



COVID-19: Industrial & Logistics Sector

Impact & Opportunities in India



May 2020

Contents

1. COVID-19 and its Global impact	3
2. Indian Warehousing overview in a pandemic	5
3. COVID-19 Impact on India	7
4. Short, medium & long term impacts	9
• Manufacturing sector	
• Logistics sector	
• Occupiers	
• Industrial Park developers	
• Investments	
5. Conclusion: Opportunities in a pandemic	14



COVID-19 and its Global Impact

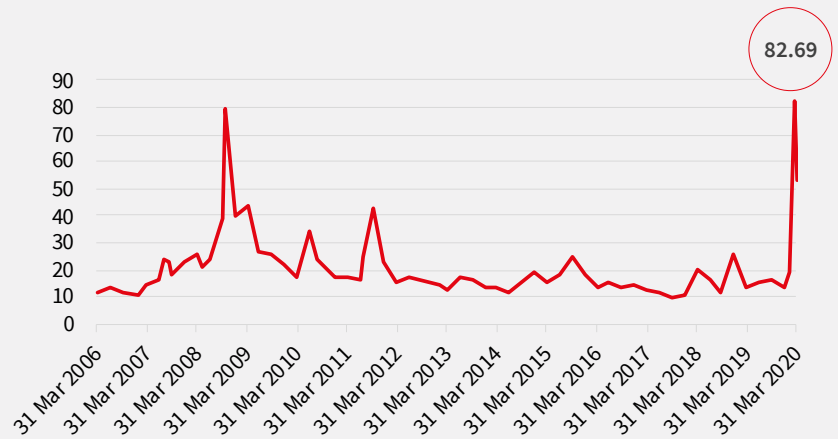
End 2019 and early 2020, the global economy was already developing to show stress as larger economies were undergoing turbulence, be it elevated debts, trade wars or overall slowing GDP growth. Then came COVID-19, a situation which further impacted the economic engine as countries began to feel the impact of the global pandemic and took drastic steps to contain the spread.

Global Development

Both services and manufacturing sector witnessed setback barring few services and industries that were identified as essential to fight the situation that witnessed an uptick. There has been a major shift in how certain sectors witnessed a change in business strategy or operations.

International trade could shrink between 13 – 32% with trading activity to and from the Global node of trade - China being on hold (Source - WTO), supply-chain and transport linkage succumbing to the contagion.

VIX Volatility Index - Historical Chart



International Trades
could shrink by
13%-32%



Market Volatility Index at
82
(all time high)



In the **United States**, the healthcare sector witnessed an uptick, while elective surgeries have taken a back seat, as critical components have taken precedence. In the UK, over 60 manufacturing businesses have been directed to ramp up production of vital medical equipment.

In the **Asia Pacific region**, Australian manufacturers are re-evaluating just in time supply chains, where a search for alternative supply chains is already in the anvil. In the FMCG space, changes witnessed include a move towards pop up warehouses in the short term and challenges relating to responsiveness of outsourced operations.

India was one of the early adopter of complete lockdown except essential services which created opportunity for online food/ restaurant delivery service providers (like Zomato, Swiggy, Paytm, etc) to collaborate with grocery business for home delivery.

In **China**, production lines have started to roll back and Wuhan is finally back in business after a stringent lockdown. However, there is a long way to recovery of the global economy as countries still grapple with the situation. That said, the majority of factories are back to work now.

We explore the major paradigm shifts that the Indian economy may witness and how they would impact future businesses, especially in the industrial, warehousing and logistics sector.



Indian Warehousing Overview in a pandemic



First Quarter, 2020 Market update

1Q New Supply
Addition* (mn. sqft.)

~15%

Contraction in
1Q2020

Y-o-Y Warehouse Net
Absorption¹ (mn. sqft.)

~30%

Contraction in
1Q2020

Supply Scenario

The lockdown[#] response to prevent the pandemic in India began at the last week of the first quarter of the year (1Q2020). This resulted in having some impact on the supply addition of new warehouse spaces in the warehousing market.

There has been a contraction of approx. 15% in new supply in the first quarter of the year (1Q2020) against the previous quarter (1Q2019). However, on a closer look, the quarterly new supply addition is higher than the average quarterly new supply addition of first quarter in the last three years (between 2017–2019) which demonstrates the impact of lockdown has likely not set in yet.

Going forward in the next three quarters, the supply is expected to witness:

- Delay of project delivery due to labour shortage over the next 1-2 quarters post lockdown
- Projected supply of speculative spaces may be delayed by a quarter or two



Average quarterly New
Supply in first quarter in
the last 3 years



Quarterly New
Supply in 1Q2020

The impact of the lockdown is still evolving, but the impact on the overall annual supply of new warehouse spaces, though eminent, needs further assessment as it evolves.

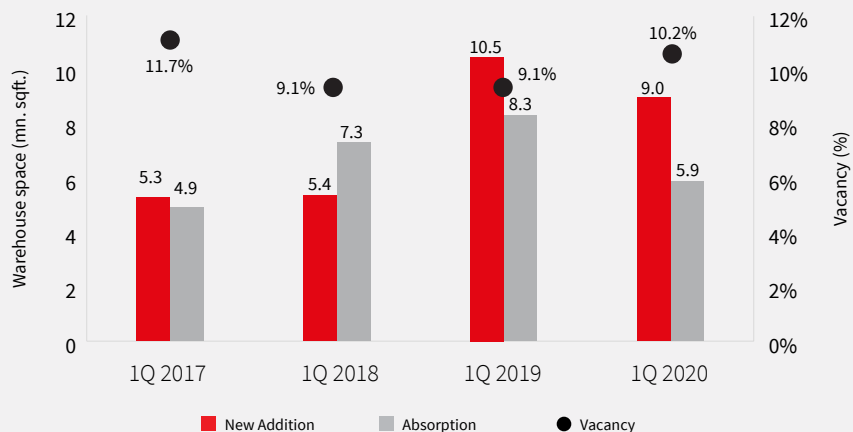
*In Top 8 Cities. Top 8 Cities include Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, Mumbai, NCR Delhi, Pune

All market opinion is based that the current lockdown ends on 17th May and there is gradual exit from it with restrictions removed on construction and other operations

¹Net Absorption is the warehouse space occupied excluding renewals & churning



Y-O-Y Warehouse New Supply Addition (Speculative & BTS) vs Net Absorption¹ in 1Q



**Current
Vacancy Level**
(India Overall)

For Grade A
& Grade B

10%

Demand Scenario

The quarterly demand has relatively been lower than the previous first quarter of last three years (2017 – 2019) demonstrating a contraction of approx. 30%.

While the second quarter demand is expected to witness limited activity, there can be gradual revival in the demand post lockdown[#] as leases and active RFPs that were in various stages of closure may be executed.

Increased enquiries from e-commerce and 3PL players are

expected exploring in-city spaces among other options. Grade A properties are expected to witness preference from occupiers due to adherence to additional safety norms

The pent up demand and project closures might be pushed by 2 quarters and Q4 will be an interesting quarter to watch out for. The fundamentals remain strong and there is opportunity for India to capture the pie of manufacturing demand in case companies re-plan their Global Supply Chains from BCP point of view.

Rental Scenario

Minor correction in rental in short term due to cost pressures and uncertainty in demand. Rental discounts/deferment or sub leasing rights may be expected by tenants

In the long term, enhanced Facility Management with higher regulatory compliance may result in higher CAM Charges



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COVID-19 Impact on India

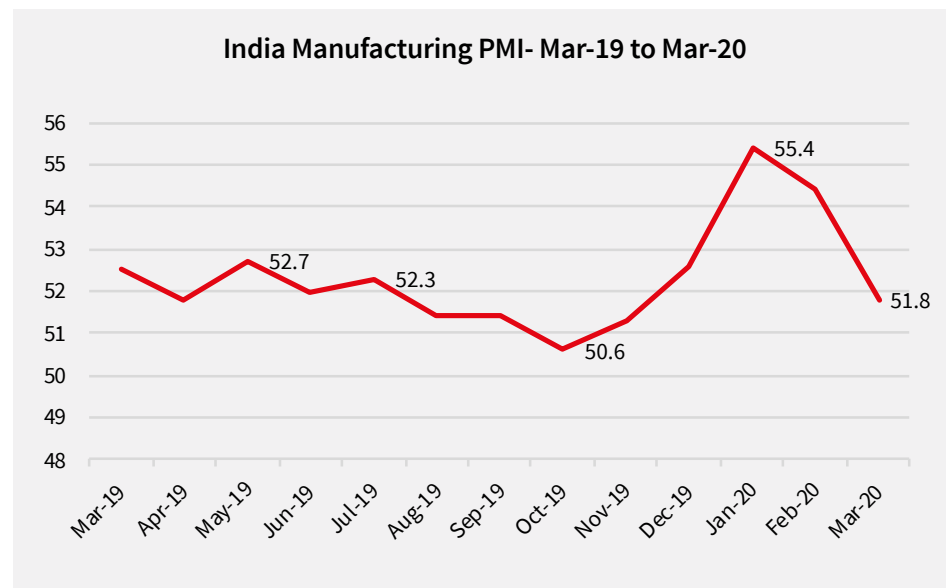
The Indian economy was facing some turbulences since the 3rd quarter of 2019 as industrial production fell, especially in auto and related sectors, rising unemployment and growing uncertainties of NPAs among banks, etc. continued to plague the market. However, the economy was recovering back in 2020 as the central government and Reserve Bank of India took various steps to support recovery and growth. This recovery however witnessed a second wave of turbulence by the end of 1st quarter of 2020 driven by the global pandemic.

In the aftermath of this ensuing slowdown triggered by a weak business climate and ongoing liquidity concerns, the Indian real estate market, which contributes nearly 8% to the nation's GDP, is likely to witness further impact.

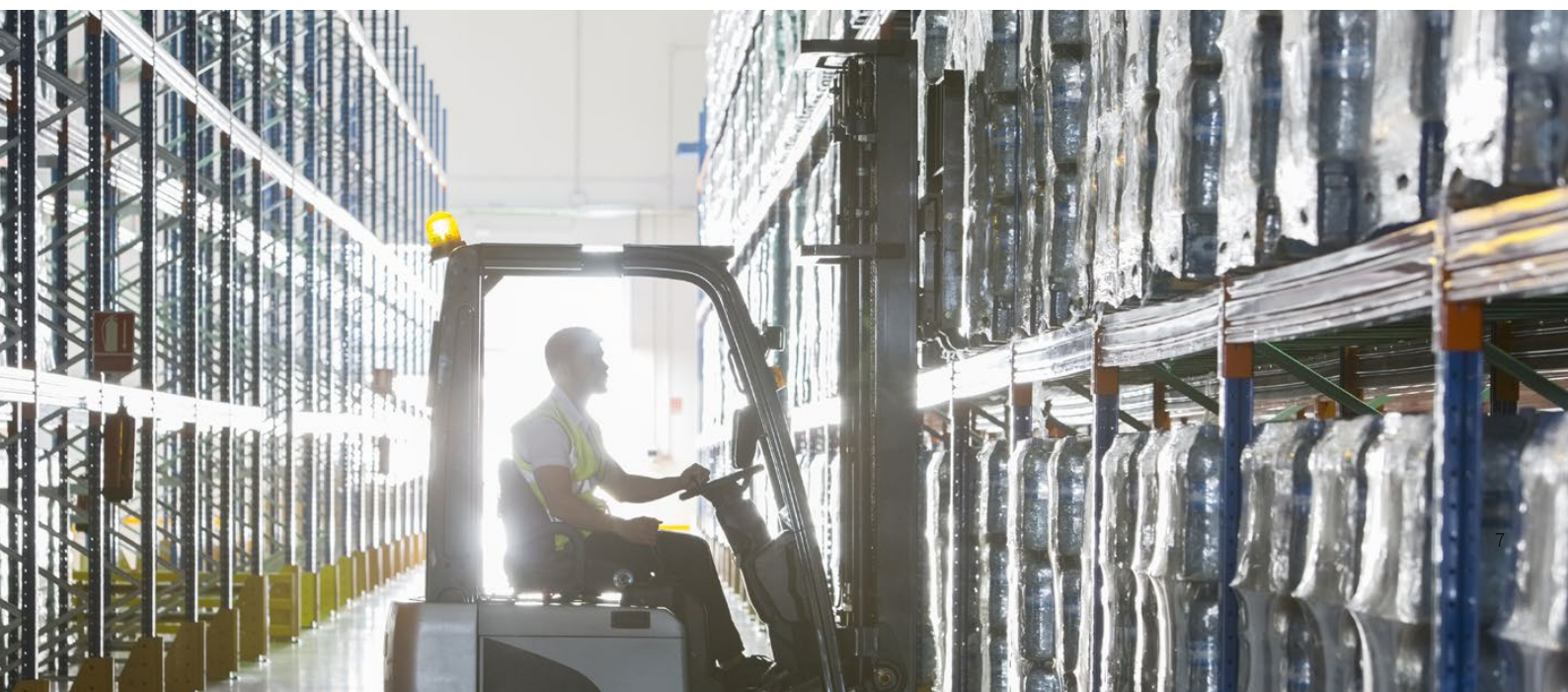
Within the industrial sector, manufacturing has had the largest impact. Electronics and automobile segment, due to its dependency on China for critical component and pre-COVID-19, sector slowdown witnessed most organizations stopped operations.

On the other hand, ecommerce has been one of the beneficiaries, along with pharma and warehousing sector. Factors leading to this are due to the lockdown where consumers are diverted towards online transactions for procuring daily essentials.

The Purchasing Managers' PMI Index in 2020, for the entire Manufacturing sector has declined from 55.3 in January to 54 in February and forecasted to reduce to 40 until July 2020 and slowly recover back to 50 points the later half of Q3 this year.



The Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors



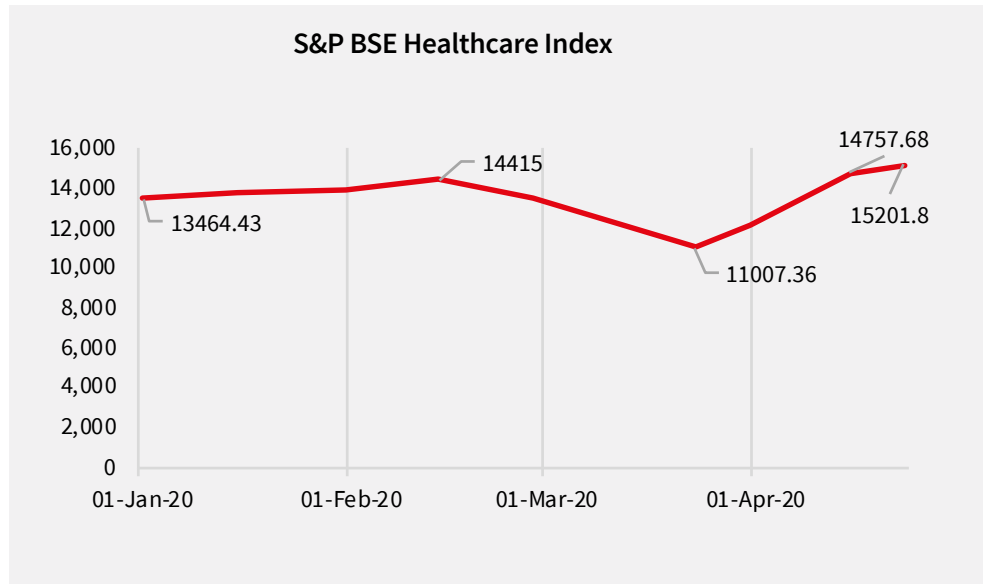
In the Pharmaceutical industry, there is an increased interest on generic medicines. BSE Healthcare index has gained ~2% in a week in March 2020 and 5.72% since the start of 2020.

In the Automobiles segment, large manufacturers, have suspended manufacturing for an indefinite period. Vehicle production is predicted to contract by 8.3% percent this year, after a beleaguered contraction of 13.2% percent in 2019 as per a report by Fitch Solutions.

The Electronic Industries Association of India estimates that production capabilities in the electronics segment will reduce by 50%, due to dependence of core components from China.

In the Ecommerce and Warehousing sector, the interconnected sectors are seeing quite a steep increase in demand for services. Due to the lockdown, emotional/panic buying are leading towards home delivery services. 3PL's have a critical role to play in managing the delivery of essential materials, where they are already in progress of engaging with government officials for exceptional movement of their staff for "essential services" during the lockdown phase.

The impact of the lock down is still evolving, but the impact on the overall economy though eminent, needs further assessment as it evolves.



Short, Medium & Long term impacts

Manufacturing sector

Global supply chains have been disrupted, due to high level of dependence on core components from China and other countries. Normalisation in supply chain from China is expected in Q2 & Q3 of 2020.

Few industries in the manufacturing space, such as electronics, Pharma and Auto parts are expected to regain gradual normalisation with stabilisation of supply chains.

In the long term, organisations will look to diversification of their supply chains, as part of the more stringent business and continuity plans. Some of the MITI –V (Malaysia, Indonesia, Thailand, India, and Vietnam) countries are set to gain.

Industry bodies are engaging proactively with state/central government for several structural reforms to ensure the Indian manufacturers can optimise, this opportunity.



Short term



Drop in production of auto-parts, electronics and pharmaceuticals due to supply chain disruption as most primary materials are imported from China



End consumer based industries such as ecommerce and omni-channel retail will gain traction

Medium term



Ancillary businesses of bottling and packaging industries related to pharma will witness growth.



Small cars market to grow post lockdown



Telecom sector to grow due to increase in internet based consumption.



Manufacturer might consider existing vacant ready built industrial spaces.

Long term



Potential Supply chain diversification



BCP's to become stringent and new norm.



Telecom sector to grow rapidly to support technology dependence



Automation and IoT related technologies to gain traction.

Logistics sector

Inter state lockdown, has froze supply chains of multiple sectors, both in production as well as stock piling. Restrictions on Airfreight has also reduced movement of critical components of production for various industries globally.

These restrictions have also limited transactions in the growth oriented ecommerce sector. Post lockdown, a change in consumer behaviour is expected towards ecommerce and e-payments. Urban logistics or in-city warehousing will gain traction due to higher penetration of groceries ecommerce.



Short term



Inter state lockdown to limit transport movements to essential commodities



Air cargo to hit major core components in production

Medium term



Urban logistics and in-city warehouses will be in demand



Increase in outsourcing activities to 3PL due to cost pressures and efficiency enhancement

Long term



Drive from ecommerce, will increase growth and expansion of logistic players



Government policy and infrastructural support will accelerate activity



Mall developers have opportunities to innovate designs to accommodate storage spaces within for retail tenants.

Occupiers

In the short run, while few sectors like auto, heavy machinery, chemicals might renegotiate existing rentals, sectors such as FMCG, ecommerce, pharmaceuticals, cold storage will see increased growth and demand for additional warehouse spaces, as well as stringent health norms are facilities.

Occupiers will re-align their overall real estate strategy based on post COVID-19 scenarios, such as migrant labour, consumer demand and government support.

As part of BCP, organizations would also explore de-risking supply-chains and hence will diversify into MITI-V regions, leading to higher demand in India.



Short term



FMCG, especially demand for essential goods and groceries will lead to short term leases



Rental breathers will be explored by Occupiers, & will explore subleasing options



Online shopping, will be the new norm and a habit, leading to supply chain realignment

Medium term



Last Mile & Just-in-Time delivery model will be questioned with occupiers looking for more safety stock



Facility Management will be relooked intensively



Rental deferment and holidays can be considered as alternative to rental renegotiations

Long term



Increased warehouse space offloading to 3PL for storage by small and medium occupiers



Increased adoption of automation inside and outside the box

Industrial Park Developers

Large Organised Developers will set to gain with the industry moving more towards Grade A spaces and application of technology and automation to reduce the cost of operations in warehouses. Smaller developers would tend to upgrade or construct high-quality spaces to cater to the changing demand.

While sector fluctuations will impact few developers in the short term due to uncertainties, in medium to long term, demand is set to improve. E-commerce and 3PL / logistics service providers would remain the dominant occupiers and growth is set to regain, based on changing behavioural pattern of consumer and smaller manufacturing trying to use 3PL / logistics service providers to gain scale and operational efficiency.



Short term



Extended lockdown and migration of construction labour force leading to delay in project completions



Delay in ongoing projects would force occupier to look for temporary / flex leased



Sub-leasing of unused / white spaces in warehouses



Softening in rentals due to cost pressures & uncertainty in lockdown times

Medium term



Labour shortage to remain for 1 – 2 quarters



Construction delays can compress annual forecasted supply by 20% - 30% in 2020



Cold storage sector will see growth

Long term



Developers may have to adhere to Enhanced Facility Management & increased regulatory compliance, resulting in higher common area maintenance (CAM) Charges



Construction to support automation & robotics in operation foreseen

Investments

Investors might remain cautious, critically scrutinising portfolios before investment. However, industrial asset class might emerge as safer investment options compared to some of other real estate asset classes.

Investors who are well funded would be keen to optimise these times of volatility to get better deals as land prices might drop and developer expectations can be more aligned to investment.



Short term



Overseas Sovereign funds may withdraw funds to support bailout programmes in their domestic markets



Debt availability might be tightened

Medium term



Demand for portfolio valuation and business restructuring opportunities



Considering global financial markets, capital rates may hold up



Indian industrial investors will explore diversified products for cost efficiency



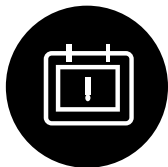
New investments will remain cautious in the rest of 2020. However, some good opportunities may present themselves

Long term



Well-funded groups with unutilised capital will invest, to optimise long term return and the current short term volatility

Conclusion: Opportunities in a pandemic



Attention

Short Term
(Q2, 2020)



Get Set

Medium Term
(Q3, 2020-Q1, 2021)



Go

Long Term
Q2, 2021-2022)

Impact

- Disrupted Manufacturing Supply Chain
- Online shopping will be the new norm
- Labour availability constraints – Delays in project delivery
- 'Force Majeure' setback
- Rental deferment / holiday can be considered as breathers for tenants
- Debt availability might be tightened

- Realignment of Supply Chain - Last Mile & Just-in-Time delivery model will be questioned
- Online groceries wins big
- ECommerce further strengthens
- Rents flatten
- Facility Management will be relooked intensively
- Consolidation continues

- Manufacturing – India consider BCP
- Electronics, Auto, Engineering, Pharma – Main focus
- Automation and IoT related technologies to gain traction
- Grade A industrial space dominates
- Construction to support automation & robotics in operation foreseen
- Rents strengthening

Opportunity

- Short Term / Flex Leases to make up for the project delays
- Ecommerce and omni-channel retail will gain traction
- Cautious funding outlook. However, industrial asset class might emerge as safer investment options compared to some of other real estate asset classes

- Subleasing of white / unutilised spaces
- Leases pick-up
- Retail & commercial opens up for In-City / Urban logistics
- Manufacturer might consider existing vacant ready built industrial spaces
- Enhanced Facility Management & increased regulatory compliance - higher common area maintenance (CAM) Charges

- Government policy and infrastructural support to accelerate manufacturing
- Manufacturing BTS and land transaction strengthens
- Bigger box lease transactions with increased warehouse space offloading to 3PL
- Ecommerce continues to dominate
- Increased investments to optimise long term return

Increased demand and digital acceptance due to the current state of affairs and India emerging as a BCP manufacturing location is expected make the space even more attractive for the investors and manufacturers in the medium to long term.

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