Strong upcoming supply to keep up with demand

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Despite a marginal drop in q-o-q absorption, Q3 2017 has witnessed a substantial 16.5% increase y-o-y in leasing activity. In view of the office deal pipeline, we expect leasing to pick up further towards the year-end. Forthcoming supply is likely to complement demand. We advise occupiers to prepare expansion strategies well in advance as limited options are available in preferred locations.

Forecast at a glance

Demand
The dominance of the technology sector is likely to continue with a slight increase in demand from sectors such as engineering and manufacturing and banking sector.

Supply
City has robust supply pipeline of 26 million sq ft (2.4 million sq m) under various stages of construction for the next 3 years leading to a 19-20% increase in the city's total inventory.

Vacancy rate
Supply demand equilibrium should keep the vacancy level at around 8% in medium to long term.

Rent
Rents to witness marginal increase in Q4. We expect overall city rents to rise up to 8-10% in total over the next three years.

Price
In proportion to rental forecast, capital value is set to increase in next 3 years.

Demand to pick up further in Q4

In Q3 2017, Bengaluru witnessed gross absorption of 3.0 million sq ft (0.27 million sq m) indicating a drop of 5% q-o-q. However, the city recorded gross absorption of 10.0 million sq ft (0.9 million sq m) over the first nine months, representing a considerable increase of 16.5% from the same period last year. We are positive about gross absorption in Q4 as well in view of a robust deal pipeline and keep our yearly forecast of 13.0 million sq ft (1.2 million sq m) for the Bengaluru office market, marginally up from last year.

Leasing activity was highest in Information Technology and Information Technology Enabled Services (IT-ITeS) Sector (39%), followed by Engineering & Manufacturing (24%), Banking and Financial Services (BFSI) (18%) and Coworking (9%). Average rents inch ed up by 1.2% q-o-q driven by micromarkets such as EPIP Zone/Whitefield, Bannerghatta Road and the Outer Ring Road (ORR).

As in Q3 2017, ORR remains the preferred location with a major contribution of 74% in total absorption followed by SBD (8%), CBD (5%) and EPIP Zone/Whitefield (4%). Occupiers such as Paypal, Span Infotech and Paytm chose to relocate and expand their office spaces to ORR. We expect this micromarket to remain Bengaluru's most sought-after office destination as the supply pipeline is likely to complement strong demand.

Rental Values

<table>
<thead>
<tr>
<th>Micromarkets</th>
<th>Rental Values (^1)</th>
<th>q-o-q change</th>
<th>y-o-y change</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBD</td>
<td>110 - 170</td>
<td>0.0%</td>
<td>16.7%</td>
</tr>
<tr>
<td>Outer Ring Road</td>
<td>75 - 85</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>(Sarjapur - Marathahalli)</td>
<td></td>
<td></td>
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<tr>
<td>Outer Ring Road (K.R.</td>
<td>70 - 80</td>
<td>2.7%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Puram - Hebbal)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bannerghatta Road</td>
<td>55 - 70</td>
<td>1.6%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Hosur Road</td>
<td>30 - 40</td>
<td>0.0%</td>
<td>7.7%</td>
</tr>
<tr>
<td>EPIP Zone/Whitefield</td>
<td>35 - 45</td>
<td>3.9%</td>
<td>6.7%</td>
</tr>
<tr>
<td>Electronic City</td>
<td>30 - 40</td>
<td>0.0%</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

Source: Colliers International India Research

\(^1\)Indicative Grade A rentals in INR per sq ft per month
2.4 million sq ft Grade A office space likely to be added in Q4

Q3 witnessed new supply of 1.4 million sq ft (0.13 million sq m), implying a year-to-date number of about 7 million sq ft (0.65 million sq m). About 2.4 million sq ft (0.2 million sq m) of Grade A office space is likely to be further added to Bengaluru's inventory in line with our previous prediction of 26.0 million sq ft (2.6 million sq m) by 2020, a 19-20% increase to the current total stock. Another 24.0 million sq ft (2.4 million sq m) of office space is projected to be completed in the form of built-to-suit space in the next three years.

Q3 witnessed new launches of a handful of new projects amounting to 6.4 million sq ft (0.5 million sq m) in the ORR. Over the next three years, we expect that the ORR will retain its position in terms of demand as well as supply with a 50% share of total upcoming supply followed by EPIP/Whitefield (18%).

A minor drop was witnessed in vacancy rates from 8.5% in Q2 to 8.0% in Q3. In our opinion, supply-demand equilibrium in Bengaluru should keep the vacancy level at around 8% over the medium to long term.

Colliers' View

The Karnataka state government has launched “Vision 2025”, a seven-year governance strategy to promote overall development of the state. The Asian Infrastructure Investment Bank (AIIB) has planned to invest USD336 million (INR 21,000 million) in the Namma Metro Phase 2 (Bayapanahalli to Whitefield). Also, a signal-free 17 km road extension of the ORR (Silk Road to Mysore Road) is progressing towards completion.

All these initiatives should help in improving the infrastructure of the city; however, timely completion will remain the key. In our opinion, real estate development may be adversely impacted in the event of delays in planned infrastructure projects.

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