Asian Cities - 1H 2021

SPOTLIGHT

Savills Research

Mumbai Offices

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Mumbai's revival - Strong fundamentals to aid growth

ECONOMIC OVERVIEW

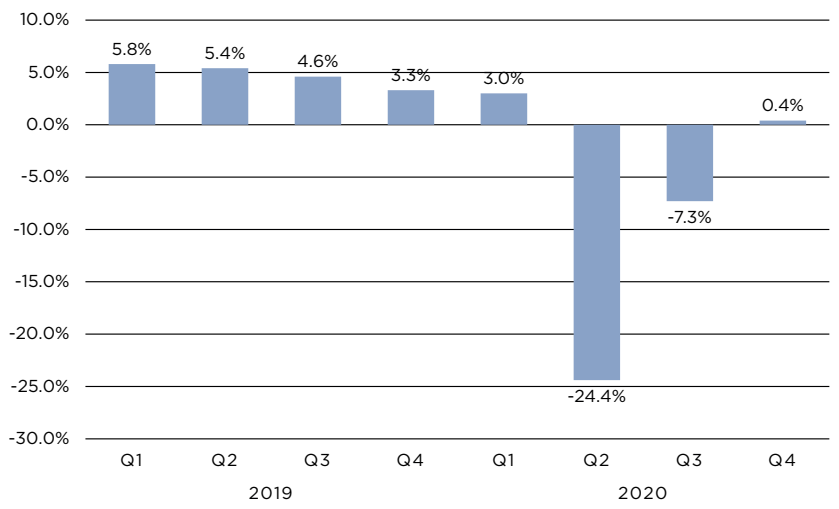
Starting April 2020, in common with most global economies, India witnessed two successive quarters of contraction. GDP declined by 24.4% in the April-June quarter and by 7.3% in the following quarter. The April-June contraction, which was the steepest in Indian history, was a result of a nationwide lockdown necessitated by the pandemic. However, GDP grew by 0.4% during the October-December quarter, reflecting the recovery process. The manufacturing sector, which reported a contraction of 1.5% in Q3/2020, rose by 1.6% in Q4/2020. Apart from this, agriculture, forestry, and fishing grew by 3.9% in Q4/2020. Among other industries, trade, hotels, transport, communications, and broadcasting-related services recorded a lower QOQ contraction in Q4/2020. Quite significantly, construction showed strong growth of 6.2% in Q4/2020, compared to a contraction of 7.2% in Q3/2020.

This recovery towards the end of 2020 was a promising sign, as it was assumed to signify the end of the pandemic-induced recessionary phase. 2021 started on a positive note on the back of a massive nationwide vaccination programme. However, by the close of the first quarter, a second COVID wave had begun and spread at a much steeper rate than the first wave. This surge has caused tremendous strain on the healthcare infrastructure.

India's first wave had peaked after nearly six months of control and preventive measures at about 97,400 daily infections on 17th September 2020. On the other hand, the second wave reported over three times that number in just over a month of build-up. It has strained all sectors of the economy, and the outlook is once again clouded. A host of such factors led Oxford Economics to downgrade its 2021 GDP growth forecast to 10.2% from 11.8% previously. The situation remains dynamic at this stage, as most states continue to prolong lockdowns and other restrictive measures.

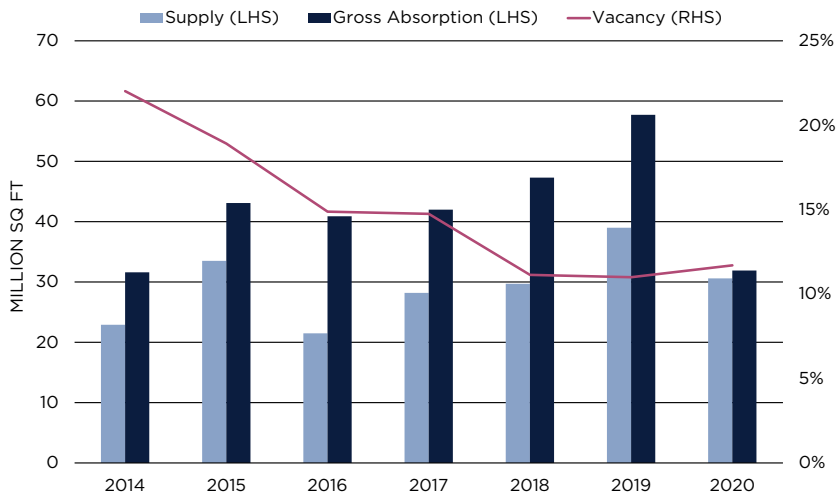
However, to boost vaccination rates, the government is considering approving several international vaccines, has given grants to domestic companies to expand their vaccine production capacities, and has made all adults eligible for vaccines from 1st May 2021. This is arguably the largest vaccination programme in the world. We expect to witness targeted lockdowns and varying degrees of restrictions, instead of a blanket nationwide lockdown during the second and third quarters of 2021. It is widely anticipated that suppressed consumer needs and dormant business plans will help with the recovery and buttress the economy as the impact of the second wave begins to wane at the end of second quarter. It must also be noted that there are expert opinions regarding an impending third wave, but it has not been forecast with any degree of accuracy or certainty.

GRAPH 1: India GDP Growth Rate, Q1/2019 to Q4/2020



Source Ministry of Statistics and Programme Implementation, Government of India

GRAPH 2: India Supply, Absorption and Vacancy, 2014 to 2020



Source Savills Research

INDIA COMMERCIAL OFFICE OVERVIEW

Office activity in India has grown strongly over the last few years, with a CAGR of over 8% during 2014-2019. 2018 and 2019 were record-breaking years for office leasing. 2020 was expected to be a third successive growth year, but the pandemic-induced slowdown reversed the trend, shaping the 2020 story very differently.

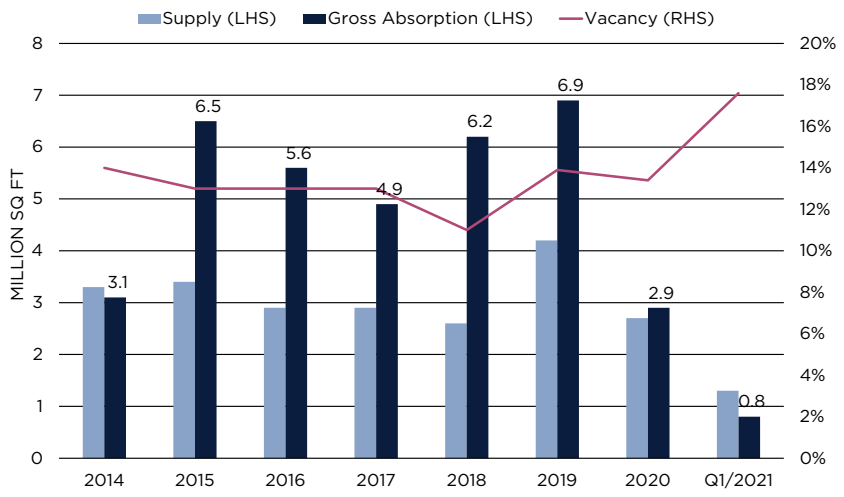
2020 saw a temporary trough in office market activity with both leasing activity and new completions declining from the previous year. Office space absorption across India's six major cities stood at 31.9 million sqft in 2020, which was a 43% YoY fall. It is to be noted that 2019 saw an all-time record-high of 55.7 million sq ft of leasing.

Demand continued to be driven by the technology sector in 2020, constituting 48.7% of total leasing. This was marginally higher than 46.3% in the previous year. Interestingly, some large consolidations and expansion deals were recorded during 2020. Of the total office leases in 2020, around 60% comprised deals which were 100,000 sq ft each or larger.

New completions during 2020 also declined by 35% YoY to about 30.6 million sq ft. The overall India vacancy level increased marginally to 11.7% in 2020 as new supply exceeded the pace of leasing activity. Most cities witnessed rises in vacancy levels as demand remained subdued. Generally, the markets saw stable rents with certain pockets leading the decline as occupiers gained an upper hand in certain cases.

Once a significant majority of the population is vaccinated leading to near normalcy, we expect India to remain a preferred global outsourcing destination on account of its large base of technical knowledge and cost-effective talent.

GRAPH 3: Mumbai Supply, Absorption and Vacancy, 2014 to Q1/2021



Source Savills Research

TABLE 1: Key Transactions, 2021 YTD

TENANT	BUILDING	MICROMARKET*	AREA (SQ FT)#
Hindustan Platinum	Lodha Excelus	Eastern Suburbs	32,800
AU Small Finance Bank	Rupa Sapphire	Navi Mumbai	21,700
Motilal Oswal Financial Services	Lodha Supremus II	Thane	21,600
Priceline.com Technology	NESCO IT Park	Western Suburbs II	21,100
Munich RE	The Capital	New CBD	19,800

Source Savills Research
* Eastern Suburbs: Wadala, Sion, Chembur, Ghatkopar, Mulund, Kanjurmarg, Powai
Navi Mumbai: Airoli, Vashi, CBD Belapur, Mahape, Turbhe, Ghansoli, Thane-Belapur Road
Western Suburbs II: Goregaon, Malad, Kandivali, Borivali
New CBD: BKC
Indicative numbers only

The trend of subdued leasing activity and constrained new supply continues in 2021, after a brief hope in early months, as markets remain strained during the ongoing second wave. However, confidence is expected to return as the country progresses with vaccinations. Once a significant majority of the population is vaccinated leading to near normalcy, we expect India to remain a preferred global outsourcing destination on account of its large base of technical knowledge and cost-effective talent. India should witness a systematic growth of Global In-house Centres (GICs) and start-ups, as well as gig workers.

MUMBAI COMMERCIAL OFFICE OVERVIEW

Mumbai has been a consistent performer in terms of leasing activity and supply infusion, which meant that the city remained among the top three in India until 2016. Between 2017 and 2019, its rank slipped to no. 4 as Hyderabad started gaining greater occupier attention. After two successive years of registering robust leasing activity in 2018 and 2019, 2020 turned out to be an unexpectedly slow year for Mumbai.

After notable leasing activity of 6.9 million sq ft in 2019, Mumbai registered a steep 59% YoY decline in space take-up, to record about 2.9 million sq ft in 2020. This happened as occupiers delayed leasing decisions owing to the pandemic. Due to rising cases of COVID-19, leasing activity in 2021 has remained subdued too, with Q1/2021 witnessing a mere 0.8 million sq ft of office leasing. While new leases remain rare, term renewals by occupiers who are approaching lease expiration, or those who are completing their lock-in periods, maintained momentum. For reference, about 90 million sq ft of leases are due for renewal in India in 2021, of which Mumbai's share is about 17 million sq ft.

Despite the lull in absorption, overall rental values in most micro-markets remained stable in 2020. The rental values in the Old CBD market, however, declined by 6% YoY. The city witnessed a supply infusion of about 1.5 million sq ft, of which almost 90% was in Navi Mumbai and Eastern Suburbs. The CBD markets[1], both the Old CBD and the New CBD, witnessed no new completions during 2020. Amidst limited supply and subdued leasing activity, vacancy levels declined marginally by 0.5 percentage points YoY to 13.4% in 2020.

In Q1/2021, however, vacancy levels increased to 17.6% as new supply surpassed leasing activity and select occupiers continued to surrender space in tough market conditions.

1 Old CBD – Nariman Point, Cuffe Parade, Ballard Estate, Fort, Churchgate, Colaba.
New CBD – Bandra-Kurla Complex (BKC).
Historically, most companies have had their head offices in the Old CBD (Nariman Point), located in south Mumbai. Due to limited scope for expansion on account of land scarcity, most occupiers have been relocating to other parts of the city. BKC, owing to its strategic location in the centre of the city and closer to the airport compared with the Old CBD, has emerged as the prime CBD. BKC offers premium quality real estate and is the most expensive micro-market in terms of office rents and capital values in the city.

OUTLOOK – EMERGING TRENDS LIKELY TO SHAPE THE COMMERCIAL REAL ESTATE STORY

Infrastructure development to aid real estate activity in select corridors

Mumbai is one of those cities which is undergoing massive change as its infrastructure upgrade is taking place on several fronts. The upcoming trials of metro lines 2A and 7, development of Navi Mumbai airport, the Mumbai Trans-Harbour Link, Coastal Road and Versova-Bandra Sea Link, among other developments, are the key to its future. These are expected to have a large-scale impact on leasing and investment activity in prominent micro-markets such as the Western Suburbs, Bandra-Kurla Complex (BKC, the New CBD), BKC Periphery and Navi Mumbai.

Occupiers' preference for flexibility and employee wellness

The pandemic has altered the way occupiers conceive of workplaces. Current times warrant increased emphasis on employee wellness initiatives, while companies strive to rebuild business momentum. As employee wellness plans improve productivity and increase job satisfaction, occupiers are focusing on these initiatives to enhance employee efficiency as well as safety. Further, occupiers are also looking at workplace options which offer them the flexibility to expand or contract with less onerous clauses.

Based on an occupier's survey conducted by Savills in Mumbai during March 2021, flexibility to exit and amenities to enhance employee well-being are the two topmost priorities of occupiers when structuring transactions in the post-COVID world. Hence, we expect flexible workspaces, especially managed offices, to become attractive options in the short-term.

'Hub & Spoke' model likely to gain significance

As occupiers adopt remote-working strategies to ensure business continuity, we foresee a 'Hub & Spoke' model selectively coming into play. We expect physical offices to continue, as occupiers undertake portfolio optimization via the right mix of traditional offices, flexible workspaces, and remote-working strategies.

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