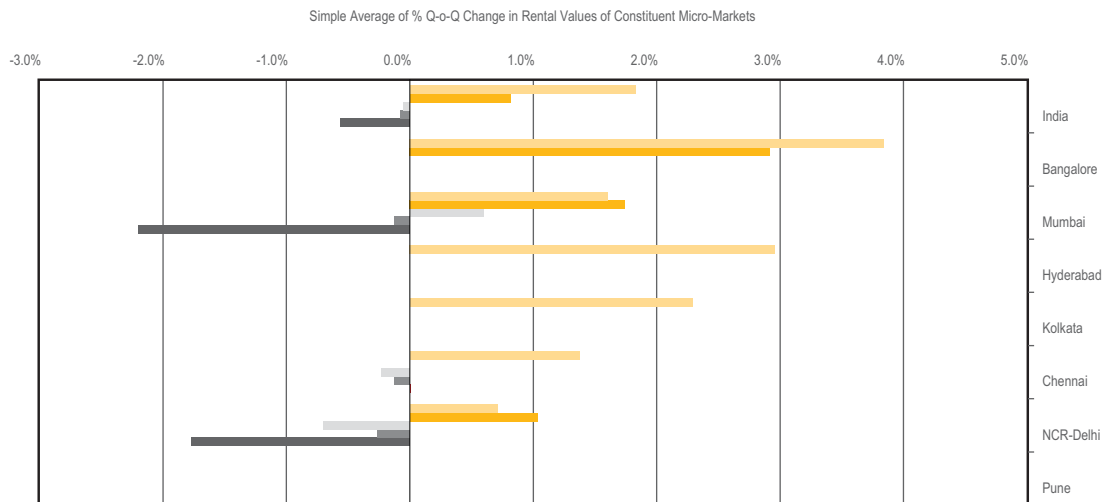
Vacancy in office space in India was recorded at 19.1% at end-1Q11, increasing by 80 bps q-o-q. While vacancy in Kolkata and Chennai stood above 25% mark at end-1Q11, vacancy in Mumbai, Pune, NCR-Delhi and Bangalore stood in the range of 10-22% (Figure 10). Vacancy in Hyderabad stood at a low 5.6% at end-1Q11. Although vacancy has risen in cities since 2008, CBDs and SBDs are relatively occupied when compared to suburban markets. Vacancy is expected to rise sharply across markets reaching 22.3% by end-2011 due to the huge influx of supply expected in the office market.

In 1Q11, Mumbai with 61.9 million sq ft of operational stock overtook Bangalore which trails behind closely with 60.8 sq ft of operational investment grade office space. Bangalore, Mumbai, NCR-Delhi and Chennai lead the market in terms of office stock, thus classified as Tier I cities, followed by Hyderabad, Kolkata and Pune, which have less than 30 million sq ft of operational stock each and

are thus classified as Tier II cities (Figure 10).

The supply overhang is expected to remain in the coming years, resulting in continuous accretion of vacant stock. However, properties in good location with favourable catchments and tenant profile would attract potential occupiers to ensure healthy leasing activity. This polarisation of demand with preference for such properties will result in the increase of natural vacancy rates across various markets turning the near term. Natural vacancy rate in the market is the vacancy rate in a market at which there is neither excess demand nor excess supply. It includes frictional vacancy from turnovers or churning and structural vacancy caused by mismatch between space requirements of tenants and space availability offered by landlords. At a vacancy of 19.1% at end-1Q11, the total vacant stock at the Pan-India level is 53.5 million sq ft. However, as per our estimates, a natural vacancy rate of 7-8% exists in the market resulting in an effective vacancy of 11-12%, which will keep rents under pressure in the near term.

**Figure 11: Simple Average of Change in Rental Values of Constituent Micro-Markets**



	Pune	NCR-Delhi	Chennai	Kolkata	Hyderabad	Mumbai	Bangalore	India
1Q11	0.0%	0.7%	1.4%	2.3%	3.0%	1.6%	3.8%	1.8%
4Q10	0.0%	1.0%	0.0%	0.0%	0.0%	1.7%	2.9%	0.8%
3Q10	0.0%	-0.7%	-0.2%	0.0%	0.0%	0.6%	0.0%	0.0%
2Q10	0.0%	-0.3%	-0.1%	0.0%	0.0%	-0.1%	0.0%	-0.1%
1Q10	0.0%	-1.8%	0.0%	0.0%	0.0%	-2.2%	0.0%	-0.6%

Note: Figures are representative of India's seven metropolitan cities - NCR-Delhi, Mumbai, Bangalore, Chennai, Hyderabad, Kolkata and Pune  
Source: Real Estate Intelligence Service (JLL), 1Q11



### **Office sector has entered the initial growth phase with gradual increase in rentals**

Office markets in India appreciated by an average of 1.8% q-o-q in 1Q11, continuing the quarterly growth of 0.8% witnessed during 4Q10. The growth has primarily been led by the prime markets of Mumbai, Delhi and Gurgaon along with the low vacancy IT markets of Bangalore and Hyderabad (Figure 11). More rental appreciation is expected in the coming quarters, as demand remains strong and incremental office space is absorbed. The demand has primarily come from IT/ITES and BFSI sectors, who continue to both lease and buy office space.

The first quarter of 2011 has seen an increase in investment sales of office space, particularly in stable income yielding assets by private equity funds.

