INDIA WAREHOUSING MARKET REPORT 2018 INSIGHT SERIES #4

Knight Frank

The Return Dynamics in Indian Warehousing Sector

While the Indian Logistics sector has always held great promise, game-changing measures such as the GST and the Logistics Parks Policy taken by the Central Government definitely make it seem like an idea whose time has come. The Indian warehousing sector especially is attracting a lot of investment interest from stakeholders willing to commit long-term capital in this asset class. 100% foreign direct investment (FDI) in the storage and warehousing sector under the automatic route has been permitted since several years. In addition to this, the government has recently announced infrastructure status to the logistics industry. This decision will enable companies in the logistics and warehousing sector projects to access funds at lower cost, longer tenure and enhanced limits. Companies would now be accounting for lesser cash outflows due to debt and interest repayments in the initial years unlike earlier as the debt financing can be taken with longer repayment tenure. It would also enable them to raise larger amounts of funds as external commercial borrowings (ECB), borrow longer tenure funds from insurance companies, pension funds, and sovereign funds and also make them eligible to borrow from the India Infrastructure Financing Co. Ltd (IIFCL). Moreover, even the banks would be able to lend to this sector with lower provisioning requirements than earlier. The approval process also gets simplified.

The Government of India has set out certain conditions that need to be met for a project to be classified under infrastructure status. The government has defined “logistics infrastructure” to include a multimodal logistics park comprising an Inland Container Depot (ICD) with a minimum investment of INR 50 crore and minimum area of 10 acres, cold chain facility with a minimum investment of INR 15 crore and minimum area of 1,858.05 sq.mt. (20,000 sq.ft.) and/or a warehousing facility with a minimum investment of INR 25 crore and minimum area of 9,290.23 sq.mt. (100,000 sq.ft.)

Institutional players will not invest in unorganised and small warehouses; they generally invest or set up large warehouses and professionally run logistics parks. Currently, the new facilities that are being built by institutional players are generally of large sizes, bigger than the minimum requirements as specified above and hence, they would stand to benefit from the infrastructure status.

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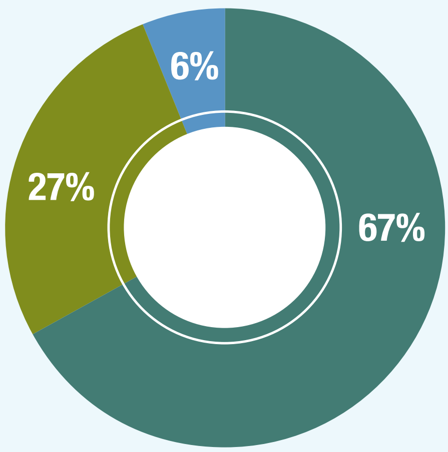
Increasing institutional investor interest

Investors had started taking cognizance of the opportunities in this sector much before the government could implement the reforms such as implementation of GST and granting infrastructure status to logistics industry including warehousing. The past few years have witnessed massive participation from institutional investors. Some of them have purchased ready assets, whereas others are investing in a mix of ready and greenfield assets.

Warehousing investment accounted for around 26% of the total private equity (PE) investments into real estate during January 2014 – January 2018. Around USD 3.4 billion (INR 22,100 crore) of institutional capital has flown into this sector during this period. The actual size of capital movement would be higher, as these numbers only cover the major investments by organised players.

FIGURE 1



MIX OF NEW DEVELOPMENT AND ACQUISITION	6%
NEW DEVELOPMENT	67%
ACQUISITION	27%

Source: Knight Frank Research, Media reports, Company press release

New developments or greenfield projects accounted for 67% of the total investments followed by 27% for acquisition of complete projects.

TABLE 1

Some of the major investors include

Canada's Ivanhoé Cambridge and QuadReal Property Group
Ascendas Firstspace
Warburg Pincus
Canada Pension Plan Investment Board (CPPIB)
Everstone Capital Management
Brookfield
DHL India*
Allcargo Logistics*

Note: * Investments for captive expansions

TABLE 2

Some of the major developers include

Indospace
Embassy group
Assetz
e-Shang Redwood
Panchshil Realty

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TABLE 3

Some of the noteworthy investments during January 2014 – January 2018 include

YEAR	DEAL PARTICIPANTS	DEAL SIZE (INR CR)	DEAL SIZE (USD MN)	DEVELOPMENT TYPE
Jun-17	Ascendas Firstspace JV	3,900	600	Mix
Oct-17	IndoSpace third fund - IndoSpace III	3,575	550	New
May-17	CPPIB investment in IndoSpace	3,250	500	Acquisition
Oct-17	Canada's Ivanhoé Cambridge and QuadReal Property Group investment in Logos India	2,600	400	New
Aug-17	Assetz Group tie up with Logos India	2,600	400	New
Jan-14	Allcargo Logistics*	1,000	154	New
Aug-16	Warbug Pincus investment in Stellar Value Chain Solutions	813	125	New
Jun-17	e-Shang Redwood	650 annually	100 annually	New

Note: * Investments for captive expansions

Source: Knight Frank Research, Media reports, Company press releases

Equity IRR for development projects

Earlier, due to the unorganised nature of the industry the equity IRR for a development project was low. Now with all the policy reforms that are being undertaken there is a paradigm shift in the industry structure where it is becoming favourable for organised players. On account of this structural transformation, the attractiveness of taking up a warehouse development project is evident. Our assessment, reflected in the Equity IRR of a warehouse development project, indicates how warehousing as an asset class is becoming lucrative avenue in the spectrum of commercial real estate development.

Limited warehouse supply from the organised segment, amidst the increasing demand brought by reforms in the sector has translated into heightened investor interest in the available warehouse stock. While the trend, currently, is a mix of brownfield and greenfield projects, the shrinking opportunities would make greenfield investment the only way to participate in the asset play that the sector will have on offer.

Meanwhile in light of the slump in the Indian residential market over the past few years and the track record of poor returns, investors preferred to invest in rent-yielding commercial assets. With increased investor activity in the commercial segment and the acute shortage

Demand for large warehousing spaces is likely to see steady increase as occupiers are now looking to move out of their smaller warehouses and consolidate their activities in larger facilities.

in supply of good quality of office space, the cap rates are declining and inching below 8% from the 9–10% range witnessed a few years ago. The risk-reward ratio would start becoming unfavourable as the cap rates start to decline further below 7–7.5%. As a result, there has been a considerable shift in investors' focus towards the warehousing sector. The warehousing assets are offering a higher cap rate around 150–200 bps greater compared to what commercial assets are currently offering.

As observed in the below table, the equity IRR achievable for a warehouse development project can go as high as 28%. Clusters like Nelamangala-Dabaspete in Bengaluru and Jeedimetla-Medchal in Hyderabad yield 12% IRR as opposed to the 28% of Chakan-Talegaon cluster in Pune.

TABLE 4

City	Warehousing cluster	Quoted land rate (₹ mn/hectare)	Quoted rentals (₹/sq.mt./month)	Equity IRR achievable for a development project
Ahmedabad	Changodar - Bagodara	2 - 14	108 - 194	18%
Ahmedabad	Aslali - Kheda	2 - 13	108 - 215	16%
Bengaluru	Hoskote - Narsapura	3 - 6	129 - 172	18%
Bengaluru	Nelamangala - Dabaspete	4 - 9	108 - 172	12%
Chennai	Sriperumbudur - Oragadam cluster	4 - 16	161 - 301	22%
Chennai	NH 5 - Periyapalayam cluster	3 - 61	151 - 258	22%
Hyderabad	Jeedimetla - Medchal	6 - 20	108 - 194	12%
Mumbai	Bhiwandi	5 - 20	118 - 215	20%
Mumbai	Panvel	10 - 20	183 - 269	16%
NCR	NH - 48 Cluster	4 - 10	129 - 237	26%
NCR	Ghaziabad Cluster	4 - 16	151 - 237	26%
Pune	Chakan - Talegaon	4 - 12	172 - 301	28%
Pune	Wagholi - Ranjangaon	4 - 14	129 - 237	22%

Source: Knight Frank Research

* 1 acre = 0.41 hectares
** 1 sq.mt. = 10.76 sq.ft.

Demand for large warehousing spaces is likely to see steady increase as occupiers are now looking to move out of their smaller warehouses and consolidate their activities in larger facilities, which are presently in short supply compared to the demand. This demand-supply gap is visible in the current premium commanded by organised players owning these assets. For example, in the Bhiwandi warehousing cluster in the Mumbai Metropolitan region (MMR), the rents for unorganised spaces are as low as INR 97 per sq.mt. (INR 9 per sq.ft.), whereas organised players are commanding rents in the range of INR 150-215 per sq.mt. (INR 14-20 per sq.ft.) in the same region. As more and more companies streamline their logistics networks, it would be observed that unorganised players or smaller organized players would consolidate, giving acquisition opportunities to large players. The industry is expected to witness a structural shift over the next 3–5 years.

The Equity IRR achievable for a warehouse development project can reach up to 28%, with returns exceeding 20% for majority of the major markets.

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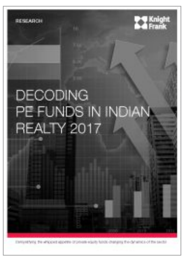

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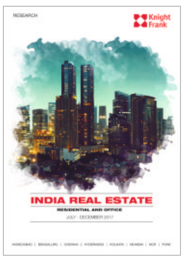

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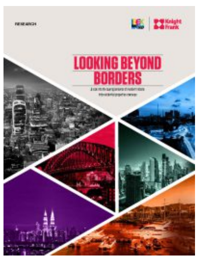

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