RESEARCH

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ECONOMY & REALTY

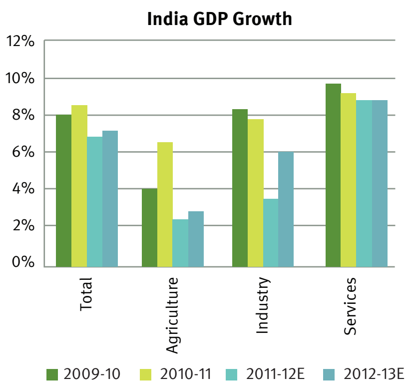
Knight Frank

Outlook

India's economic growth over the last 6 years has been commendable with an average Gross Domestic product (GDP) growth of more than 8.6% since 2005-06. Except for 2008-09, when the economy grew by mere 6.7% due to the impact of global recession, the annual GDP growth has remained above 8%. However, since the past few quarters, slowdown in the global economy and tight monetary policy has dragged down the GDP growth to less than 7%. For 2011-12, GDP is expected to grow at 6.9% as against 8.4% growth achieved during 2010-11. For 2012-13, it is projected to grow at 7.2%.

GDP of a country constitutes of three major segments namely agriculture, industry and services. Among the three segments, growth of industry segment is estimated to drop drastically to 3.6% during 2011-12 from 6.8% in 2010-11. However, the fall in industry segment's growth will not impact total GDP significantly as it only forms 26% of the economy. Industry segment comprises of manufacturing, mining and construction. Service segment, which has the largest share in GDP at 55%, is expected to grow at 8.8% during 2011-12. This will provide some comfort to the economic growth and compensate for the loss due to slowdown in the industry and agriculture segments.

Economic growth of a country has a direct bearing on the real estate sector and especially on the office space segment. The level of economic activity influences the amount of incremental office space demanded during a year. Currently, the top seven cities of India that is Mumbai, National Capital Region, Bangalore, Pune, Chennai, Hyderabad and Kolkata together occupy 389 mn sq.ft of Grade-A office space.



Source: RBI, Knight Frank Research

A lot of this space was constructed during the boom period of 2005 to 2007. However, recessionary condition in 2008 led to many projects getting delayed and these projects eventually entered the market post 2009 when the domestic economy started showing signs of recovery. This resulted in huge amount of new office space supply entering the market during the previous two years. During 2010-11, a total of 38 mn sq.ft of new space was constructed in the top seven cities and it was 37 mn sq.ft during 2011-12.

OFFICE SPACE ABSORPTION DURING 2011-12 WAS MERELY 2% LOWER THAN 2010-11 DESPITE GDP GROWTH SLOWING DOWN FROM 8.4% TO 6.9% DURING THE SAME PERIOD. THIS IS IN SHARP CONTRAST TO THE POPULAR BELIEF THAT 2011-12 WAS A DULL YEAR FOR OFFICE MARKET

In terms of absorption, these cities have witnessed a healthy trend during the last two years. While 39 mn sq.ft of space was absorbed during 2010-11, it was 38.2 mn sq.ft during 2011-12. Office space absorption during 2011-12 was merely 2% lower than 2010-11 despite GDP growth slowing down from 8.4% to 6.9% during the same period. This is in sharp contrast to the popular belief that 2011-12 was a dull year for office market in terms of absorption.

Healthy absorption rate ensured a drop in vacancy level to 21% by the end of Q4 2011-12 from 27% in Q4 2009-10. Over the last two years, a large number of corporates have been shifting to newly constructed Grade-A office space in the Secondary Business Districts (SBD) from the old buildings in the erstwhile Central Business District (CBD). The need for operating from a large single office rather than having multiple smaller offices spread across various locations has fuelled the demand for Grade-A buildings with large floor plate and enhanced common facilities.

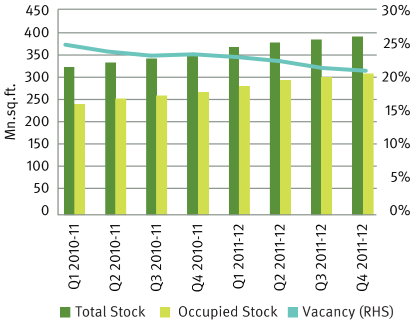
HEALTHY ABSORPTION RATE ENSURED A DROP IN VACANCY LEVEL TO 21% BY THE END OF Q4 2011-12 FROM 27% IN Q4 2009-10.

IT/ITeS sector constitutes the largest segment of office space in India and contributed to more than half of the total space absorbed during 2011-12. Although its share has fallen marginally during 2011-12 as compared to 2010-11, IT/ITeS sector still remains the driving force of Indian office space market. Share of manufacturing sector has witnessed an increasing trend over the last two years and contributed 19% in total absorption

India Research

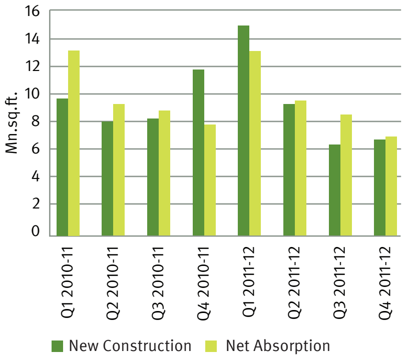
Dr. Samantak Das National Head - Research
+91 (022) 6745 0101
samantak.das@in.knightfrank.com

Stock & Vacancy Levels - India



Source: Knight Frank Research
Note: Data pertains to Mumbai, NCR, Bangalore, Pune, Chennai, Hyderabad and Kolkata

Incremental Supply and Absorption - India

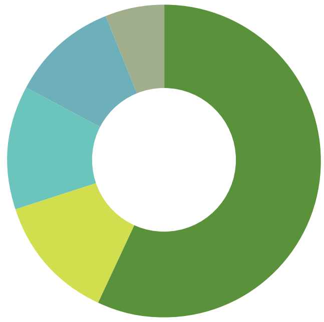


Source: Knight Frank Research
Note: Data pertains to Mumbai, NCR, Bangalore, Pune, Chennai, Hyderabad and Kolkata

during 2011-12. Share of other service sectors which includes consulting, education, logistics and other such companies, has increased from 11% to 16% in the last two years. Growth rate of more than 9% in the service sector GDP over the last few years has fuelled the need for additional office space from this sector and is expected to grow further in the coming years. Banking, financial services and insurance (BFSI) sector is another leading contributor to office space in India. However, its share in total absorption has come down from 13% to 8% in 2011-12 as demand from other sectors has increased.

Going forward, the slowdown in economic growth is expected to bring down the need for additional space by these sectors and this could lead to higher vacancy levels. Demand for office space from manufacturing sector will be impacted to a greater extent as compared to service sector. GDP growth of service segment is estimated to grow at 8.8% during 2012-13, much higher than industry segment growth of 6%. Absorption of space during 2012-13 is expected to be considerably lower than the previous two years and this will make it all the more challenging for developers to maintain existing levels of rent. However, the latest move by Reserve Bank of India (RBI) of reducing the repo and reverse repo rate by 50 basis points (bps) each could provide the much needed impetus to the economy and help in reviewing the demand scenario for office space in the coming quarters.

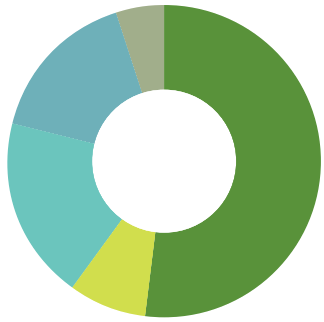
Industry wise Break-up of Absorption - 2010-11



- IT/ITES - 57%
- BFSI - 13%
- Manufacturing - 13%
- Other Service Sectors - 11%
- Other - 6%

Source: Knight Frank Research
Note: Data pertains to Mumbai, NCR, Bangalore, Pune, Chennai, Hyderabad and Kolkata

Industry wise Break-up of Absorption - 2011-12



- IT/ITES - 52%
- BFSI - 8%
- Manufacturing - 19%
- Other Service Sectors - 16%
- Other - 5%

Source: Knight Frank Research
Note: Data pertains to Mumbai, NCR, Bangalore, Pune, Chennai, Hyderabad and Kolkata

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Dr. Samantak Das National Head - Research
+91 (022) 6745 0101
samantak.das@in.knightfrank.com

KnightFrank.co.in