Real Estate Research

September 2024

Indian Real Estate Outlook

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IN A NUTSHELL

- India is today the fifth largest economy in the world, and following major supply side reforms, alongside exceptional demographics, the economy is set to overtake Germany and Japan by the end of the decade.
- Indian commercial real estate is in its early stages of development. Transaction volumes have been rising gradually over the past ten years, reaching an annual level of close to €10 billion in early 2024.
- Taking together our expectations for entry yield, yield compression and rent growth, our initial forecasts for the Indian market suggest that prime net returns across the office and industrial sectors over the next five years could be in the range of 13-15%, with Bangalore and Mumbai tending to outperform Delhi.
- We believe initial investment into India should focus on a small number of the largest and fastest growing markets, such as Mumbai, Bangalore, and Delhi. Within these markets we favour the development of high specification logistics, the development of data centres, and investment into core office.

Young, educated and growing, India is poised to be one of the largest economies in the world. While driving demand, this future success will also require extensive development of modern real estate across all major sectors. For a long time, Indian real estate has been a sleeping giant, but the giant is stirring, and will soon be ready to wake.

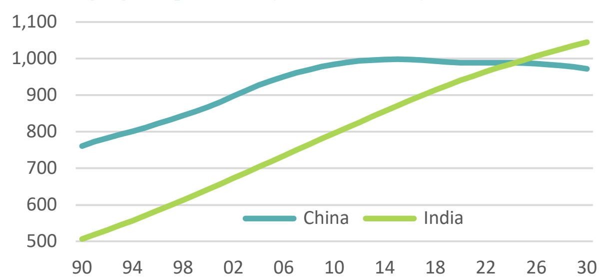
Macroeconomics

A Sleeping Giant Awakens

Having sat in twelfth place just twenty years ago, India is today the fifth largest economy in the world.[1] The country however remains a long way away from fulfilling its full potential. Despite impressive annual real growth of 6% over the past decade, output per head remains a fraction of that seen in China.[2] However, this appears set to change.

Following major supply side reforms, digitalisation, and infrastructure improvements – raising the country's Ease of Doing Business ranking from 142nd in 2014 to 62nd in 2019[3] – the country looks set for a sustained period of strong GDP growth. Add to this an exceptional demographic profile, with a young, highly educated, and growing population, the economy, appears set to overtake Germany and Japan by the end of the decade, with some projecting it could be the largest economy in the world before the end of the century.[4]

Working-age Population (15-64, Million)



Sources: UN Population Database, February 2024

The economy also looks to be more resilient to external shocks. External debt is today more manageable, supported by a growing cushion of FX reserves as well as significant

[1] IMF, June 2024
[2] Oxford Economics, June 2024
[3] World Bank, June 2024
[4] CEBR, July 2023

domestic funding. And with a lower current account deficit, India and the Rupee are seen as less vulnerable to fluctuations in external financing and foreign capital flows.[5]

Inflation, interest rates and the cycle

Resilience does not mean the economy has been immune to effects of global increases in inflation and interest rates over the past two years. This was particularly the case given consumer exposure to food prices, which pushed inflation to a peak of 7.4% in July 2023.[6]

Inflation has since moderated, sitting below the Reserve Bank of India's (RBI) 4% target, and despite a 250-basis point increase in the RBI repo rate to 6.5%, the economy grew at around 7% in 2022 and 2023, a rate of growth DWS expects to be maintained throughout this year and next.[7]

Over the past 30 years the economy has been volatile, but the recently implemented reforms and improved resilience, could help to support, and stabilise future growth. Inflation, for example, is projected to be structurally lower, as prudent fiscal policy and a credible central bank are expected to keep long-term inflation expectations under control.[8]

The recent election, which saw the ruling BJP lose its parliamentary majority, did create some short-term volatility across India's equity and bond markets. However, we don't expect this to lead to a major reversal or slowing in the county's reform programme. Indeed, the DWS team has often argued that this result could be seen as a long-term positive, providing checks and balances to the leadership, bolstering democratic health.[9]

Rise of the service sector

The export of services, particularly high-tech services, has been a key component of Indian growth. While China has made the most out of goods globalisation, India is expected to ride the wave with services.

The role of Global Capability Centres (GCC) set up by multinational companies, especially from the US, is mainly responsible for the strong rise in services export. From simple call centres, IT, and back-office services, they extend into research and development, including analytics, robotic process automation, machine learning, and cloud computing.

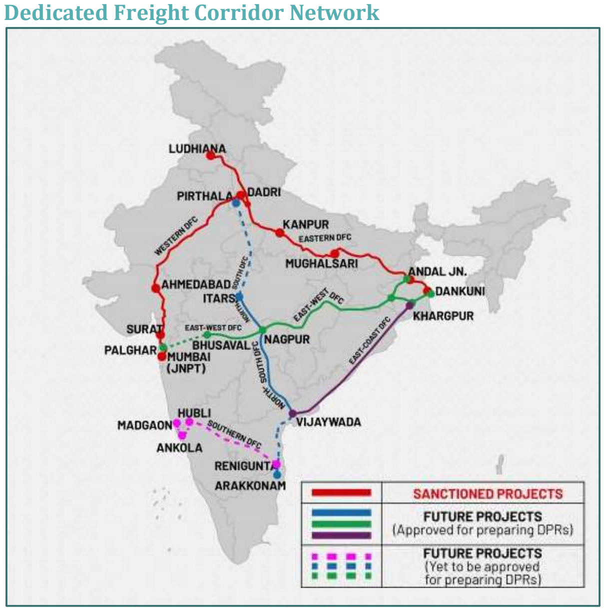
It is estimated that 40% of GCCs globally are in India, employing 1.7 million people alone[10], with around five million people as a whole working in IT services – a figure that is projected to double by the end of the decade.[11]

Make in India

Unlike many other emerging markets, manufacturing has not been a major driver of economic growth. Today the sector accounts for less than 15% of GDP, compared to 28% in China, and over 50% in services.[12]

There have been major plans to increase manufacturing output, with the government launching the Make in India initiative in 2014, including a Production Linked Incentive (PLI) scheme. So far there is little evidence to suggest these have had a big impact, but with major investment in infrastructure, including road, rail and port facilities, a trend towards a China-plus-one supply chain strategy, as well as a growing base of domestic consumers, this suggests Indian manufacturing could become a greater source of growth and employment over the coming decades.

Dedicated Freight Corridor Network



Source: Invest India, June 2024

[5] DWS, April 2024
[6] Trading Economics, June 2024
[7] DWS CIO View, June 2024
[8] DWS CIO View, June 2024
[9] DWS CIO View, June 2024
[10] DWS, HSBC, April 2024
[11] HSBC, NASSCOM, EY, DWS, February 2024
[12] DataStream, DWS, February 2024

City Performance

Mega cities power ahead

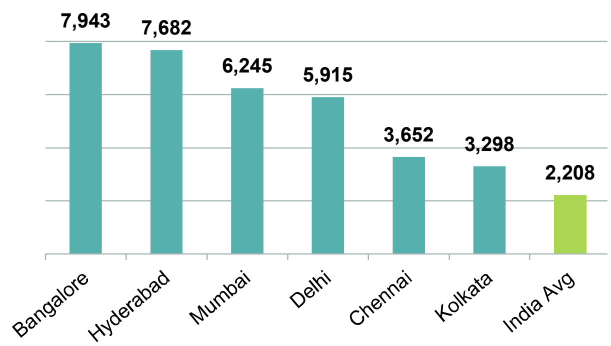
There is a huge range in the economic performance of different Indian regions and cities. Major metropolitan areas such as the National Capital Region (including Delhi), Mumbai and Bangalore in particular stand out as bastions of people, employment, and productivity.

These metropolitan areas are some of the largest in the world in terms of population and continue to grow rapidly. Bangalore, for example, is today estimated to have a population of around 16 million people, a figure which is projected to reach 19 million by the middle of the next decade.[13]

The United Nations estimates that by 2035, India will contain 5 of the top 30 largest metro areas in the world by population, with Delhi taking the number one spot, with a forecast 43 million people.[14]

GDP per head in these cities is somewhere between three and four times the national average. In part the result of their size and agglomeration benefits, there is also likely a positive feedback loop, as higher wages and greater opportunities draw in larger share of domestic migration.

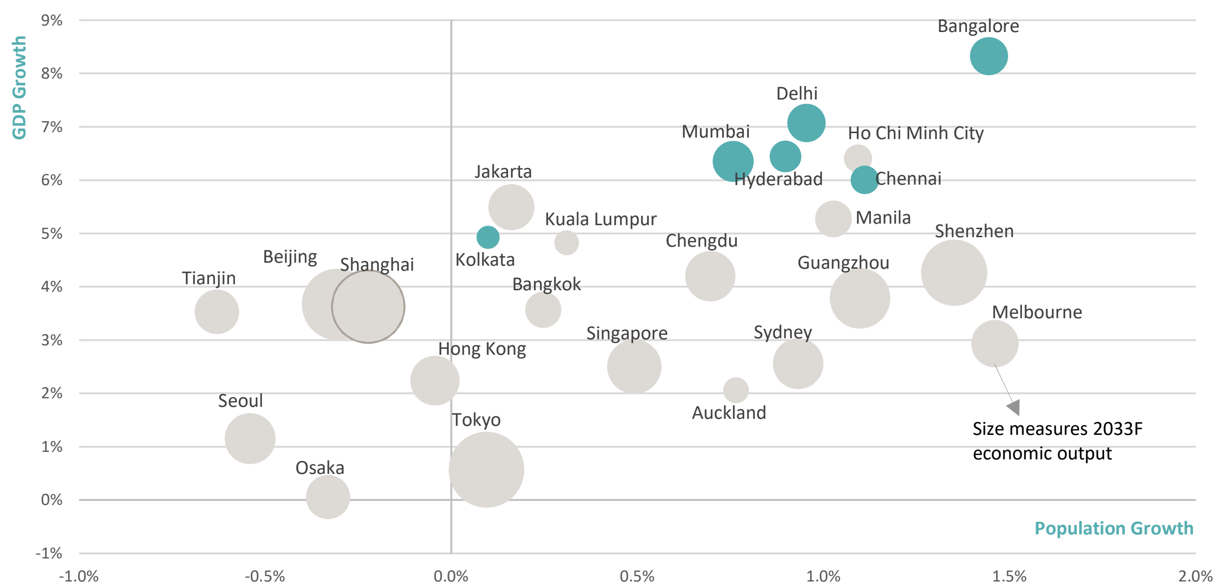
GDP per Capita 2023 (Real US$, 2015 Prices)



Sources: DWS, Oxford Economics. As of June 2024.

As shown in the chart below the major cities in India are projected to continue to see outsized GDP and population growth for at least the next decade to come. According to Oxford Economics, over the next ten-years GDP and population growth in Delhi, Mumbai and Bangalore are expected to be some of the highest across all major APAC cities, with smaller markets such as Chennai, Kolkata and Hyderabad also expected to do well.

Comparison of APAC Cities by GDP and Population (CAGR, 2023-33f)



Sources: DWS, Oxford Economics. As of June 2024.

[13] Oxford Economics, June 2024

[14] United Nations, World Urbanization Prospects, 2018

Real Estate

Emerging market supported by strong demand drivers

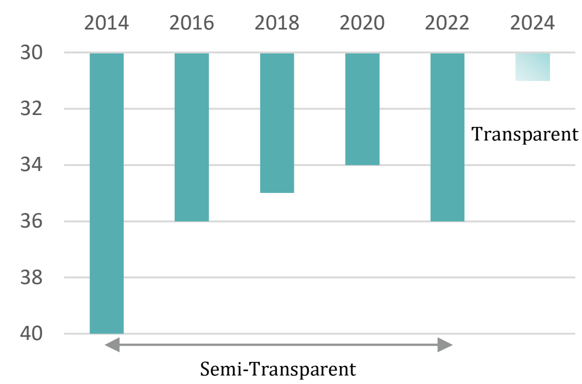
Indian commercial real estate is in its early stages of development. Emerging real estate markets are often characterised as fragmented, lacking in quality stock, reduced transparency, and low liquidity. This is generally true of the Indian market and will certainly create challenges for any investor looking to deploy capital.

The transparency of the Indian market has significantly improved in recent years, supported by ongoing regulatory reform and standardisation, and the digitalisation of the land registry. According to JLL, Indian Tier-1 cities saw the greatest increase in transparency between 2022 and 2024, and now sits alongside the likes of Dubai and South Korea.[15]

While overseas capital has become increasingly active over the past decade, the market remains dominated by domestic developers and investors. Accessing product is therefore likely to require a different approach to more established markets.

Greater risks and higher barriers should be compensated for through high returns. Given the macroeconomic and real estate fundamentals of the Indian market, global institutional investors are increasingly recognising these opportunities. According to the latest PWC / ULI Emerging Trends Survey, Delhi and Mumbai were in 2024 the 7th and 9th highest ranked cities in APAC in terms of investment prospects.[16]

India's Global Real Estate Transparency Ranking



Source: JLL GRETI 2024, August 2024

Real Estate Fundamentals

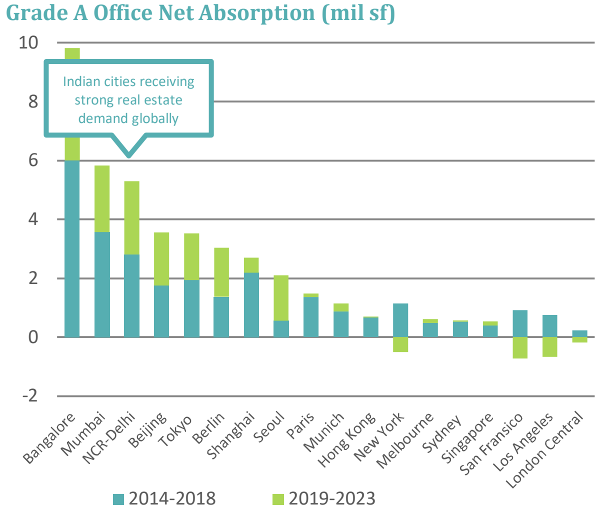
Office

According to Colliers, there is approximately 66 million square metres of Grade A office stock in India, broadly equivalent in size to Central London, Central Paris, Berlin, Madrid, and Milan combined.

The market has recently recorded both high levels of demand, and high levels of new supply. Despite substantial average vacancy rates of around 17%, this is somewhat clustered around older stock, reflecting both the level of new development as well as a shift in demand towards better quality space, particularly from rapidly growing sectors of banking, finance & insurance, and tech.[17]

The growth of the Indian service sector can be clearly seen in the level of net absorption recorded over the past decade. Over the last ten years, office net absorption in Tier 1 Indian cities of Bangalore, Mumbai and NCR Delhi significantly outpaced other global cities, particularly over the last five years with several cities facing lacklustre demand post-pandemic.

Grade A Office Net Absorption (mil sf)



Sources: DWS, JLL, PMA, Colliers, CBRE, February 2024

Development and high vacancy may have been a drag on rental growth but has certainly not prevented Grade A rents from rising. According to Colliers, average rents across the major cities increased 5% in the year to Q4 2023.[18]

[15] JLL, August 2024
[16] PWC, ULI, November 2023
[17] Colliers, January 2024
[18] Colliers, January 2024

We would expect vacancy to remain elevated for the foreseeable future, but where demand is strong, we don't believe this will hold back rent growth. It's notable that over the past decade, fast growing Bangalore recorded average annual rent growth of around 6%.[19]

According to our latest forecasts, we expect Grade A rents to continue to grow over the coming five years, averaging somewhere between 4%-5% per annum, with Bangalore and Mumbai tending to outperform other major markets.

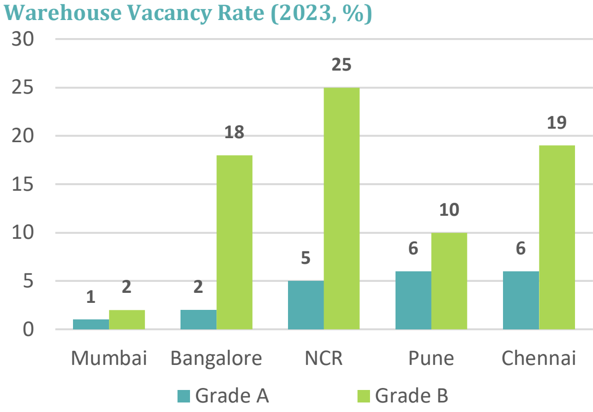
Logistics

Like trends observed across many developing economies, India's logistics sector is at a nascent stage and undersupplied relative to its population. On a per capita basis, the total warehouse stock in India's top 8 cities is limited at less than 0.3 square metres, which pales in comparison to other countries such as the US (4.6), UK (1.1) and China (0.8).[20]

Of significance is the ongoing transition from lower quality to Grade A warehouses, with occupiers especially third-party logistics providers and omnichannel retailers increasingly seeking operational and cost efficiencies.

High demand for institutional grade warehouses with increased automation and storage capacity has pushed average Grade A warehouse vacancy rates to around 5% compared to 15% observed across Grade B warehouses.[21]

Warehouse Vacancy Rate (2023, %)



Source: DWS, JLL, May 2024

Meanwhile, the government has established its National Logistics Policy aimed at reducing India's relatively high logistics costs (13-14% of GDP) compared to global peers such as China (10%) and US/EU (8%).[22] This would require improvements to transportation networks as well as multimodal connectivity, including the need for more strategically located warehouses to help streamline supply chains.

Other logistics demand drivers include e-commerce which is expected to grow strongly at 17% CAGR between 2023-2030,[23] where e-commerce penetration levels in India remains low at 5-6%, compared to China (35%) and US (24%).

Over the last two years, logistics facilities have benefited from rising demand and supply-side factors including higher land prices and construction costs with rents growing by 6% per annum.[21]

It is worth highlighting that both demand and supply levels are expected to grow significantly over the next few years, as limited barriers to land acquisition and development approvals have led to an influx of investments into the sector.

Overall, we expect the Grade A logistics market to remain largely balanced, with vacancy likely to remain low and relatively stable, supporting average rental growth of around 5%-5.5% per annum over the next few years.

Residential

Today the residential real estate market is dominated by the for-sale market, with only a small amount of institutional quality rental stock.

Given the outlook for population and employment across the major cities it looks likely that demand for housing will grow strongly over the coming decade. Indeed, during 2023 residential sales across the top seven cities in India reached record breaking levels.[24]

In time, we would expect to see the emergence of an institutional rental market, including segments such as corporate and student housing, however our experience from other markets would suggest that this may not occur in the immediate future.

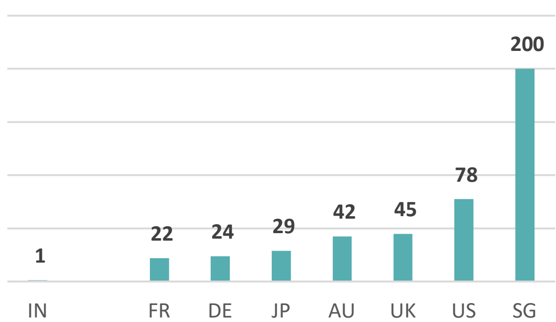
[19] Broker Sources, June 2024
[20] DWS estimates from Oxford Economics, Knight Frank, JLL, May 2024
[21] JLL, February 2024
[22] EY, Envisioning the Future of Indian Logistics@2047, April 2023
[23] India Brand Equity Foundation, May 2024
[24] January 2024

Data Centres

The surge in internet usage, digital enterprise transformation, and India's digital economy drive have escalated the need for data centre infrastructures. With the increasing demand for cloud services, generative AI, big data analytics, and high-performance computing, data centres in India have emerged as critical infrastructure supporting the digital economy.

The Indian Data Centre market is projected to grow from 2,000 MW in 2024 to 5,000 MW by 2029,[25] a CAGR of 19% and around 500 MW[26] already under construction. Nonetheless, capacity per head remains small compared to countries such as the US and Singapore, and at 1 MW per person, is low even when compared to the likes of Malaysia (18 MW), Vietnam (3 MW) and Indonesia (2 MW).

Data Centre Capacity (MWs) per million persons, 2024



Source: CommScope, 2024

In addition to the structural demand drivers associated with digitalisation and the growth of AI, Indian government policy is also expected to be supportive. For example, the government is pushing for increased data localisation, while privacy and security have also contributed significantly.

Most states have defined data centres as 'essential services' to ensure uninterrupted operations throughout the year. Furthermore, there is an intense competition among Indian states, with state governments actively fostering the data centre sector.

The growth trajectory of India's digital landscape has also strengthened significantly over the past year. Notably, data consumption per user per month has surged from 1 GB in 2017 to 17 GB in 2022. Projections indicate that average monthly data traffic per smartphone is expected to reach 50 GB by 2027, aligning closely with estimates for China.[27]
In recent years, data centre operators have displayed significant interest in land acquisitions. Data Centres have attracted US$ 35 billion commitment between 2018-2023.[28] Mumbai, currently ranking third in terms of IT load under construction (following Virginia and Atlanta).[29]

In the past, India's data centre capacity has significantly lagged that of its peers. Relative to its population India's capacity is only half that of countries like Indonesia, Vietnam, and the Philippines while significantly even lower compared to developed economies globally.

Despite contributing 15% of global data traffic, Indian data centres account for a mere 6% of the global capacity.[30] This disparity highlights substantial untapped potential for growth in the sector.

Real Estate Capital Markets

Volumes trending higher despite disruption

Transaction volumes in India have been rising gradually over the past ten years, reaching an annual level of close to €10 billion in early 2024.[31]

The level of investment is relatively small given the size of the market, although we would expect this figure to continue to increase, particularly as developers look to trade assets, and once institutional capital becomes more established within the market.

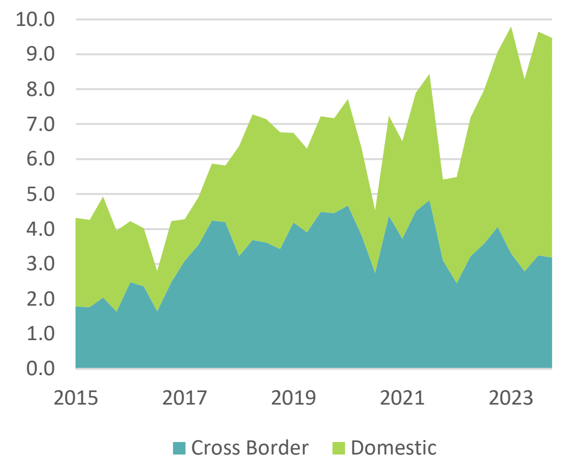
Historically, the market has been broadly balanced between local and international investors. In recent years however domestic capital has taken a more prominent position which likely reflects the more general slowdown in global real estate demand.[32]

Domestic demand has typically been dominated by non-institutional privates, however over the past five years listed REITs have become increasingly active, accounting for more than 10% of deals done since the first REIT was listed in

[25] Mordor Intelligence, 2024
[26] CBRE, December 2023
[27] Biswagner Anarock, August 2022
[28] CBRE, December 2023
[29] Cushman & Wakefield, 2024
[30] DWS estimates from Care Rating, Biswagner Anarock, May 2024
[31] MSCI, June 2024
[32] MSCI, June 2024

2019.[33] Today there are four REITs which have raised a combined $3 billion of equity through primary issuances.[34]

Transaction Volumes (€ billion, 12 month rolling)



Source: MSCI, June 2024

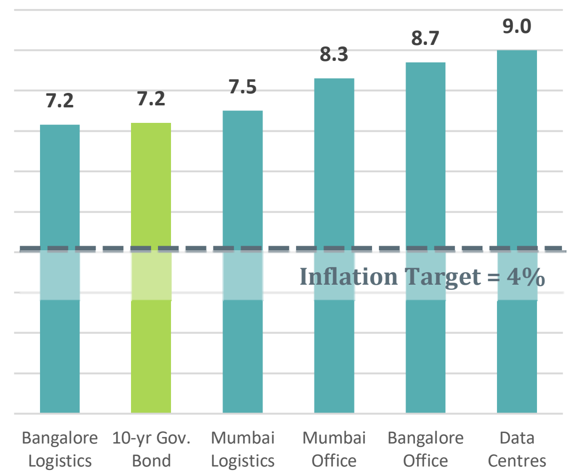
Mumbai, Bangalore, and Delhi have been by far the most active markets over past five years, accounting for 50% of all transactions. Other smaller, but still significant markets included Chennai (7%), Pune (3%) and Hyderabad (2%).[35]

Office has been by far the most actively traded sector. Excluding development sites, office has accounted for almost two thirds of deals done since 2014, followed by Industrial (16%), Retail (12%) and Hotel (7%). Over time we would expect to see a broadening of activity across the sectors, something we're already starting to see, with the Industrial share rising to 25% since 2021.[36]

The trend increases in transaction activity, alongside a fall in borrowing costs, has put downwards pressure on prime real estate yields over the past decade. Since the early 2010s, prime office yields have compressed by around 150 basis points, sitting at around 8-8.5% today.[37]

Unlike the office sector, which has seen some yield expansion in the past three years in response to higher interest rates, logistics yields have continued to compress. Prime logistics yields have fallen by around 100 basis points since 2020 to 7.5% in Mumbai and just 7.2% in Bangalore – below the 10-year government bond yield.[38]

Prime Real Estate Yields (End 2023, %)



Source: Macrobond, Broker Sources, DWS, June 2024

Accurately projecting future movements is difficult in any market, but exceptionally so for emerging markets. Today the spread between the 10-year bond and prime real estate yields is at around a record low, which would suggest that real estate yields may not fall much further unless we see a substantial reduction in borrowing costs.

However, rising liquidity, improved access to finance, and the entrance of lower cost of capital investors, could all put downwards pressure on real estate yields. Add to these projections for strong rental growth, and it would not be unreasonable to envisage real estate yields hitting new lows.

Our latest forecasts are for yields to compress by around 50 basis points over the coming five years. This mainly reflects the outlook for bond yields, but as noted above, may prove to be conservative.

Investment Returns

Forecast for Double digit prime net returns

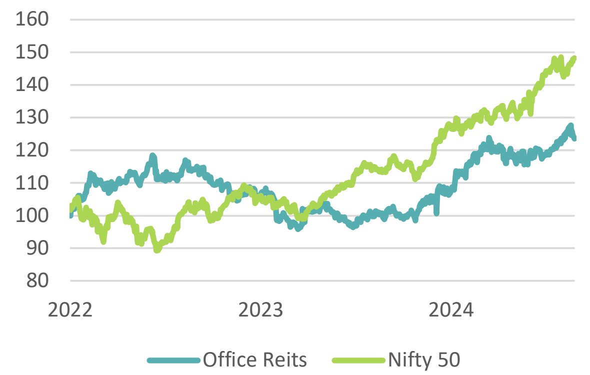
There are no reliable sources of long-term return performance for the Indian market at either the fund or the property level. Prime series of historical rents and yields may

[33] MSCI, June 2024
[34] NAREIT, April 2024
[35] MSCI, June 2024
[36] MSCI, June 2024
[37] JLL, June 2024
[38] JLL, Knight Frank, June 2024

provide some guidance, however given its small size and rapid change, the performance over recent decades is unlikely to be a reliable indicator of future returns.

The REIT market should help to provide a helpful indicator of performance going forward. It's encouraging that Indian office REITs have tended to record a positive total return over recent years – in stark contrast to most other REIT markets globally – nonetheless the depth and length of time series is still prohibitively short to draw many conclusions.

Office REIT Total Return Index (Jan 2022 = 100)



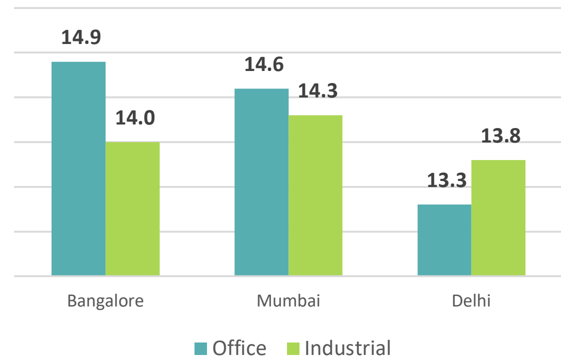
Note: Based on weighted average performance of Brookfield India REIT, Embassy Office Parks REIT, Mindspace Business Parks REIT
Source: DWS, Macrobond, September 2024

Projecting performance is likely to have a higher degree of forecasting error than more developed markets. However, lower than average transparency should be somewhat compensated for through a higher return, and indeed for those investors with local presence and expertise, should prove an advantage.

Taking together our expectations for entry yield, yield compression and rent growth, our initial forecasts for the Indian market suggest that prime net returns across the office and industrial sectors over the next five years could be in the range of 13-15%, with Bangalore and Mumbai tending to outperform Delhi.

While Indian real estate may offer the potential of higher returns, investors should pay attention to avoid any potential pitfalls. Selecting an appropriate local joint venture partner is critical to avoid lengthy dispute resolutions difficult to navigate in India. Comprehensive due diligence checks through highly qualified legal and other industry experts is necessary to tackle issues arising from limited market transparency, particularly over land title ownership and development rights where records may not be readily updated.

Forecasted Prime Net Total Return (2025-29f, %)



Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.
Source: DWS, June 2024

Investment Strategies

Target markets

We believe an initial investment strategy into India should focus on only a small number of the largest and fastest growing markets. We favour Mumbai, Bangalore, and Delhi. These cities, with their populations well above ten million and GDP per head more than double the national average, represent over 50% of the transactions market, and are set to see some of the fastest economic and population growth in APAC.

Logistics Development

The logistics sector looks well placed for growth. Supported by rising consumption, increasing ecommerce penetration, extensive infrastructure development, the government led push to grow manufacturing, and the shift in production away from China, the sector appears set to benefit from multiple structural demand drivers. Given evident supply shortages, particularly for Grade A space, we see potential opportunities to develop high quality stock, capturing strong rental growth, and returns that we believe could be more than 20%.

Data Centres Development

Data centres have the potential to be a large part of the Indian real estate market. While still a very small part of the market, the sector has the potential for major growth as an already IT superpower further embraces digitalisation and artificial intelligence.

With little standing stock, development will be required to gain access to the data centre market. While this comes with some obvious constraints around access to water, power and land, and potential risks around planning and development, with the growth in demand, the government's push for data localisation, ample capital looking to enter this sector and future institutionalisation. Keeping these risks in mind, we believe this strategy could yield returns well above 20%.

Core Office

The office sector in India provides greater access to standing stock. And while supply has been historically strong, and vacancy rates high, the growth of service sector jobs is expected to drive strong office employment over the coming decade. With a focus on cities such as Bangalore and Mumbai, we see opportunities to buy prime offices, potentially achieving a return of around 15%, or possibly take on Core+ strategy to refurbish and relet well located but older stock, with a view to achieving returns closer to 20%.

Source: Bing Images, June 2024

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