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NEW SUPPLY TO SUPPORT LEASING IN 2019

Summary & Recommendations

We expect leasing in Chennai in 2019 to surpass that of 2018, which witnessed a slowdown in Grade A gross leasing. However, regulatory reforms such as the Tamil Nadu ICT Policy and the relaxation of the FSI for commercial buildings, coupled with infrastructure upgrades should further support the demand for Grade A office space in Chennai over 2019-2021.

> With a few transactions in the finalisation stages, we expect an increase in office space take-up by flexible workspace operators in 2019.

> We advise occupiers to be strategic in selecting their office locations by making commitments to new supply in preferred locations with good connectivity that currently have limited availability.

		Q4 2018	Full Year 2019	2018–21 Annual Average
Demand	> We expect demand for Grade A office space in 2019 to surpass 2018, with gross absorption of 4.6 million sq ft (427,510 sq m)	970,000 sq ft	4.6 mn sq ft	4.5 mn sq ft
Supply	> We expect an addition of around 19.4 million sq ft (1.8 million sq m) of Grade A supply over 2019-2021, increasing office stock by over 35%.	130,000 sq ft	2.9 mn sq ft	5.5 mn sq ft

		QOQ / End Q4	YOY / End 2019	Annual Average Growth 2018–21 / End 2021
Rent	> Overall city rents to increase at a CAGR of 2.4% over 2018-2021 driven by premium buildings in preferred location.	0.6% INR56.2	2.5% INR57.1	2.4% INR60.1
Vacancy	> While the vacancy rate is likely to decline in 2019, we expect it to rise from 2020 onwards owing to an increase in new completions.	1.3pp 12.7%	-1.7pp 9.3%	3.6pp 16.3%

Source: Colliers International
Note: Demand represents gross leasing; 1 sq m = 10.76 sq ft; pp: percentage point

ENHANCED CONNECTIVITY AIDS LEASING IN OFF CBD LOCATIONS

Chennai recorded 3.9 million sq feet (364,310 sq metres) of gross leasing in 2018, which is a 18% decline from the previous year. This is likely due to low availability of Grade A office space in preferred locations such as Old Mahabalipuram Road (OMR) pre-toll and Mount Poonamallee High (MPH) Road. However, we expect the gross leasing over 2019-2021 to grow at a robust average annual pace of 4.5 million sq feet (426,140 sq metres).

2018 also witnessed a decline in number of transactions as well as average transaction size from 22,500 sq feet (2,091 sq metres) to 19,000 sq feet (1,765 sq metres). Despite this slowdown, in view of the robust supply pipeline in preferred locations, we expect the leasing momentum to be well supported by supply over 2019-2021.

Compared to 2017, due to the low availability of Grade A office space, OMR Pre Toll witnessed less leasing, accounting for 20% of the total 2018 leasing volume, whereas in 2017, around 32% of take-up was in this micromarket. OMR Post Toll saw similar leasing momentum to 2017, accounting for 19% of the total leasing volume. In contrast to other micromarkets, Guindy is characterised by excellent road and metro connectivity, hence it witnessed increased leasing compared to 2017, representing 17% of 2018 leasing volume. Other micromarkets such as MPH Road and the Central Business District (CBD) also witnessed increased traction, accounting for 19% and 16% of the total 2018 leasing volume, respectively.

Demand for Grade A office space was driven by expansion and consolidation of companies in the Information Technology and Information Technology Enabled Services (IT-ITeS) sector, accounting for 37% of the total leasing volume in 2018. Banking, financial services and insurance (BFSI) witnessed heightened traction, accounting for 14% of the total leasing volume. Other sectors that garnered occupier interest in 2018 were engineering and manufacturing with 7%, and the media sector with 5% of total leasing volume. Flexible workspace operators almost doubled their space take-up yoy, accounting for 9% of leasing volume.

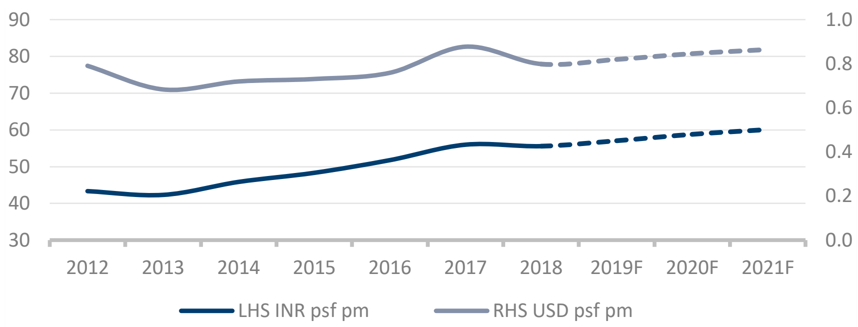
Chennai, gross effective rental values, Q4 2018

	Q4 2018 (INR psf pm)	Q4 2018 (USD psf pm)	QOQ Change (%)	YOY Change (%)
CBD[1]	70 – 90	1.0 – 1.3	0.0	0.0
Off CBD[2]	60 – 75	0.9 – 1.1	0.0	0.0
GST Road[3]	35 – 45	0.5 – 0.6	0.0	0.0
MPH Road[4]	55 – 65	0.8 – 0.9	4.3	4.3
OMR pre-toll[5]	57 – 83	0.8 – 1.2	0.0	5.3
OMR post-toll[6]	32 - 45	0.5 – 0.6	0.0	10.0
Ambattur	30 – 45	0.4 – 0.6	0.0	0.0

Source: Colliers International
Note: Indicative Grade A rentals, includes both Non IT and IT-ITeS buildings; excludes Special Economic Zones (SEZs)

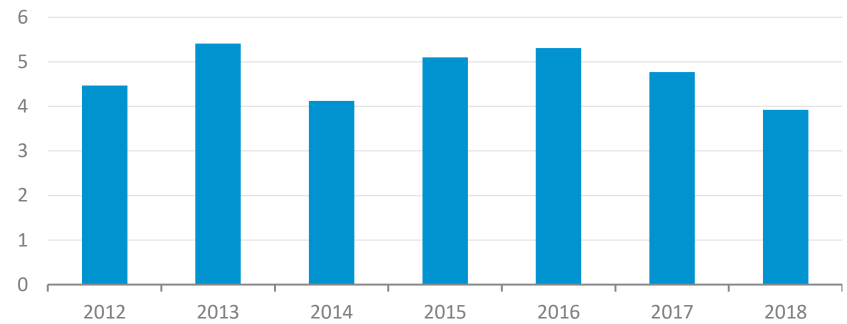
[1]Nungambakkam, Nandanam, Teynampet, RK Salai, Alwarpet, Egmore, T Nagar, Chetpet
[2]Anna Nagar, Kilpauk, Nelson Manikam Road, Vadapalani, Guindy, MRC Nagar, Adyar
[3]Grand Southern Trunk Road
[4]Mount-Poonamallee High Road
[5]Old Mahabalipuram Road Pre-Toll (Madhya Kailash – Perungudi)
[6]Old Mahabalipuram Road Post-Toll (Thoraipakkam to Sholinganallur; Semmencherry to Siruseri; Pallavaram Thoraipakkam Road)

Chennai, rental trend 2012-2021F



Source: Colliers International

Chennai, gross office absorption (million sq ft)



Source: Colliers International

Chennai, major leasing transactions, Q4 2018

Client	Building Name	Area (sq ft)	Location
The Hive	SRP Stratford	88,225	OMR - Pre Toll
Smartworks	Olympia National Tower	75,330	Guindy
IndiQube	Brigade Vantage	60,620	OMR - Pre Toll
Infosys	RMZ One Paramount	46,157	MPH Road

Source: Colliers International
Note: All figures are based on market information on 31 December 2018

SPECIAL ECONOMIC ZONE (SEZ) SUPPLY DOMINATING PIPELINE

2018 witnessed a substantial addition of around 2.5 million sq feet (232,340 sq metres) of Grade A office space, a 41% increase from the previous year. Based on scheduled timelines of Grade A developers in the city, we project a robust supply pipeline of around 19.4 million sq feet (1.85 million sq metres) over 2019-2021. We expect this new supply to increase Chennai's total office stock by over 35%. As around 70% of the upcoming supply consists of IT-SEZ developments, we expect developers to expedite construction so as to transfer incentives to occupiers with the impending sunset clause in March 2020 that will terminate the tax benefits.

OMR Post Toll is scheduled to account for around 50% of the total upcoming supply over 2019-2021, providing a good opportunity for occupiers looking to relocate or consolidate and as hedge against an increase in rents. However, the preferred location for technology occupiers, OMR Pre Toll, is witnessing around 20% of the upcoming supply over 2019-2021.

In view of a robust supply pipeline supporting the demand for Grade A office space in Chennai, we expect rents to increase around 2.4% compounded annually over 2018-2021. This rental increase will likely be driven by micromarkets such as OMR Post Toll, OMR Pre Toll and MPH Road.

Fueling our expected increase of take-up in Chennai are the regulatory reforms such as the release of the Tamil Nadu ICT Policy and the relaxation of Floor Space Index (FSI) norms for commercial buildings from the earlier ratio of 1.5 to 2.0, along with infrastructure developments such as the completion of Phase II of the metro and the proposed elevated corridor over OMR.

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