

THE NEW FACE OF INDIAN WAREHOUSING: A TRANSFORMATION TOWARDS AN ORGANISED PLAY

A warehouse is a key component of logistics which defines the efficiency of the supply chain. In India, the logistics cost as a percentage of the Gross Domestic Product (GDP) is almost double that of the logistics cost to GDP ratio in developed countries. With warehousing accounting for as much as 25% of the logistics cost, as an asset class it has been mired with challenges such as occupiers' preference for multiple but small warehouses. The trend worked as a counter mechanism to avoid inter-state taxes that were applicable on sale of goods and not on stock transfer.

This mindset limited automation in warehousing and thrust on warehouse design and management. This long-standing attitude of occupiers is slowly mitigating as the sector is getting organised. The introduction of the Goods and Services Tax (GST) primarily set the ball rolling. At the same time, inherent changes in the overall regulatory environment courtesy compliance regulations in place (mainly in pharmaceutical industry), quality parameters of regulators and clients and risks and penalties associated with non-compliant warehouses are making a world of difference.

Further, large warehouses come with the promise of achieving economies of scale and efficiency in operations and safety and security of goods. Amid this changing scenario, we have also observed the foray of many international businesses and emergence of e-commerce players who prefer to establish their warehousing footprint only through legally compliant warehouses.

Structural reforms changing the warehousing ball game

The government has introduced many reforms which have brought the warehousing sector under limelight and stirred interest of various participants globally.

- 100% Foreign Direct Investment (FDI) is already permitted in the warehousing and storage sector under the automatic route.

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- The roll-out of Goods and Services Tax (GST) has only acted as a catalyst for organised warehousing.
- The recent grant of infrastructure status to the logistics sector including warehousing is likely to propel the need for integrated logistics sector development and boost domestic and external demand leading to spur in manufacturing and job creation. This will have a ripple effect on warehousing development. The recognition would also help the logistics sector access infrastructure lending at easier terms and enhanced limits, access to external commercial borrowings, longer tenor funds from insurance companies and pension funds and be eligible to borrow

- from India Infrastructure Financing Company Limited (IIFCL).
- The Make in India programme was launched, with an objective to increase manufacturing sector growth to 12-14% per annum in medium term and whip up its share from 16% now to 25% of GDP by 2022. Thrust on enhancing global competitiveness of the Indian manufacturing sector, creating 100 million jobs by 2022, setting up multimodal logistics parks and industrial corridors will translate into more warehousing demand as both the sectors closely complement each other.

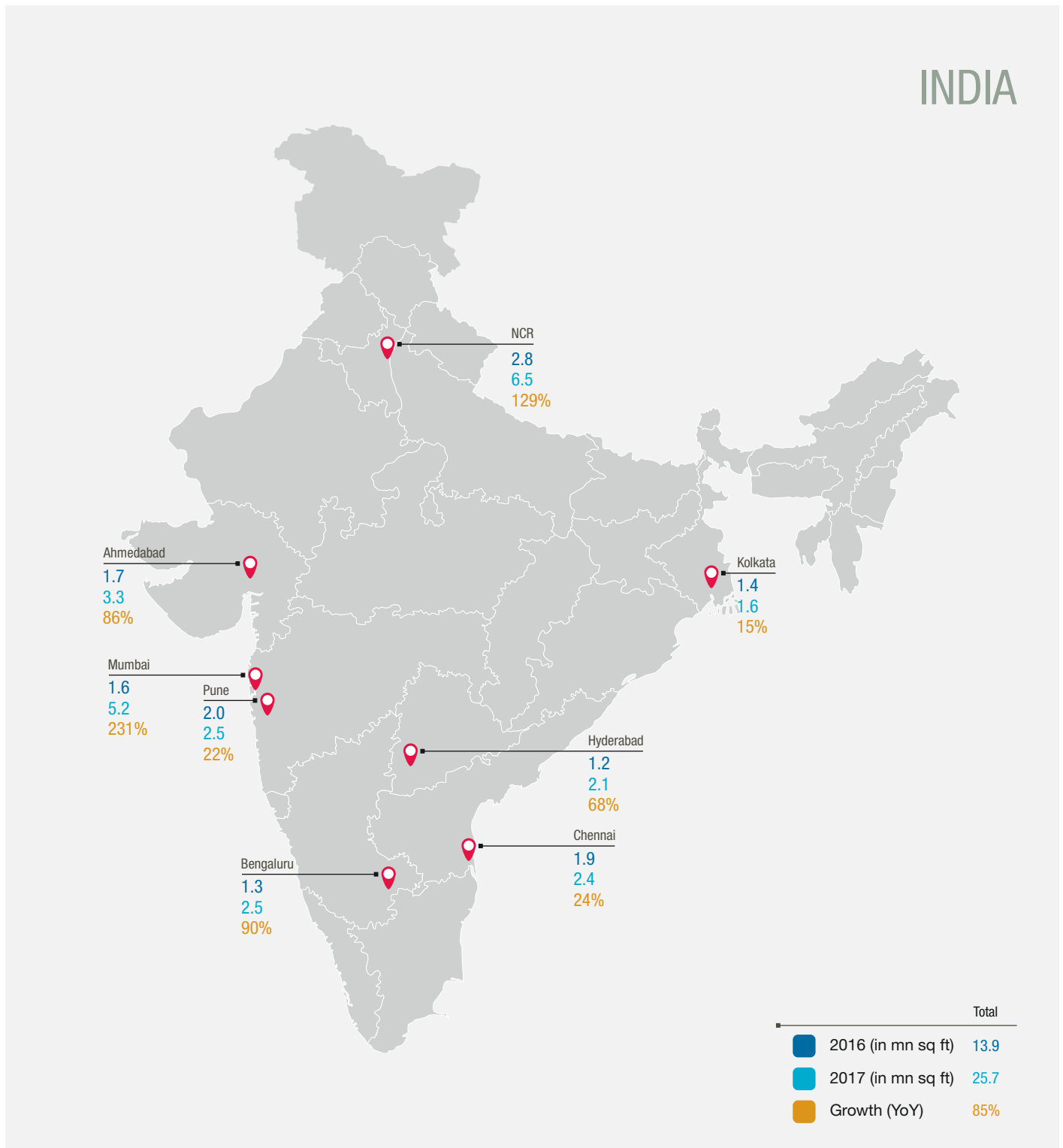
Organised warehouses experience a near double leasing volume in 2017

Though the Indian warehousing sector largely remains unorganised, some organised players have recently ventured into warehousing activities. The recent government initiatives have brought the warehousing sector at the

culmination of exponential growth which is already visible in the growth in annual leasing volume. The total leasing volume in the organised warehousing segment across the top eight cities (Ahmedabad, Bengaluru, Chennai,

Hyderabad, Kolkata, Mumbai, NCR and Pune) in 2017 stood at 25.7 million sq ft recording an 85% year-on-year (YoY) growth over 2016.

INDIA



Source: Knight Frank Research

- In 2017, Mumbai, NCR and Bengaluru witnessed maximum increase in leasing volume over 2016 as these three cities along with their peripheries constitute the vital hubs on the industrial corridors envisaged by the government which incentivised warehousing activities.
- Of the total leasing volume in 2017, NCR accounted for the maximum 25% share or 6.5 million sq ft on the back of strong demand for manufacturing-led warehousing space concentrated on NH-48, NH-19 and NH-24. Post GST implementation, many occupiers who were sitting on the fence, expanded their warehousing footprint in NCR robustly.
- Mumbai accounted for 20% or the second-highest share of 2017 leasing volume. The growth in warehousing leasing volume in Mumbai was predominantly led by e-commerce, big box retailers and third party logistics providers (3PLPs).
- Ahmedabad which accounted for 13% share in leasing volume has also seen a surge in warehousing demand in Asali-Kheda and Changodar-Bagodara belts.
- Whilst Bengaluru and Pune each contributed 10% to the leasing volume, the share of other cities remained in single digits.

TABLE 1

Major warehousing clusters

| City | Major Warehousing cluster | Major Occupiers |
|-----------|--------------------------------|---|
| Ahmedabad | Changodar - Bagodara | DHL, Flipkart, MRF Tyres |
| | Aslali - Kheda | HUL, DMart |
| Bengaluru | Hoskote-Narsapura | Volvo, Medreich |
| | Nelamangala-Dabaspete | Hitachi, Pepsico, DB Schenker |
| Chennai | Sriperumbudur-Oragadam cluster | Indev Logistics, Apollo, Indutch |
| Hyderabad | Jeedimetla - Medchal | Flipkart, DHL, Nestle, Delhivery, Ratnadeep |
| Mumbai | Bhiwandi | Allcargo Logistics, Amazon, H&M, DHL, Myntra |
| | Panvel | Aramex Logistics, Exide Batteries, Jaguar Sanitary ware, Apollo Tyres |
| NCR | NH – 48 Cluster | Amazon, Decathlon, Subros |
| | Ghaziabad Cluster | Amazon |
| Pune | Chakan - Talegaon | IKEA, Mahindra Logistics, Ericsson |
| | Wagholi - Ranjangaon | Haier |

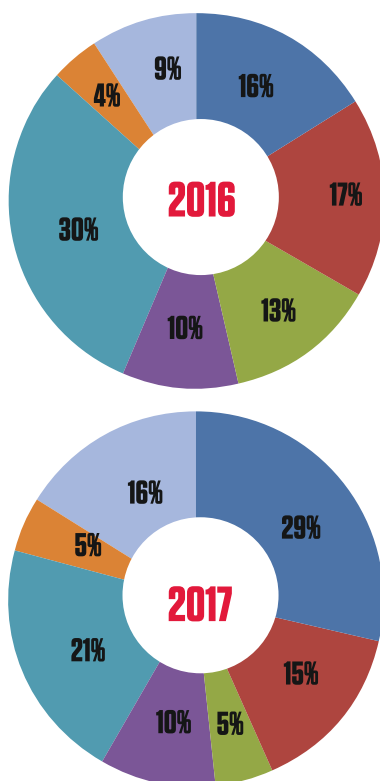
Source: Knight Frank Research

Warehouse supply transforms to keep pace with its most sophisticated occupiers

Such transformation into organised warehouse supply got accentuated in the recent period mainly by the sophisticated occupiers namely 3PL and e-commerce, which thrive on efficient business model. The

recent government initiatives have opened the floodgates for warehouse development. GST implementation has catalysed many industries to re-think their warehouse strategies. Though the extent of consolidation

in warehousing sector will vary depending upon the industries involved, some industries have emerged a frontrunner in warehouse occupancy. In 2017, the top three occupier industries were third party logistics (3PL) followed by manufacturing and retail.

All India Industry wise share of transactions in 2016 and 2017

| | 2016 | 2017 |
|---------------|------|------|
| 3PL | 16% | 29% |
| e-commerce | 17% | 15% |
| FMCD | 13% | 5% |
| FMCG | 10% | 10% |
| Manufacturing | 30% | 21% |
| Others | 4% | 5% |
| Retail | 9% | 16% |

Source: Knight Frank Research

3PL – From a 16% share of total transactions in 2016, the share of 3PL increased to 29% of 2017's leasing volume. 3PLs which provide transportation, warehousing and administration services have become an integral part of the supply chain process as businesses realize the importance of outsourcing logistics and complete logistics management. Factors such as India's rapidly growing consumption base, last-mile delivery capabilities, increasing trade and increasing push for technology operations have made 3PLs more or less indispensable for

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businesses today. With 3PLPs bringing in cost efficiencies and logistics competitiveness, demand for specialized 3PL is only set to increase manifold. Going forward, we anticipate the spending on 3PL providers to increase further which should translate into more warehousing demand by 3PLPs.

Manufacturing – In 2017, manufacturing sector accounted for a 21% share in warehousing transaction volume. Though the share of manufacturing was 30% of transaction volume in 2016, the actual volume of space take-up in 2017 in sq footage surpassed vis-à-vis 2016 as the gross volume had heightened by 85% during the same period. With the push to the Make in India initiative, the state governments are also incentivizing manufacturing activities in their states by repealing old laws and setting up fast-track approval systems. The announcement of 5 industrial corridors will also promote manufacturing clusters by enhancing connectivity. These positive changes have improved India's ranking from 131 to 100 in the Ease of Doing Business Index by World Bank in 2018. The continued focus on economic reforms also led Moody's to revise India's rating from Baa3 to Baa2 and change India's outlook from stable to positive. As manufacturing sector is one of

the biggest occupiers for warehouse space consumption, these positive reforms will help increase warehousing space requirements from major manufacturing industries.

Retail – The retail industry's share increased substantially from only 9% of warehouse transaction volume in 2016 to 16% of transaction volume in 2017 excluding the e-commerce segment. Per our earlier studies, the brick-and-mortar retail industry's warehousing space requirement in India's top seven markets (Ahmedabad, Bengaluru, Chennai, Hyderabad, Mumbai, NCR and Pune) is expected to grow at a compounded annual growth rate (CAGR) of 6% for the next two years with an expected annual additional space requirement of 8 million sq ft till 2020. The changes in the FDI policy have ushered in the entry of many international brands and big box retailers in India. Many big box retailers have either launched or are in the process of launching operations in India as part of which they are actively scouting for warehouses. We expect this trend to continue driving warehousing demand in the country going forward.

Meanwhile, the **e-commerce** industry's share in total warehouse leasing volume remained largely steady in 2016 and 2017. From a 17% share in total warehouse leasing transactions in 2016, e-commerce's share stood at 15% in

2017. With the Indian e-commerce sector rapidly increasing its sales performance, shrinking delivery timelines of major online marketplaces only highlights the need to have distribution centres and storage facilities closer to consumption hubs. As the e-commerce players expand the market in terms of size, demand for compliant warehouses is only set to increase in future. Knight Frank studies forecast a 19% CAGR for the warehouse space requirement emanating from the e-commerce industry leading to a total additional warehouse space requirement of 14.4 million sq ft from 2016 to 2020. The need to stay closer to consumption hubs will propel a new wave of warehousing demand by e-commerce occupiers.

Future Outlook

Warehousing is set to enter a new phase of growth as regional developers have understood the importance of infrastructure and quality specifications as part of their standard offering. Some have also started selling their portfolios to bigger developers. Limited supply of quality warehouse stock has also spiked investor interest as they eye this asset class in light of strengthening demand.

TABLE 2

Trends to watch out for in 2018

- Fragmented and unorganised players to pave way for large organised players
- Organised warehousing to transform storage spaces into modern warehouses providing value added services
- Smart warehousing solutions and automation to modernize warehouse operations
- Consolidation from multiple warehouses to few large facilities
- Inventory carrying costs to shrink for businesses
- Institutional investor interest in warehousing to intensify as the country implements a unified taxation system

Demand for large warehousing facilities is set to increase as occupiers focus on consolidating in such spaces. As these spaces remain short in supply, this demand-supply gap is helping organised players to charge higher rentals than their unorganised counterparts in the same location. Their ability to charge a premium arises on the back of large scale and quality warehouse parks that are built in compliance with development regulation. In 3-5 years, we expect the smaller developers to recede their market share to bigger players thereby bringing a structural shift.

In this backdrop, demand for large warehousing facilities is set to increase as occupiers focus on consolidating in such spaces. As these spaces remain short in supply, this demand-supply gap is helping organised players to charge higher rentals than their unorganised counterparts in the same location. Their ability to charge a premium arises on the back of large scale

and quality warehouse parks that are built in compliance with development regulation. In 3-5 years, we expect the smaller developers to recede their market share to bigger players thereby bringing a structural shift. In the long run, warehousing will evolve into an organised segment in the same league as its global counterparts.



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