Workspace leasing set for revival

Harsha Jethmalani
harsha.j@htlive.com

India's commercial real estate sector is set to get a new lease of life, thanks to the much-awaited clarity on the de-notification process for special economic zones (SEZs). Last week, the government proposed to amend rules under the Special Economic Zones Act, 2005 (SEZs), thus permitting SEZs to lease space partially or floor-wise.

This would help boost occupancies for office spaces in IT/ITES SEZ parks and thereby reduce vacancies, which are at elevated levels post covid-19 pandemic. Recall that, demand for office spaces took a knock when the pandemic began with most companies adopting the work from home model. Plus, lack of clarity on SEZ leasing was seen as a regulatory overhang, hurting rentals outlook.

While this is a step in the right direction, the benefits are unlikely to accrue immediately. Analysts said de-notification of certain identified SEZ areas as non-SEZs, and then leasing them could take six-eight months. Also, the permission for de-notification is subject to certain terms and conditions. For instance, the landlord or developer needs to repay tax benefits (without interest) related to non-SEZ areas (calculated in proportion to the built-up area).

Also, any tax benefits availed for developing infrastructure in and around this space needs to be surrendered. Going by estimates of JM Financial Institutional Securities, office landlords or developers will have to surrender ₹300-500 per sqft worth of tax benefits availed under the concessions in the SEZ Act.

Expectations are that the cost incurred in this process, which are in the form of tax benefit repaid, would be offset by improving rental income, going ahead. But here's a catch.

"The SEZ notification is unlikely to create substantial new demand; and while certain portfolio rents could benefit (e.g. DLF Cybercity SEZ rentals are 30% below non-SEZ rentals in vicinity); overall market rental uptick is likely only as supply cools off," Jefferies India stated in a report dated 10 December. Further, de-notification will not be permitted if it leads to a reduction in SEZ area to less than 50% of the built-up area.

But given the high vacancy, this condition may not be a challenge for now. In fact, data compiled by property consultant Colliers India showed, since 2020, vacancies across SEZs (Grade A office stock) have been on the rise, and currently are about 20% across the top six cities. "Ever since direct tax benefits were taken away for new units in SEZs from March 2020, SEZs lost their appeal as there were no major benefits provided for occupiers. Furthermore, they had to be compliant with SEZ requirements. This led to occupiers' exits and relocations to non-SEZ office spaces," said Piyush Gupta, managing director, capital markets and investment services, Colliers India, in a note. Owing to this, the share of leasing for SEZ spaces in overall office leasing dropped from 22% in 2019 to 14% in 2022, and 7% in January-September 2023, he added.

In a nutshell, these amendments are expected to help Grade A office operators to improve occupancy. In the listed space, all three listed office Real Estate Investment Trusts (REITs) and DLF Ltd are seen as key potential beneficiaries given the high vacancy share of SEZs in their office assets. (See chart). The stocks of listed REITs have been laggards fetching negative returns in 2023 so far as leasing trends in SEZs were muted even as non-SEZs did relatively better. In comparison, stocks of listed residential real estate firms gave impressive returns as demand for residential sales showcased resilience despite expensive home loan rates. Nonetheless, the return to office and new SEZ rules are sentimentally positive developments, but amid a global slowdown, the pace of recovery in leasing demand and, consequently rentals, remains to be seen.

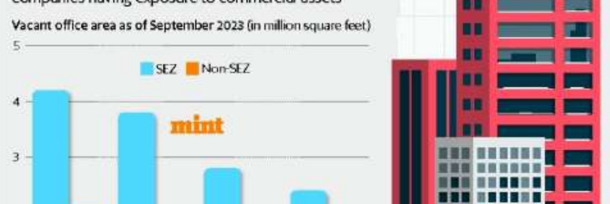
RULE REVISION

GOVT move on SEZs will help to boost occupancies for office spaces in IT/ ITES SEZ parks

WHILE this is a step in the right direction, the benefits are unlikely to accrue immediately

Crucial piece

SEZs form a big share of the vacant space of listed realty companies having exposure to commercial assets



SEZ is special economic zone
Source: Company, Kotak Institutional Equities

PRANAY BHARDWAJ/MINT