INTELLIGENT INVESTMENT

What Drove Real Estate in 2023

OUR TOP FIVE PICKS

CBRE RESEARCH | DECEMBER 2023

Introduction

The Indian economy demonstrated steadfast resilience yet again in 2023 as it continued its growth trajectory throughout the year despite global headwinds and domestic concerns primarily over food inflation. India's gross domestic product (GDP) exhibited a higher-than-expected growth of 7.6% in quarter ending September'23[1], attributable to strong trends witnessed in the manufacturing and construction sectors, in addition to the rising urban consumption and government spending. This led the Reserve Bank of India to raise its FY 2023-24 growth projections to 7% in December from 6.5% earlier[2].

Among the core real estate sectors, while **office** occupiers' sentiments remained optimistic on the back of three quarters of steady space take-up in 2023, the **industrial & logistics** sector was poised to exceed earlier estimations in the year on overall absorption. Similarly, both primary and secondary leasing in the **retail** sector continued gaining momentum given the strong supply pipeline and the ongoing festive season, while the **residential** sector inched closer towards touching a new decadal peak in unit sales and new launches by the end of the year. However, overall **capital inflows** into the real estate sector faced a potential dip in 2023 compared to the previous year owing to delays in decision-making and a general sentiment of caution around capital deployment.

That being said, the objective of this article is to go beyond the macro factors and dissect some of the most *defining demand trends* of this momentous year in a bid to answer a simple question - what *really* drove different real estate segments in India in 2023? Read on to find out!

1. Ministry of Statistics and Programme Implementation, November 30, 2023
2. Reserve Bank of India, December 8, 2023

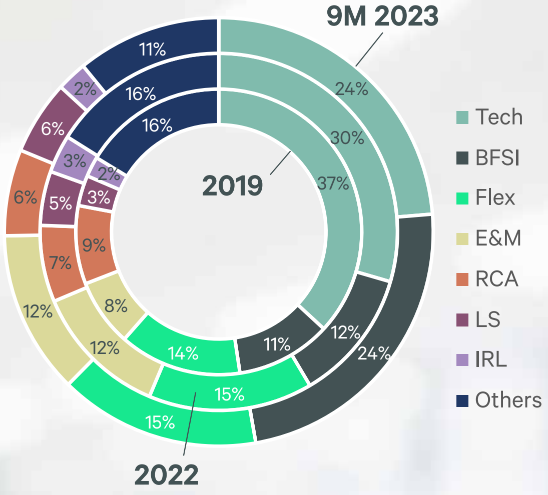
Office

Demand driver diversification acts as an insulation shield

Despite the short-term disruptions and macroeconomic challenges, office leasing in India has held ground with almost 42.2 million sq. ft. of leasing reported in 9M 2023. While various sectors feed into this demand, the technology / IT sector has long remained the backbone of office leasing in India. In the last decade, the average share of leasing by technology firms in the overall office leasing has typically been around the 35%-mark, sometimes even crossing the 40%-mark for cities such as Bangalore and Hyderabad.

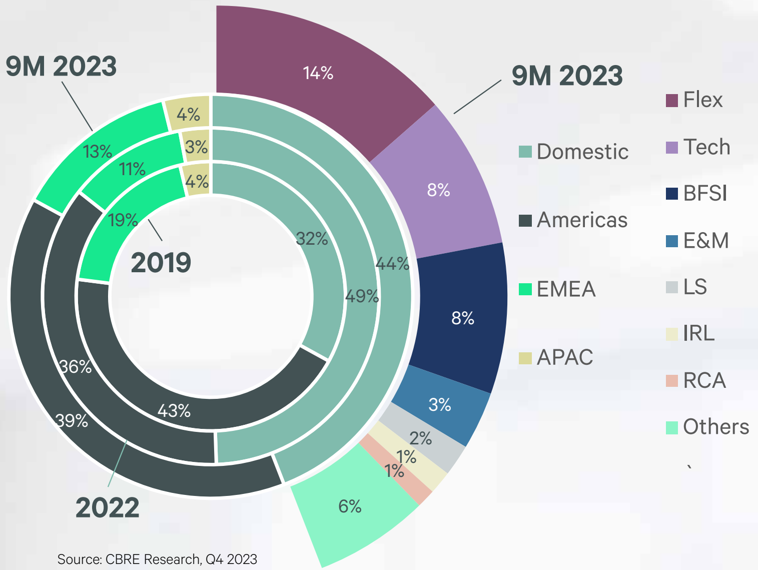
While the technology sector would continue to be a strong demand driver going forward, we have started witnessing increased demand from other key sectors such as banking, financial services and insurance (BFSI), flexible spaces, and engineering & manufacturing (E&M). This diversification in many ways has and will be responsible for insulating the office sector from global headwinds, thereby helping India breach the 50 million sq. ft. gross leasing-mark by the end of 2023.

Leasing as per industry sectors



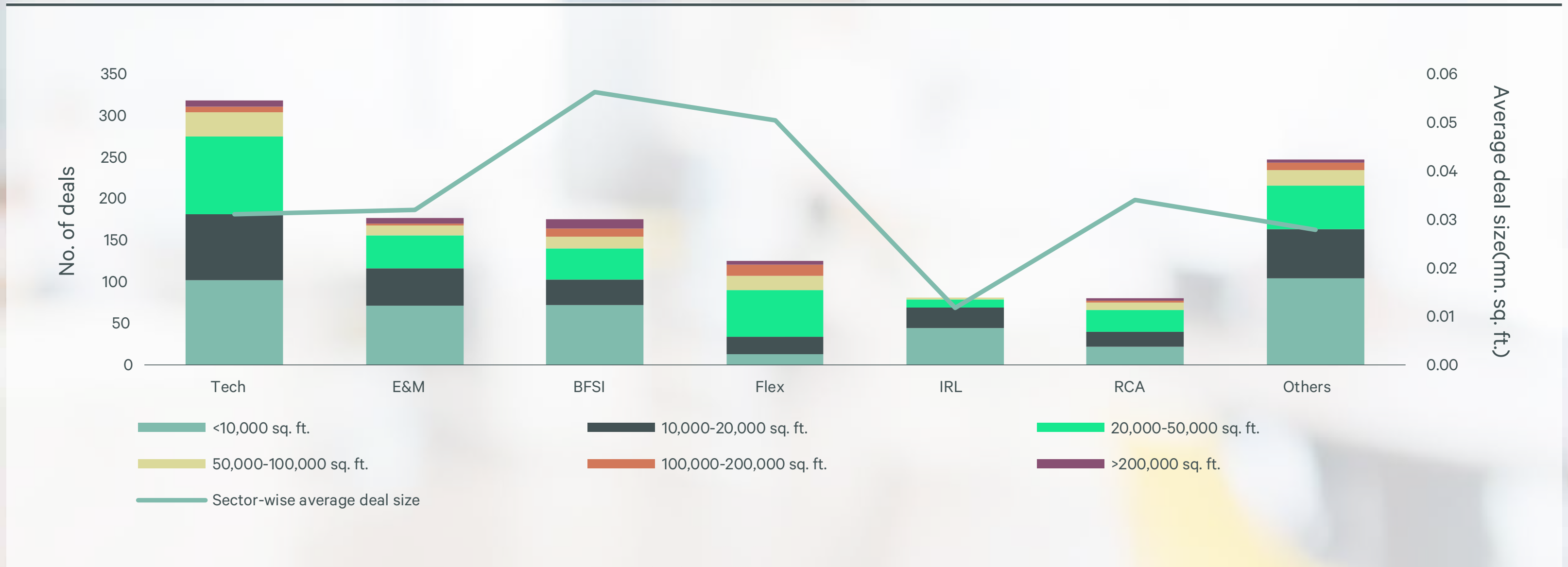
Source: CBRE Research, Q4 2023

Leasing as per domicile / geography of origin



Source: CBRE Research, Q4 2023

Number of office leasing transactions concluded (9M 2023)



Source: CBRE Research, Q4 2023

Note: Tech-Technology; E&M-Engineering & manufacturing; BFSI-Banking, financial services, insurance; Flex-Flexible space operator; IRLInfrastructure, real estate & logistics; RCA-Research, consulting & analytics; LS-Life sciences; Others-All other remaining sectors.

Led by strong balance sheet growth due to heavy infrastructure spending by the government and healthy growth in home-mortgage offtake, the BFSI sector has witnessed strong space take-up in the recent past. This growth is mainly led by global and domestic banks as well as financial institutions that are expanding their presence in the country as more employees return to the office. Domestic banks expanded their services as they continued digitising their capabilities, while global banks and financial institutions expanded their global capability centres (GCC) in India, buoyed by the availability of a deeply entrenched technology workforce in the country.

Feeding on the sentiment of caution, flexible workspaces are in high demand as organizations adapt to hybrid work and seek long-term value beyond the obvious short-term cost savings. The E&M sector has seen a fair amount of absorption mainly driven by the global supply chain realignment, the 'China +1' strategy, and the government's policy push for foreign manufacturers to set up their operations in India. Additionally, life sciences firms have expanded across the top cities, driven by both domestic and global firms that leased large contiguous spaces for building their research and development capabilities.

Going forward, we expect this demand diversification trend to grow, thereby supporting the overall growth of the office sector. Along with this industry sector diversification, the office sector also witnessed leasing widening across cities as Chennai, Pune, and Hyderabad saw significant improvement in office space take-up during the Jan-Sep'23 period. Chennai's absorption grew by 48% Y-o-Y to touch about 6.5 million sq. ft during this period, while Pune and Hyderabad's space take-up increased by 36% Y-o-Y and 35% Y-o-Y to reach 5.1 million sq. ft. and 6.6 million sq. ft., respectively, during the same time period. Led by a steady influx of investment-grade supply and occupiers' focus towards flight-to-quality, these cities continue to be on the corporates' radar.

Diversification in demand coming from different industry sectors

	PRE-COVID	POST-COVID	
	2019	2022	9M 2023
BFSI	11%	12%	23%
Flexible spaces	14%	15%	15%
E&M	8%	12%	13%

Source : CBRE Research, Q4 2023; BFSI - Banking, financial services, insurance, E&M - Engineering & manufacturing

Outlook for 2024

High-quality, investment-grade supply by leading developers and institutional owners in prime locations across cities is expected to continue drawing flight-to-quality absorption in the office sector in 2024. Key cities such as Bangalore, Hyderabad, and Delhi-NCR are likely to continue dominating completions.

Throughout 2022 and 2023, occupiers focused on bringing back staff to offices and stabilizing space utilization. While varied across cities and sectors, most companies have witnessed better occupancy rates relative to the past couple of years. Going forward, hybrid working models are likely to be the norm with 'office-first' as the approach. This is also evidenced in CBRE's interactions with occupiers in the **2023 India Office Occupier Survey**. Additionally, as per the survey, corporates have also indicated a higher preference to increase the size of their portfolios in the long-run, indicating their positive outlook on India as a preferred market for business expansion. The GCCs are also expected to scale up their operations in India, which would boost the demand for both conventional as well as flexible office spaces. At the same time, mature GCC occupiers, with a large existing footprint and long-term vision, could explore large-sized campus developments in the top cities.

I&L

Demand from 3PL and manufacturing players continue to fuel resilient growth

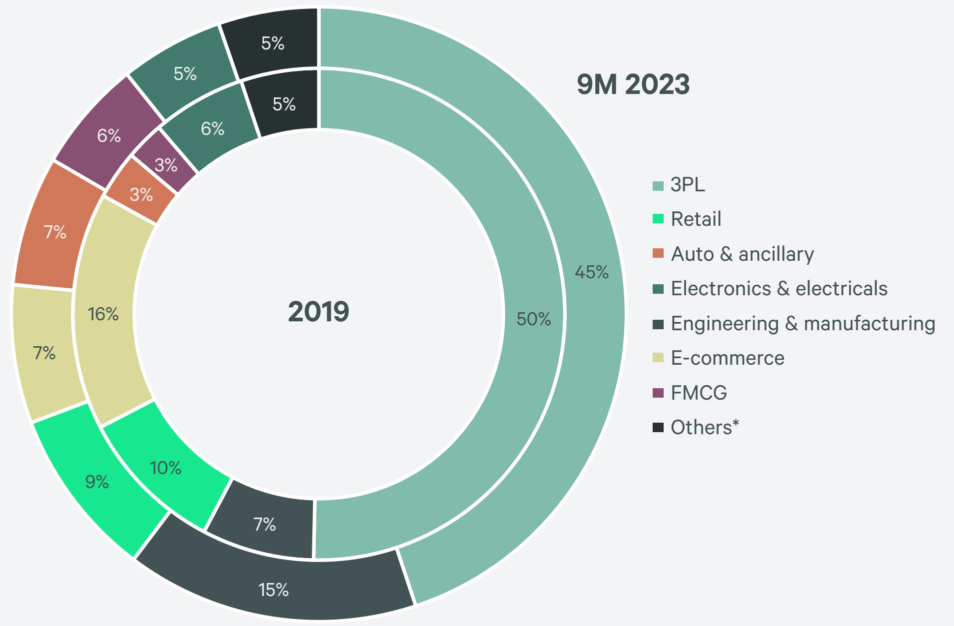
The third-party logistics (3PL) players dominated leasing in 9M 2023 with a share of 45%, followed by engineering & manufacturing players. The demand for 3PL services stemmed from interlinked stakeholders across the supply chain, including wholesalers, retailers, and e-commerce players. These stakeholders have adopted a combination of 'just in time' and 'just in case' strategies to optimize their inventory storage and delivery capabilities and mitigate long lead times.

Consequently, occupiers with inefficient infrastructure are increasingly turning to 3PL providers to meet their storage and delivery requirements. By utilizing the shared spaces with the 3PL providers, occupiers can benefit from cost advantages through the consolidation of transport, distribution, and shared warehouse expenses. This cost-effective approach has led to a strong and continuous demand for 3PL services, which is expected to persist in the foreseeable future.

Moreover, in the past two years, there has been a notable surge in demand from the E&M players, largely attributed to government initiatives such as the Production Linked Incentive (PLI) scheme. These policy enablers have encouraged growth in the manufacturing sector, leading to an increased demand for warehousing facilities within the E&M segments. The implementation of the PLI scheme has had a cascading effect, extending its impact to the auto and ancillary sector as well. As a result, the share of I&L absorption from the auto and ancillary sector has risen from 3% in 2019 to 7% in 9M 2023.

The I&L absorption would continue to be led by the 3PL and E&M sectors due to the continued adoption of 'multipolar' supply chain strategies by occupiers and the government's pro-investment efforts. Consumer demand for fast-moving commercial goods (FMCG), retail, electronics, and electrical products has intensified over the last few years. This heightened consumer demand has led these industries to reassess their warehousing and logistics strategies to meet evolving customer expectations. As a result, there is a growing need for efficient and streamlined warehousing and logistics solutions, which in turn has significantly contributed to the overall demand for warehousing within these sectors.

Sectoral spilt in I&L leasing - 2019 and 9M 2023



*Others include telecommunication, pharmaceutical / healthcare and other miscellaneous sectors
Source: CBRE Research, Q4 2023

Outlook for 2024

Backed by strong demand, leasing momentum in the I&L sector is expected to further strengthen in 2024. Rising transportation costs are likely to drive 3PL, engineering & manufacturing, retail, and e-commerce players to lease more space near industrial hubs, consumer hubs, and key transportation nodes. The e-commerce sector is also expected to witness heightened activity from H2 2024 onwards. Occupiers are also expected to increase their focus on upgradation / expansion opportunities in tier I cities, new market penetration in lower tier cities, and extension of local distribution networks in emerging logistics hubs. The demand for quality supply is also likely to persist amid growing flight-to-quality sentiments among occupiers.

Retail

Demand drivers diversified; domestic retailers lead leasing

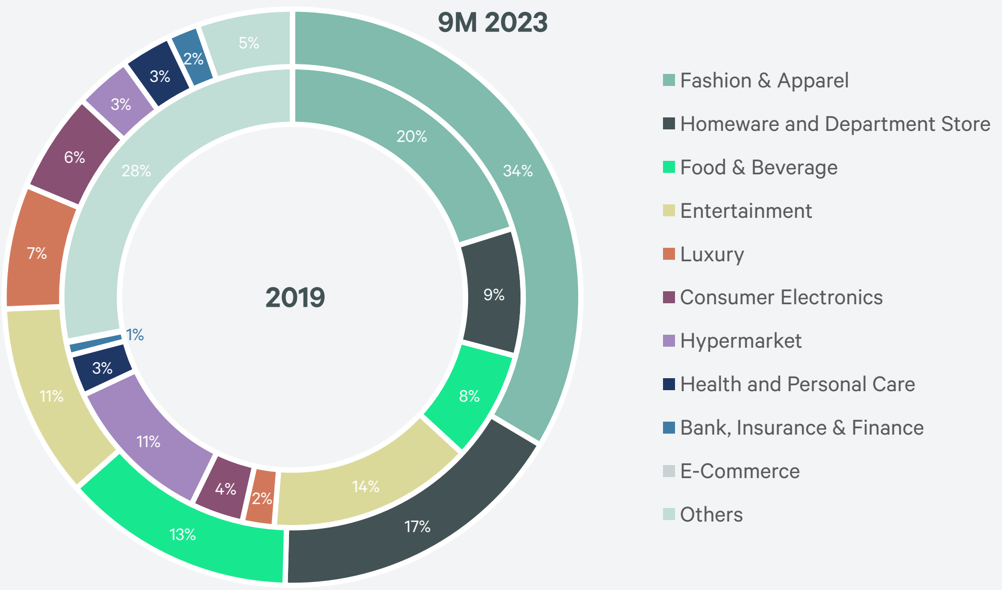
Despite inflationary pressures and international retailers remaining cautious around expansionary decisions across most global economies, the retail market in India has remained vibrant. Retail demand in 9M 2023 remained strong as leasing to the tune of almost 4.7 million sq. ft. was recorded during the period. Supply also remained robust as 3 million sq. ft. of quality supply entered the market during the same period.

However, there has been a notable shift in leasing patterns across various categories compared to the pre-pandemic period. In terms of demand drivers, the post pandemic years have started to witness a steady diversification in demand categories. While fashion & apparel continues to remain one of the top demand categories even post the pandemic, other segments such as departmental & homeware stores, entertainment zones, and the luxury retail categories have gained greater traction compared to 2019. For instance, leasing demand from homeware & department stores rose from 9% in 2019 to 17% in 9M 2023. Furthermore, the food & beverage (F&B) sector has also witnessed growth in leasing, with its share increasing from 8% to 13% during the same period. This diversification reflects the evolving market dynamics and the changing preferences of consumers.

As the retail market in India matures, we expect that the demand pie will only gain more colour as more international and domestic retailers make a beeline to tap into the growing consumer market in India.

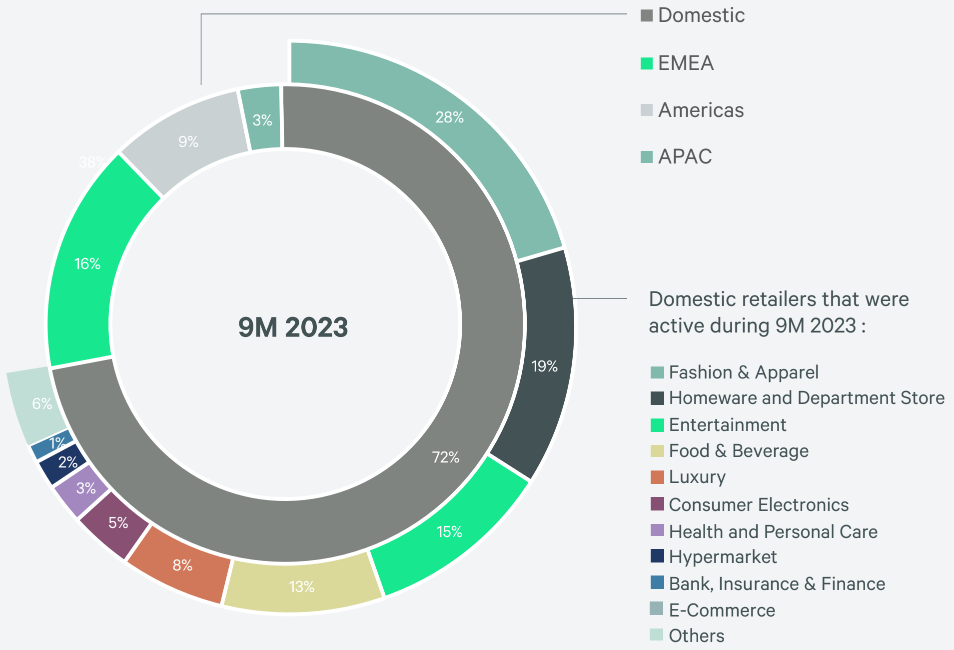
Segmentation of retail leasing as per tenant sectors and regions of origin

Fashion & apparel, homeware & department, and F&B account for more than 60% of the leasing in 9M 2023

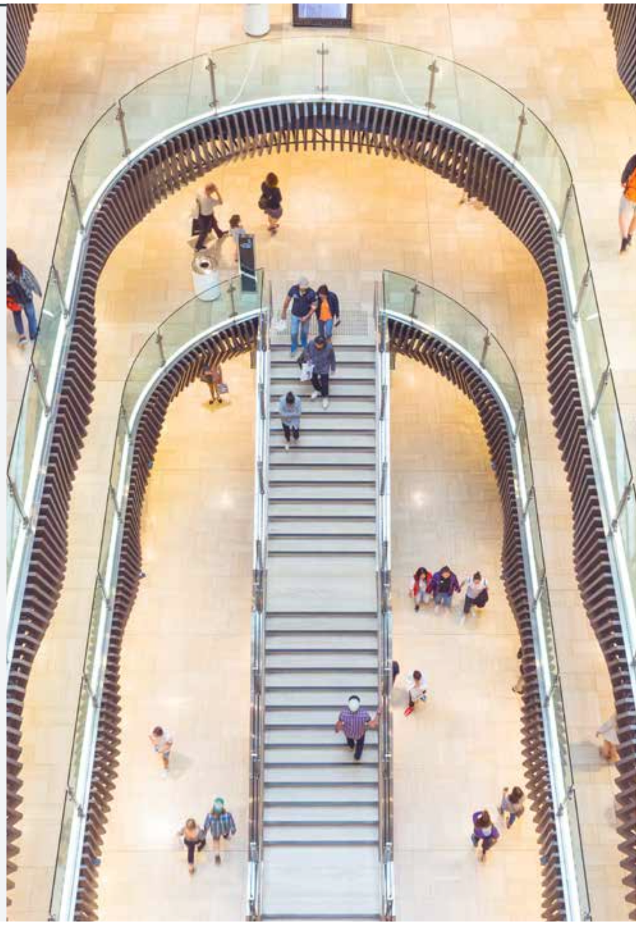


Source: CBRE Research, Q4 2023

Domestic retailers dominated leasing with a more than 70% share in 9M 2023



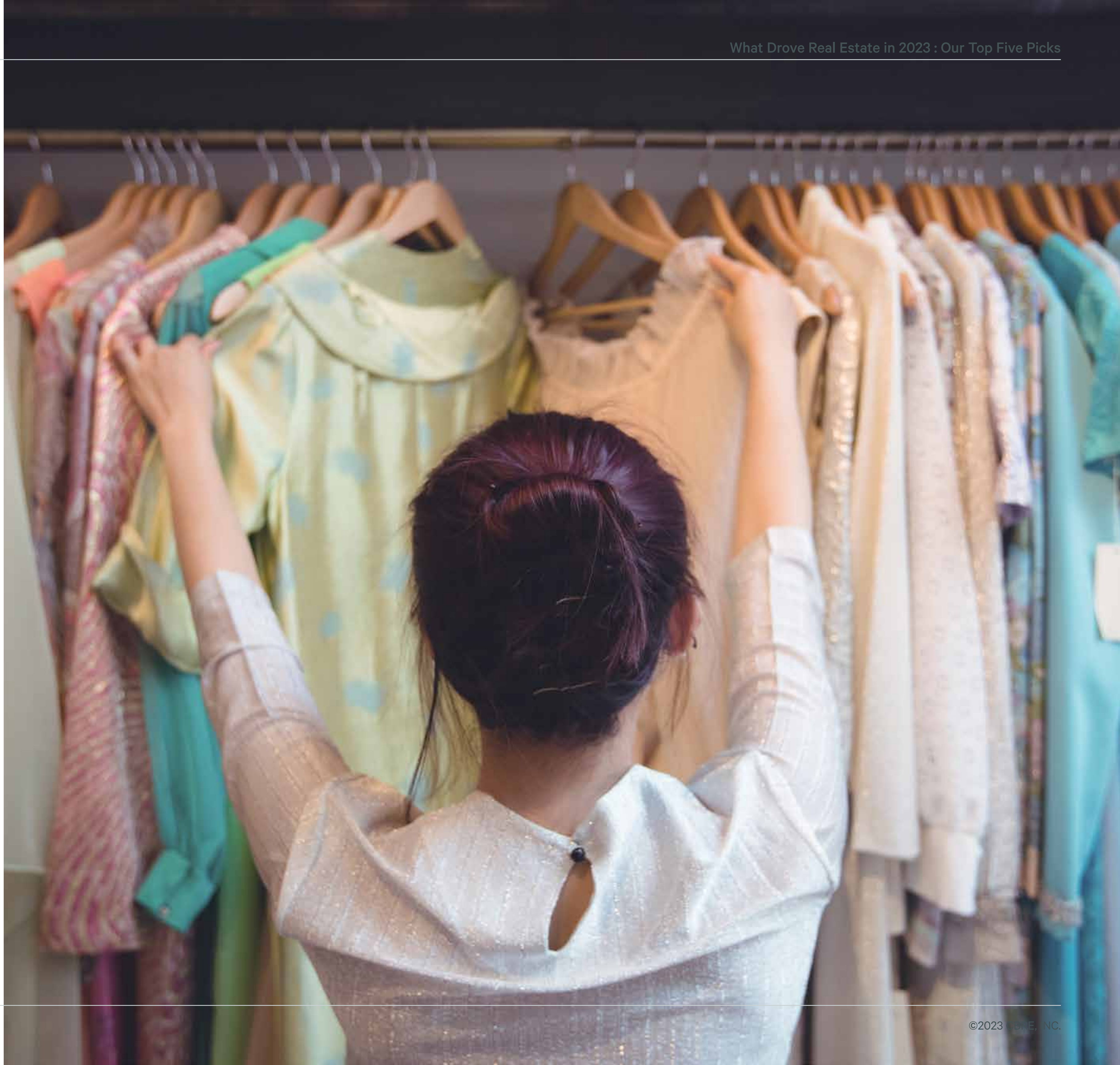
Source: CBRE Research, Q4 2023



Outlook for 2024

With consumer spending projected to remain robust in 2024, the momentum in retail leasing is expected to remain positive. Despite a sense of caution among retailers due to increasing rents and limited space availability, demand is likely to remain strong across the board. Prime high streets and shopping centers will continue to be highly occupied; landlords and retailers will prioritize not only short-term performance but also long-term strategies in this phase of the market cycle.

The momentum in supply addition, which gained traction during the second half of 2023, is expected to continue into 2024. Most leading retail developers have announced robust expansion plans not only in tier I cities, but also in tier II cities.



Residential

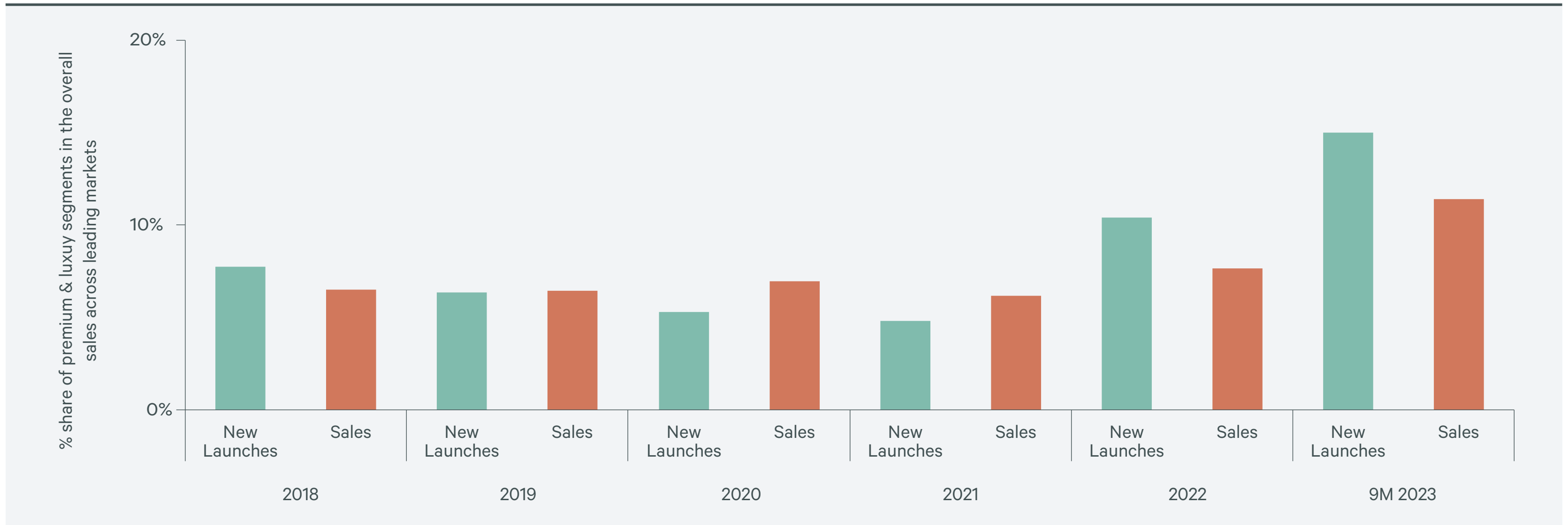
Luxury and premium housing steal the show

Despite anticipation around a lagged impact of monetary tightening, residential sales in 9M 2023 exceeded the 230,000 units-mark, registering a growth of 5% when compared to the same period last year. Sustained momentum in demand led developers to launch over 220,000 new housing units during 9M 2023, marking a marginal growth of 1%. While mid-end housing continues to pillar overall residential demand, the traction in the premium / luxury category housing segment in 2023 has been noticeable.

The premium and luxury housing segment in India, comprising of units priced at INR 2 crore and above, maintained a strong sales momentum, registering a 70% Y-o-Y increase in the Jan-Sep'23 period. The trend is even more pronounced in certain cities such as Delhi-NCR and Mumbai, where the combined share of these categories in overall sales is around 20%. The premium and luxury segment has emerged as a sought-after investment avenue, particularly for high net-worth individuals (HNIs) and non-resident Indians (NRIs) seeking to safeguard their investments amid global macroeconomic uncertainties. In fact, sales of luxury units (priced upwards of INR 4 crore) during Jan-Sep'23 grew by more than 75% when compared to the same period last year. This demand is supported by quality supply being launched by leading developers, who are launching projects across configurations such as independent floors, villas, and condominiums. Developers operating in this segment are not only tapping the demand for good-quality homes, but are also looking to strengthen their balance sheets via this self-liquidating, high-profit margin segment.

Amid transforming preferences, affordability is no longer the sole decisive factor for homebuyers as health & safety, community living, sustainability, and integration of smart home technologies have also started to emerge as being core to home-purchase decisions. Home buyers are expected to continue displaying strong preference for projects that offer enhanced accessibility to essential infrastructure, ancillary amenities, and thoughtfully designed indoor and outdoor spaces - which is likely to propel the demand for these segments going forward.

Share of premium and luxury segments in overall residential sales and launches

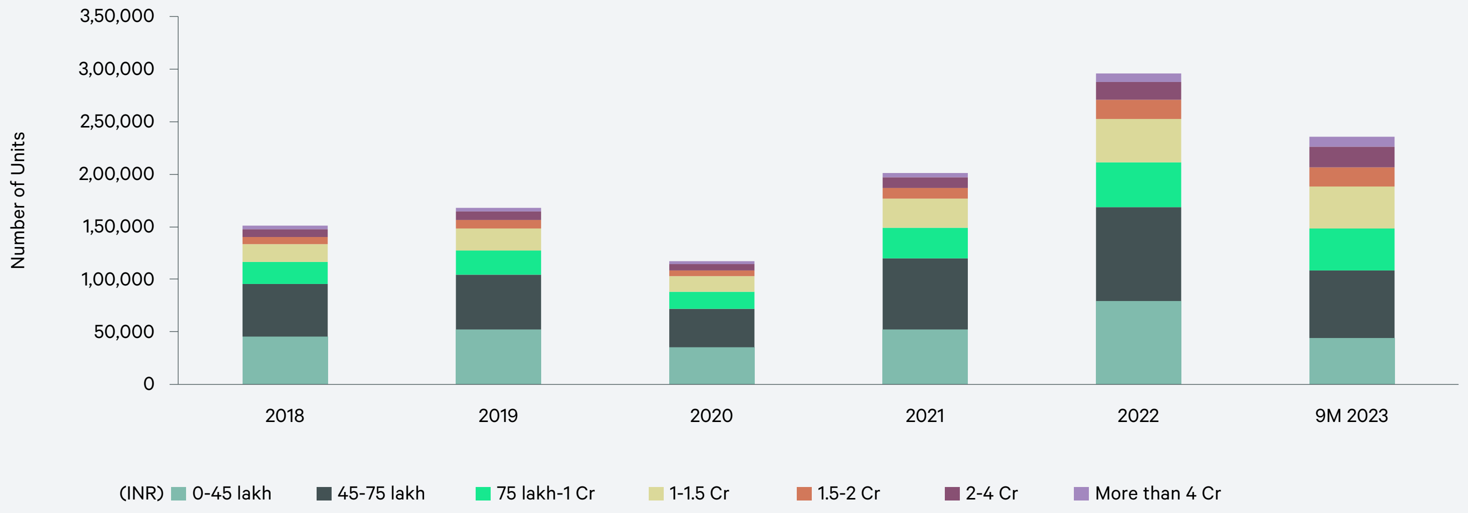


Source: CBRE Research, Q4 2023

Outlook for 2024

Looking ahead into 2024, we anticipate that the homebuying sentiment witnessed in 2023 will persist. The demand for projects in the mid-end and budget / affordable categories (INR 45 lakh – 1 crore) is projected to remain strong, aligning with the trends of the past couple of years. We also expect projects in the premium and luxury segments (INR 2 – 4 crore and above) to continue experiencing heathy growth. Capital value growth is expected to witness divergent trends across micro-markets and property categories and will largely be governed by unsold inventory levels and inventory overhang. Reputable residential developers are likely to continue exploring new cities, aiming to expand their portfolio and capitalize on their brand value.

Sales activity across ticket sizes: Robust sales visible across premium and luxury projects



Source: CBRE Research, Q4 2023

Investments

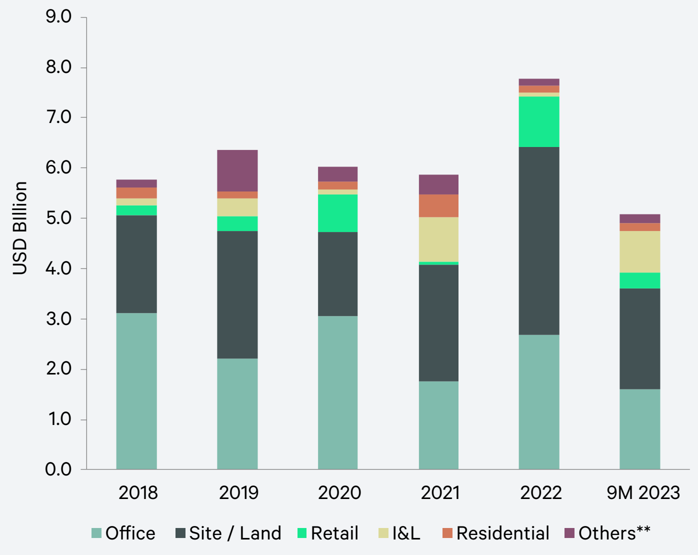
Land activity remains strong, domestic developers lead investment activity

The land acquisition space has been buzzing with high interest, primarily from the developer community. In 9M 2023, out of the cumulative USD 5.1 billion inflows into the Indian real estate sector, 40% of the overall investment was committed for land acquisition. On a cumulative basis, nearly 7,700 acres of land have been acquired by developers and investors during the 2018-22 period. Evidently, the residential sector has been at the forefront of these commitments as it garnered a share of 83% out of the total USD 2 billion that was committed for land investments during 9M 2023.

This land activity has been on the back of the strong momentum in housing sales over the past two years, thereby enabling developers to ride the wave. This heightened activity from domestic developers has to a certain extent managed to insulate the Indian real estate investment scenario from global headwinds. While activity from North American investment funds slowed down, domestic developers remained particularly active with a share of 42% in the overall investments in 2023 YTD, followed by funds headquartered in Singapore and Japan.

In our opinion, compared to 2022, the overall capital inflows are likely to taper in 2023 owing to delays in decision-making and a general sentiment of caution around capital deployment. However, we expect that opportunistic bets for the residential and industrial & logistics sectors are likely to continue gaining momentum, thereby lending support to land activity. While office is expected to continue remaining the favoured sector, the interest in alternate asset classes is also likely to strengthen, with increased capital deployment in data centres, mixed-use assets, and hotels.

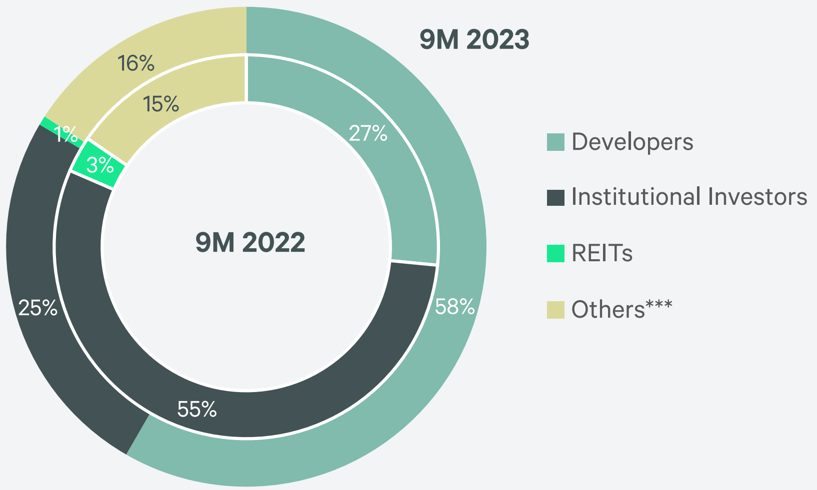
Development site dominated investments with a 40% share, followed by the office sector at 31%



**Others include hotels, mixed-use developments, data centres, and hospitals

Source: CBRE Research, Q4 2023

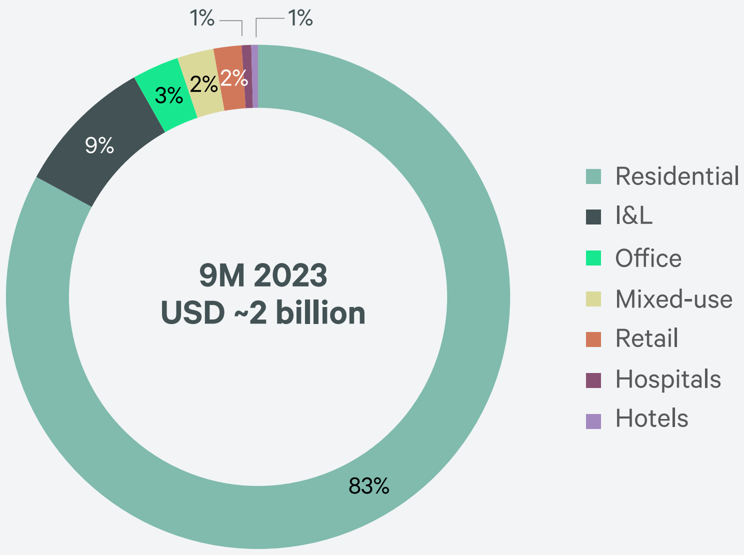
Developers garnered the highest share in investment flows during 9M 2023



***Others include private investors, corporations, and investments through various collective vehicles

Source: CBRE Research, Q4 2023

Sectoral split of land acquisition by investments in 9M 2023



Source: CBRE Research, Q4 2023

Outlook for 2024

We anticipate that capital flows in 2024 would remain steady with development sites and the office sector likely leading the investments. Metros and tier I cities are also expected to continue being the major recipients of equity inflows; however, we could also witness a rise in investments in the tier II cities due to a spurt in RE development activity backed by healthy demand, particularly in the retail and I&L sectors. We could also see the listing of the fourth office real estate investment trust (REIT) and a couple of infrastructure investment trusts (InvITs) in 2024 along with the expansion of existing REIT portfolios and diversification of institutional investor base across the listed REITs.

Contacts

Research

Abhinav Joshi
Head of Research - India, Middle East & North Africa
abhinav.joshi@cbre.co.in

Vidhi Dheri
Director - National Operations, Research
vidhi.dheri@cbre.co.in

Uttara Nilawar
Associate Director, India Research
uttara.nilawar@cbre.com

Pradeep Nair
Associate Director, India Research
pradeep.nair@cbre.com

Rajorshi Sanyal
General Manager, India Research
rajorshi.sanyal@cbre.com

Mainak Karmakar
Senior Manager, India Research
mainak.karmakar@cbre.com

Mohamed Atif Khan
Assistant General Manager, India Research
mohamedatif.khan@cbre.com

Global Research

Richard Barkham, Ph.D., MRICS
Global Chief Economist & Head of Research
richard.barkham@cbre.com

Henry Chin
Global Head of Investor Thought Leadership &
Head of Research, APAC
henry.chin@cbre.com.hk

Neil Blake, Ph.D.
Head of Forecasting & Analytics, Global
neil.blake@cbre.com

Spencer Levy
Chairman & Senior Economic Advisor,
Americas Research
spencer.levy@cbre.com

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Business Line Contacts

Advisory & Transactions

Ram Chandnani
Managing Director,
Advisory & Transactions Services
ram.chandnani@cbre.co.in

Consulting & Valuations

Rami Kaushal
Managing Director,
Consulting & Valuations, India, Middle East & Africa
rami.kaushal@cbre.co.in

Global Workplace Solutions

Rajesh Pandit
Managing Director,
Global Workplace Solutions, India & Property Management, India, SE Asia, Middle East & North Africa
rajesh.pandit@cbre.co.in

Project Management

Gurjot Bhatia
Managing Director,
Project Management,
India, SE Asia, Middle East & Africa
gurjot.bhatia@cbre.co.in

Capital Markets

Gaurav Kumar
Managing Director & Co-Head,
Capital Markets, India
gaurav.kumar@cbre.co.in

Capital Markets

Nikhil Bhatia
Managing Director & Co-Head,
Capital Markets, India
nikhil.bhatia@cbre.co.in

Operations

Rajat Gupta
Managing Director,
Operations, India
rajat.gupta@cbre.com

CBRE