COMMERCIAL
RESEARCH

Knight Frank

CHENNAI

OFFICE TRACTION@GLANCE

January 2014

The Office Traction@Glance series analyzes the office market of a city with regards to new supply, vacancy trends, key transactions, industry wise absorption, micro-market split of absorption, rental trend and future outlook.

MAIN HIGHLIGHTS OF THE REPORT

- Chennai garnered absorption of 3.5 mn.sq.ft. in 2013; substantially exceeding market expectations
- Positive traction in the IT/ITeS sector aided in restricting decline in absorption to 15% in 2013 over 2012
- Sectors with requirement of smaller office spaces may leverage demand in 2014

The year 2013 was expected to be a period of tough challenges, yet factors such as positive traction in the IT/ITeS sector aided in restricting the decline in absorption to 15% over the absorption in 2012. The share of office space absorption by the IT/ITeS sector in 2013, to the tune of 70%, depicts a remarkable come-back since its share dipped to 47% in 2011 owing to economic uncertainties.

Market Overview

The Chennai office market in 2013 struggled to survive amidst the gloomy economic predicaments in the country. Weak market sentiments and poor GDP growth projections put forth a bleak outlook for the city's office market in 2013. The IT/ITeS sector, responsible for championing Chennai's office market in the recent years, as well as the traditional economic drivers such as the manufacturing industry, had taken a pause owing to the global economic turmoil. Developers, who were buoyant about their office projects in the mid-2000s took cue from this and accordingly constricted their supply trajectory and growth plans, so much so that the city did not see any significant launch in 2012 and 2013.

Mid-2013, the expectation of the market was that the city would close the year with around 3 mn.sq.ft of office space transactions. Nevertheless, despite such negative market sentiments, Chennai managed to garner an absorption of 3.5 mn.sq.ft. in 2013, a drop of around 15% from the previous year but substantially exceeding the market expectation. This depicts the strength of the city's office market that currently boasts of around 54 mn.sq.ft. of operational space. Chennai has a resilient Central Business District (CBD), comprising micro-markets such as Nungambakkam and Anna Salai while the neighbouring locations of Egmore and T Nagar make up the Off-CBD market. The Suburban Business District (SBD) in Chennai encompasses locations like Adyar, Guindy and Mount Poonamallee Road as well as the pre-toll gate part of the Old Mahabalipuram Road (OMR). The OMR, further down the toll gate, becomes a part of the Peripheral Business District (PBD). Besides the OMR, micro-markets like Ambattur and GST Road form the PBD of the city.

BUSINESS DISTRICT CLASSIFICATION

Business District	Micro-markets
Central Business District (CBD & Off-CBD)	Anna Salai, RK Salai, Nungambakkam, Greams Road, Egmore, T Nagar
Suburban Business District (SBD)	Mt.Poonamallee Road, Porur, Guindy
SBD OMR	Perungudi, Taramani
Peripheral Business District (PBD) OMR & GST	OMR Beyond Perungudi Toll Plaza, GST Road
PBD Ambattur	Ambattur

Source: Knight Frank Research

For Chennai office market, the year 2011 had proved to be the most successful period post the economic recession. Signs of economic recovery in the country soared the market sentiments and it witnessed considerable absorption of 4.5 mn.sq.ft., translating to an increase of 45% over the absorption in the preceding year 2010. However, the momentum could not be maintained in 2012 due to the delay in global economic recovery and downward trend in the growth of the Indian economy, thereby leading to a decline in absorption by 9%. The year 2013 was expected to be a period of tough challenges, yet factors such as positive traction in the IT/ITeS sector aided in restricting the decline in absorption to 15% over the absorption in 2012. Given the present economic conditions and the state of prime office markets in the country, the lower level of absorption in 2013 comes as no surprise and reveals the cautiousness in the market.

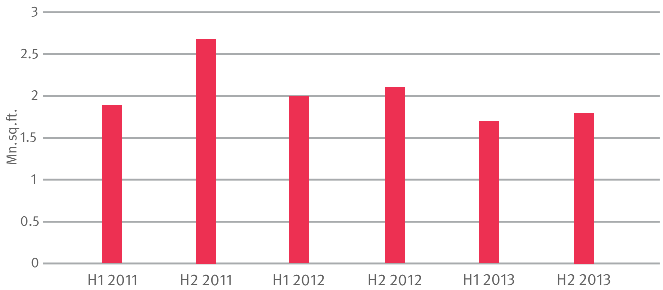
GUINDY HAS BECOME THE PREFERRED OFFICE DESTINATION FOR MANY OCCUPIERS LOOKING TO RELOCATE FROM THE CBD AND OFF-CBD MARKETS. AS A RESULT, VARIOUS DEVELOPERS ARE POSITIONING THEIR PROJECTS IN GUINDY AS PREMIUM OFFICE DEVELOPMENTS IN ORDER TO TAP INTO THIS DEMAND, OFFERING BETTER AMENITIES.

TRANSACTION SUMMARY

Lease transactions	2011	2012	2013
Total Area Transacted	4.5 mn.sq.ft.	4.1 mn.sq.ft.	3.5 mn.sq.ft.
Weighted Average Value	₹44.50/sq.ft./ month	₹45.20/sq.ft./ month	₹47/sq.ft./ month

Source: Knight Frank Research

HALF-YEARLY TREND OF ABSORPTION (2011-2013)



Source: Knight Frank Research

As is evident the second half of the year (H2) fared better than the first (H1), through the years 2011 to 2013. However, a declining trend has been observed in this stand. While the absorption in H2 2011 scored 42% over H1 2011, this petered down to just 6% in H2 2013 over the absorption in H1 2013. On the transacted rental values front, the weighted average rentals have shown slight upward movement year-on-year since 2011. While 2012 saw an appreciation of 2% over the weighted average rental in 2011, it increased by 4% in 2013 vis-à-vis 2012 values. This is mainly attributed to the limited new office space coming into the market as well as the fact that a number of transactions took place in the suburban office locations where the rentals are higher than those in the peripheral office locations.

Sectoral Analysis

DISTRIBUTION OF OFFICE SPACE ACROSS SECTORS

Sectors	2011	2012	2013
IT/ITeS	47%	53%	70%
BFSI	6%	16%	9%
Manufacturing	25%	9%	5%
Other Service Sectors	22%	22%	16%

Source: Knight Frank Research

An analysis of the sectoral distribution showed an improvement in the IT/ITeS sector that was adversely affected during the 2008-09 recession. The share of office space absorption by the sector in 2013, to the tune of 70%, depicts a remarkable come-back since its share dipped to 47% in 2011 owing to economic uncertainties impacting its operational plans. Some of the key IT/ITeS companies that took up space in the city in 2013 include industry majors such as TCS, Cisco, Mindtree Consulting, Microsoft, Siemens and Capgemini.

As with the IT/ITeS sector, much variation was observed among the share of other sectors during the period 2011 to 2013. While the BFSI sector strove to steady itself in 2012 after a weak start in 2011, it seems to have gone into a shell again in 2013. The manufacturing industry too, saw a constant decline in its share in office space absorption over the years, which is a matter of concern for an industry-centric city such as Chennai. However, despite a decrease in the share of these sectors, several prominent transactions took place during 2013. In the case of the BFSI sector, a mention can be made of Deutsche Bank occupying office space in Sunnyside in Nungambakkam, while manufacturing companies like EPT Engineering and Metso Minerals occupied new offices at Central Square in Guindy.

Other service sectors like media, telecom, aviation, healthcare/pharma and e-commerce firms have also been gaining ground gradually, although its share reduced slightly in 2013 as compared to 2011 and 2012. Companies such as Sashun Pharma, Synergy Maritime and Frost & Sullivan took up office spaces in 2013.

SELECT TRANSACTIONS IN CHENNAI OFFICE MARKET IN 2013

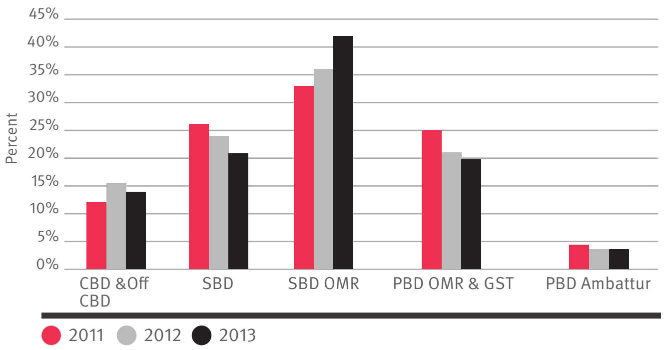
Building	Occupier	Location	Approx (sq.ft.)
Central Square 1	Value Labs	Guindy	20000
Prestige Cyber Tower	Capgemini	Sholinganallur, OMR	200000
DLF IT SEZ	Ernst & Young	Manapakkam	60000
Lords Tower	Eversendai	Ekkattuthangal	17750
TRIL Infopark	FIS	Taramani, OMR	270000
Sunnyside	Bosch	Nungambakkam	30000
Independant Building	GAVS	Sholinganallur, OMR	200000
Shriram Gateway	Slash Support	GST Road	100000
TRIL Infopark	CitiGroup	Taramani, OMR	150000
TRIL Infopark	Mindtree Consulting	Taramani, OMR	150000
SP Infocity	Amazon	Perungudi, OMR	300000

Source: Knight Frank Research

CURRENTLY THERE IS A LARGE INVENTORY OF APPROXIMATELY 7.5-8.5 MN.SQ.FT. OF READY OFFICE PROPERTIES LYING VACANT ALONG THE POST-TOLL OMR.

Geographical Analysis

MICRO-MARKET WISE SHARE OF ABSORPTION



Source: Knight Frank Research

Being strategically located with excellent connectivity to prime residential areas and developed physical and social infrastructure, the CBD and Off-CBD of the city remain one of the preferred office markets, mainly by small and mid-sized IT/ITeS companies and other service sectors. However, owing to the limited year-on-year office space supply, the region's share of absorption has been confined within the ranges of 12-16% during the period 2011 to 2013. Some of the key occupiers in these central office markets include companies such as Microsoft that relocated to Prestige Polygon on Anna Salai and Frost & Sullivan that relocated to ASV Hansa on Greams Road.

The SBD of the city, considered to be an ideal office destination due to quality office spaces, proximity to the city centre and easy access to the airport, is constricted by limited availability of land for office development. Not surprisingly, its share of absorption has declined by 20% in 2013 compared to the share in 2011. The cost of land is exorbitant in the suburban locations, thereby leading developers to consider residential development instead. While mixed use development is another avenue that can infuse new office space, the resultant quantum would not be substantial. At present, DLF IT SEZ in Manapakkam and the stand-alone office projects in Guindy are primarily responsible for office space absorption in the SBD. Of late, Guindy has become the preferred office destination for many occupiers looking to relocate from the CBD and off-CBD markets. As a result, various developers are positioning their projects in Guindy as premium office developments in order to tap into this demand, offering better amenities. In 2013, companies such as Equinity and 4a Design have taken up new offices in DLF IT SEZ and Lords Tower in Ekkattuthangal respectively.

SBD OMR, or the pre-toll region encompassing Taramani and Perungudi, has evolved as a much preferred office destination by the IT/ITeS sector. Proximity to the city centre, easy access to the airport, availability of good quality office buildings, affordable rents and developed social infrastructure are some of the reasons that have led to the SBD OMR attracting major IT/ITeS occupiers. This is reinforced by the fact that the region accounted for a remarkable share of 42% of the office space absorption in 2013, portending an improvement of 27% over the figure in 2011. Prominent IT Parks such as TRIL Infopark, Prince Infocity, Ascendas IT Park, RMZ Millenia and SP Infocity have been instrumental in garnering absorption in the SBD OMR region. Some of the key tenants that took up office space in the SBD OMR include FIS, Latent View Analytics, Citi Group and TCS in TRIL Infopark and Caterpillar in Ascendas IT Park.

THE SBD MARKETS SAW AN INCREASE IN RENTALS IN 2013, PRIMARILY DUE TO THE PREMIUM VALUES CHARGED IN GUINDY, WITH TENANTS WILLING TO RELOCATE THERE FROM THE CBD. THIS CORRESPONDS TO THE DECLINE IN WEIGHTED AVERAGE RENTALS IN THE CBD IN 2013 BY 3% OVER THE VALUES IN 2012.

Meanwhile, the post-toll OMR stretch and GST Road that make up the PBD OMR & GST Road region are other areas favoured by the IT/ITeS sector due to the higher volume of space requirement. Competitive rentals offered by these peripheral micro-markets attracted many firms to relocate here. ELCOT SEZ at Sholinganallur, SIPCOT at Siruseri, Shriram Gateway at Perungalathur and Mahindra World City at Singaperumalkoil are the major office hubs in this market. However, the distance from the city centre and lack of social infrastructure as well as traffic bottlenecks have taken the sheen off lower rentals in the region. Additional costs involved in installing electricity back-up and arranging transport facility for employees has led companies to deter away from PBD OMR & GST Road. At present, there is a large inventory of approximately 7.5-8.5 mn.sq.ft. of ready office properties lying vacant along the post-toll OMR. Thus, the contribution of this region towards office space absorption has declined by 21% in 2013 as compared to 2011. Among the notable occupiers that took up space this year in this region a mention can be made of Accenture in Shriram Gateway on GST Road and Capgemini in Prestige Cyber Tower in Sholinganallur.

PBD Ambattur on the other hand, has not seen much activity in recent years. Factors such as distance from the city centre and the airport as well as competition from other office markets like the OMR and GST Road offering similar rentals have led occupiers to overlook PBD Ambattur. Besides, it is a much smaller office market as compared to other markets of Chennai with only a handful of quality office projects, catering largely to small and mid-sized IT/ITeScompanies and other service sector industries. PBD Ambattur's share in absorption has remained constant at 4% during 2011 to 2013. Key occupiers in the region include Royal Bank of Scotland in IndiaLand IT Park while others like Dell, CSS, Serco, IQ Back Office and CMA CGM have offices in Ambit IT Park.

Rental Trend

WEIGHTED AVERAGE RENTAL VALUES OF OFFICE SPACE TRANSACTIONS IN CHENNAI (₹/SQ.FT./ MONTH)

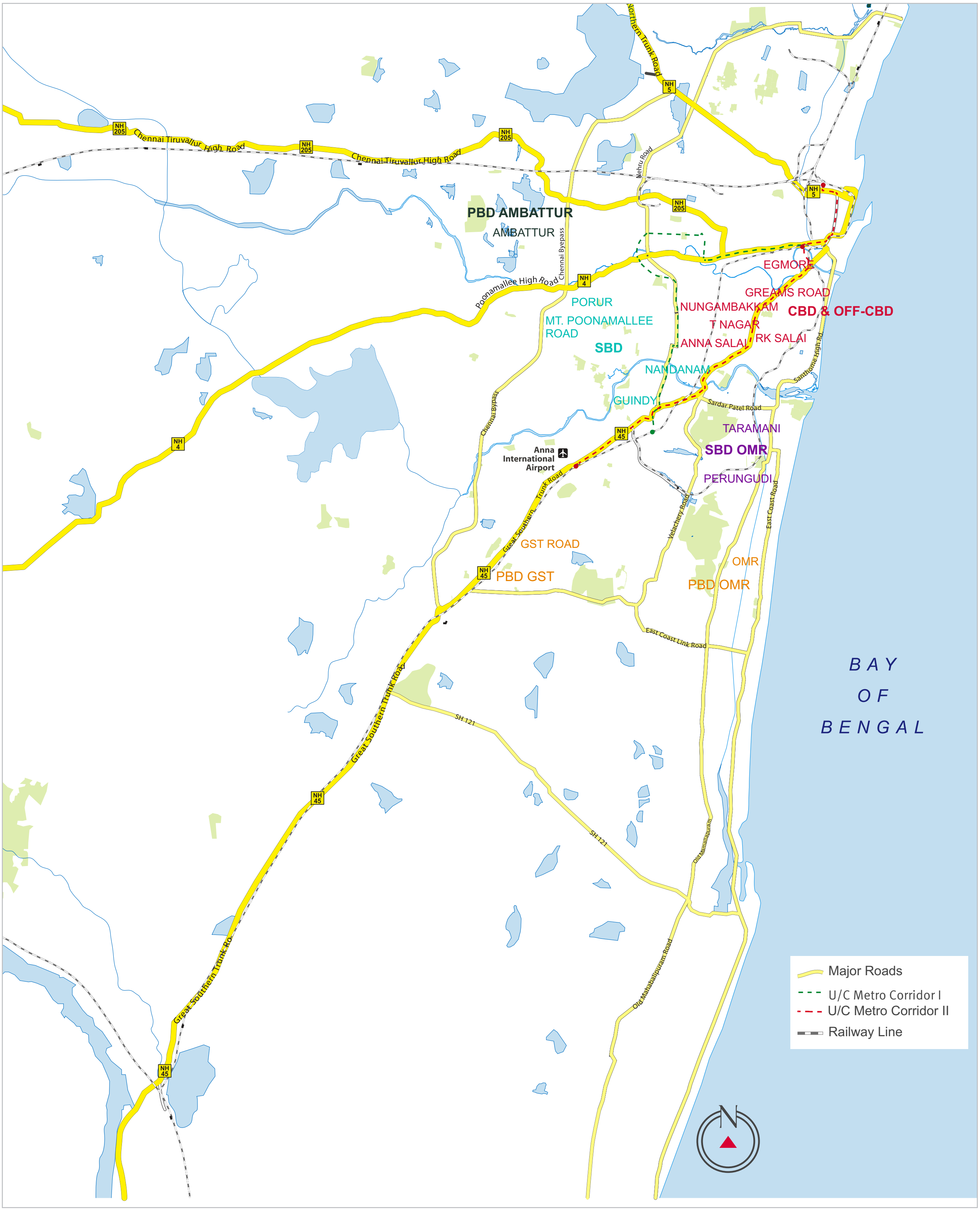
Micro-markets	2011	2012	2013
CBD & Off-CBD	60	66	64
SBD	43	50	52
SBD OMR	42	43	50
PBD OMR & GST	32	33	33
PBD Ambattur	32	32	33

Source: Knight Frank Research

AMONG THE UPCOMING AREAS OF GROWTH, PORUR HOLDS MUCH POTENTIAL, ALTHOUGH IT DEPENDS ON THE DEVELOPERS WHETHER THEY WOULD BE WILLING TO LIVE WITH THE FACT THAT RESIDENTIAL DEVELOPMENT WOULD FETCH A BETTER PRICE.

The weighted average rental values in the CBD and SBD saw maximum upward movement in 2012 during the period 2011-2013, to the tune of 10% and 16% respectively, over the values in 2011. This can be attributed to the increase in transaction activity coupled with a dearth of quality office spaces in the CBD and SBD. The revival of the IT/ITeS sector can be gauged by the rental appreciation of 16% in the SBD OMR region in 2013, over the values in 2012.The SBD markets too saw an increase in rentals in 2013, primarily due to the premium values charged in Guindy, with tenants willing to relocate there from the CBD. This corresponds to the decline in weighted average rentals in the CBD in 2013 by 3% over the values in 2012. The peripheral markets remained relatively subdued with no significant improvement in weighted average rental values during the period 2011 to 2013.

Map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AMBATTUR
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TARAMANI
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Poonamallee High Road
Great Southern Trunk Road
Northern Trunk Road
Sardar Patel Road
East Coast Link Road
SH 121
Old Mahaballipuram Road
BAY
OF
BENGAL
Major Roads
U/C Metro Corridor I
U/C Metro Corridor II
Railway Line

Outlook

The Chennai office market has managed to beat the absorption level achieved during the post-recession recovery period of 2010 by 13% with a fair amount of transaction activity in 2013, although it fell behind the peak level of 2011 by 22%. The resurgence in office space demand from the IT/ITeS sector bodes well for the city's office market. While the past few years saw developers of all grades joining the fray in developing office space to attract IT/ITeS occupiers, the stringent economic conditions have dampened the enthusiasm bringing in a sense of realism into the market. IT/ITeS companies, although recruiting, are behaving prudently and taking up genuine numbers for employment. Along with occupiers, the developers have also become cautious and are presently adopting a conservative approach to their project completion timelines.

The year 2014 has been ear-marked as a very important period, owing to the impending formation of a new central government at the helm. Sentiments are expected to improve, but they need to sustain for some time in order to bring in the required confidence in the market. While IT/ITeS sector will continue to drive demand, the Small & Medium Enterprises (SME) sectors with requirements of smaller office spaces will show increased activity, providing an opportunity to the developers to tap this demand. The manufacturing industry is expected to gain momentum in the forthcoming year.

Going forward, office projects in OMR post toll and GST Road will evince interest from occupiers having large floor plate requirements at lower rentals. Pre-toll OMR do not have much supply planned, barring SP Infocity in Perungudi. The IT/ITeS sector will be the driving force for office space demand. Guindy is poised to emerge as an alternative to CBD and off-CBD locations, catering to the demand of the non-IT/ITeS sector with a smaller office size mandate. The upcoming Metro Rail would be an added advantage to this office micro-market.

Meanwhile, considerable supply is in the pipeline along the post-toll OMR which will be released into the market in phases over long intervals. Among the upcoming areas of growth, Porur holds much potential, although it depends on the developers whether they would be willing to live with the fact that residential development would fetch a better price.On the other hand, the CBD will continue to remain an important market in terms of value with non-IT/ITeS sectors contributing to office space demand here. On the rental front, values are expected to remain stable in most micro-markets, although marginal appreciation is envisaged in projects witnessing occupier interest.

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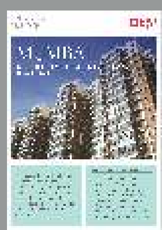

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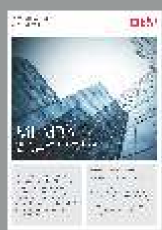

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