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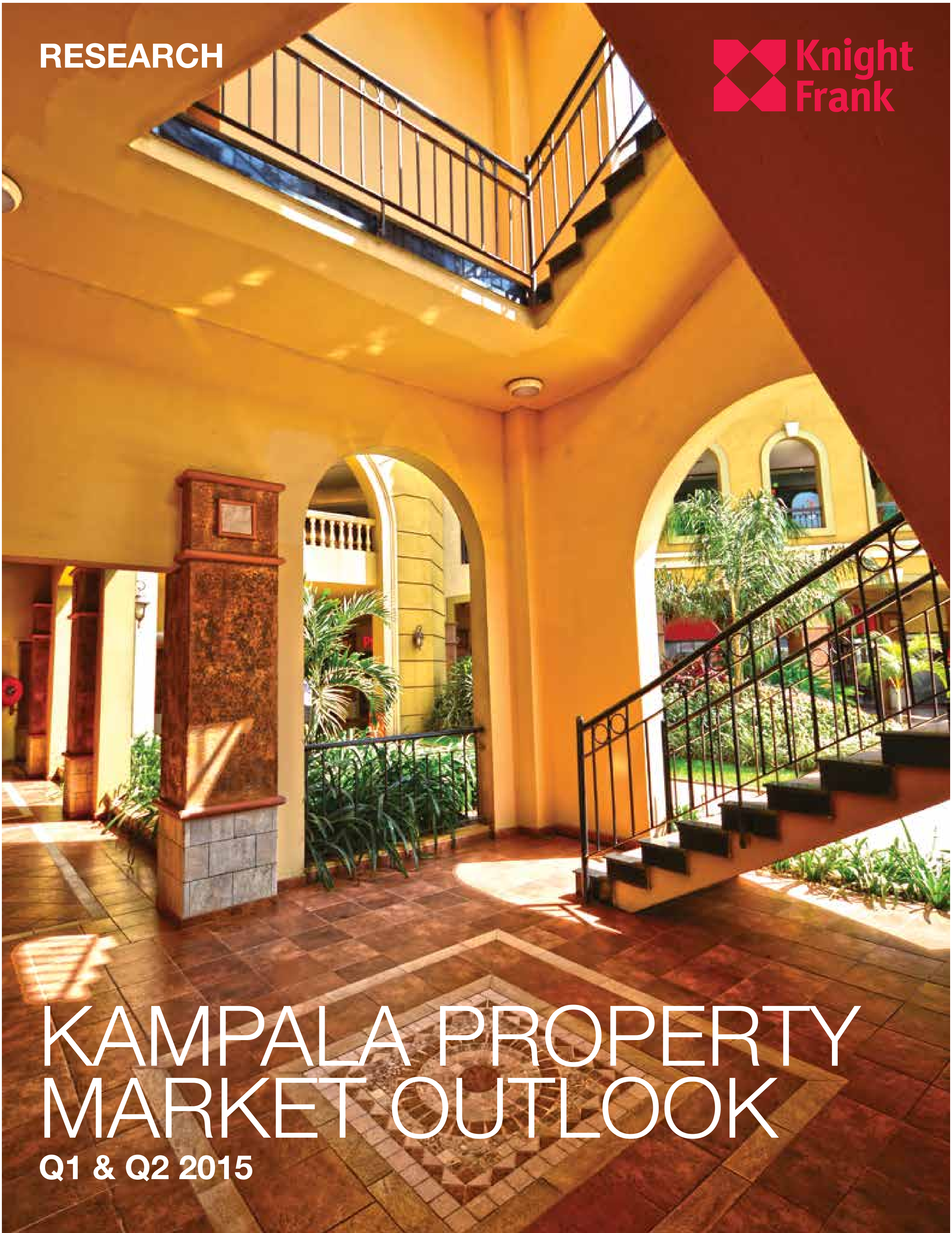


KAMPALA PROPERTY MARKET OUTLOOK

Q1 & Q2 2015

ECONOMIC UPDATE	SECTOR BY SECTOR ANALYSIS	Q3 & Q4 2015 OUTLOOK

HIGHLIGHTS

Weak shilling against USD contributes to exchange rate pressures

Changing shopper patterns leads to reduced retail trading in the CBD

Investors delaying development decisions due to pending elections early next year

Demand for middle income housing stifled by expensive mortgage financing

Cover Image:
A section of The Village Mall in Bugolobi, Kampala. Photo by Mehul Kanani

KAMPALA PROPERTY MARKET OUTLOOK **Q1 & Q2 2015**

Economic Update

Uganda's GDP was estimated at 5.3% for the financial year 2014/15, supported by growth in the private sector, improvement in the agricultural sector and growth of aggregate demand. GDP is expected to grow to 5.8% in 2015/16 supported by increased public sector investment.

Annual core inflation continued to rise in Q1 and Q2 2015 and stood at 4.8% in May 2015. The declining performance of the Uganda shilling partly contributed to this rise in core inflation. Headline inflation also increased throughout Q1 and Q2 2015 and stood at 4.9% in May 2015.

To curb inflationary pressures, Bank of Uganda implemented a tight monetary policy by raising the Central Bank Rate (CBR) to 12% in April 2015 and then again to 13% in June 2015. This resulted in commercial banks increasing their lending rates to an average of between 21% - 23% on shilling denominated loans in Q2 2015. These increments in interest rates are expected to reduce aggregate demand.

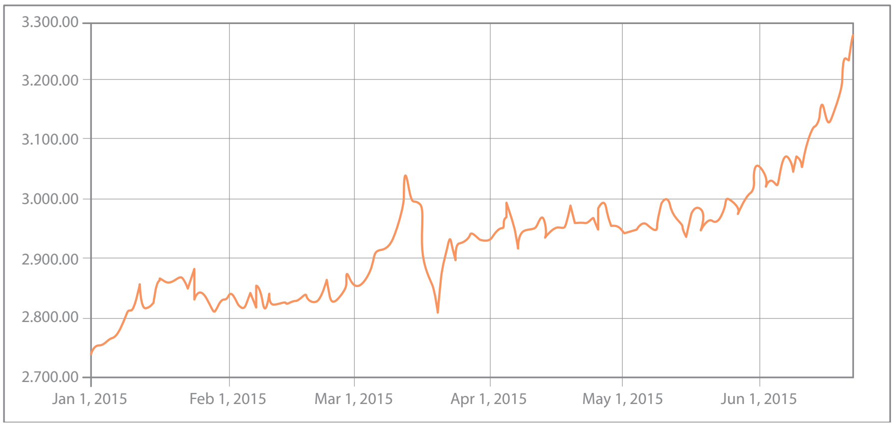
The depreciation of the shilling since January 2015 (See Figure 1.0) reflected a weak balance of payments position. The exchange rate crossed the 3000/- per dollar mark in Q2 2015 and the major contributor to the exchange rate pressures was the weak demand for exports and continued strengthening of the dollar against most currencies globally.

There have been concerns raised about the shilling's outlook due to the government's plan for the 2015/16 financial year to increase public spending by 71% ahead of a general election next year and a widening current account deficit.

Retail

The first half of 2015 has seen a lot of movement and continuous evolution of the retail sector in Kampala. The trend of consumers moving to suburban retail nodes has continued and the suburban malls are starting to cement themselves as leisure shopping outings, and changing the landscape of consumer movement and behavior in and around Kampala.

Figure 1.0
Graph showing the Ugandan shilling against the dollar, January – June 2015.



Source: Oanda, 22nd June, 2015

Victoria Mall, Entebbe

Figure 2.0
Prime retail rentals

<50 m^2	\$ 25 – \$ 45
<100 m^2	\$ 22 – \$ 38
<500 m^2	\$ 20 – \$ 35
>500 m^2	\$ 16 – \$ 20
Anchors	\$ 12 – \$ 15

NB: Please note that rental levels may vary in the above bandwidths due to shopfront-to-depth ratios, store configuration and floor level and size which has an impact on the ability to trade.

Source: Knight Frank Uganda. July, 2015

Malls under the management of Knight Frank have seen average growth of 14% in motor vehicle traffic and 9% average growth of foot traffic. This has had a negative impact on trading densities in the Central Business District environment of Kampala which in turn has meant that Central Business District retailers are starting to consider taking up space in suburban Kampala and are either expanding or relocating their existing business operations.

Trading in suburban malls has been robust in all leisure categories. However the devaluation of the shilling over the last two quarters continues to impact on general retail by pushing the price of imported products higher and eroding profit margins considerably.

Shopping Centre development in greater Kampala is seeing a huge uptake in planning and this is directly attributed to the changing shopping patterns of the local consumer and the high demand for future space being shown by Southern African, Middle Eastern and Northern Hemisphere retailers who continue with their global expansion. East Africa has been earmarked as a large potential growth market due to the ever expanding middle class and the relatively unstructured retail environment, offering and space.

The future bodes well for the consumer as more retail outlets, means more competition and better price points for consumers and obviously better choice.

Figure 3.0
Prime residential rentals

3-4 bed furnished townhouses	\$ 2,500 - \$ 3,500
3 bed serviced apartments	\$ 2,500 - \$ 3,500
2 bed serviced apartments	\$ 2,000 - \$ 3,000
1 bed serviced apartments	\$ 1,500 - \$ 2,000

Source: Knight Frank Uganda. July, 2015

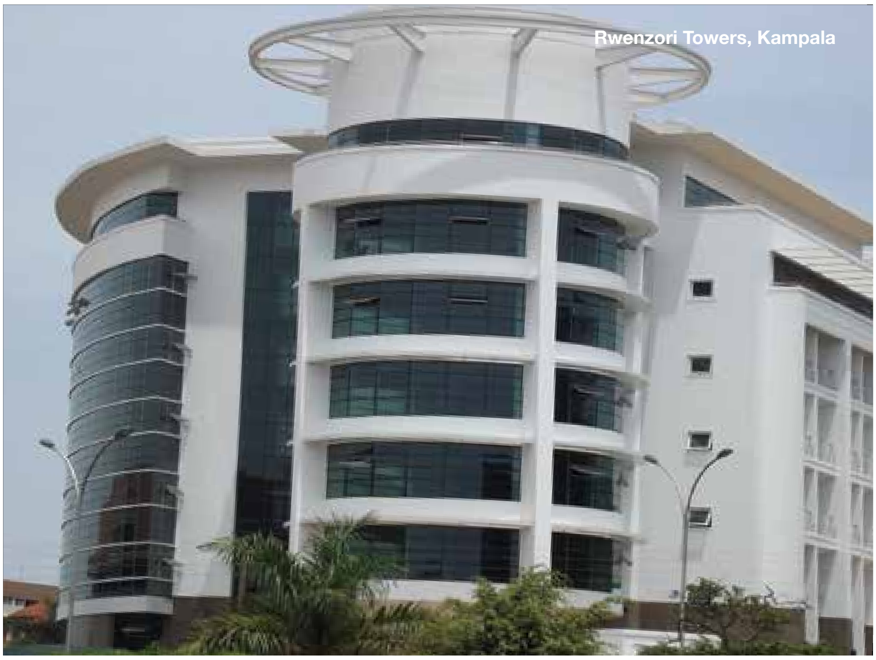
Residential

The first half of the year 2015 saw a noticeable slowdown in the residential letting market with limited demand for accommodation from the expatriate community and corporate companies as most in the Oil and Gas sector continued to steadily downsize whilst other affiliated service providers and downstream support companies closed down operations completely.

The residential sales also experienced less activity compared to this time last year, as a result of increased mortgage interest rates that have risen to 21% - 23% per annum. The forthcoming election in 2016 is also causing anxiety and uncertainty within the mid to upper niche of the residential property market hence holding off decision making to invest until after the elections. This is a typical behavioural pattern of African property markets which take on a particularly cautious attitude towards elections.

There still remains however, demand for middle income housing (UGX 250,000,000 – UGX 500,000,000/-) which is stifled by expensive mortgage financing and a continuously depreciating shilling for the dollar denominated property prices. There is also increased activity within the auctioned properties market, this may well continue into the long term if the shilling continues to depreciate and interest rates continue to rise.

The prime residential property pipeline Is active and as an example, there are approximately 850 planned apartments in the pipeline scheduled to be completed over the next 1 – 2 years in Kololo alone. Greater Kampala metropolitan area is seeing increased growth in development of apartments and middle income housing in gated communities. There are 3 satellite towns planned in Garuga, Mukono, and Bukerere, and these will have a mixture of house types in varying price brackets. (Figure 3.0)


Rwenzori Towers, Kampala

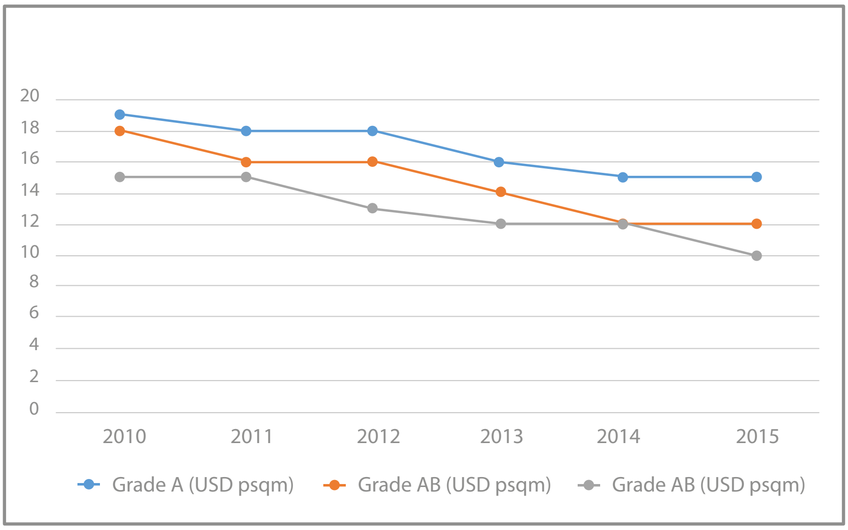
Commercial

The first half of the year 2015 looked promising for the commercial property sector, with few projects being completed while others are breaking ground. We believe this is mainly attributed to the investment appetite in office space developments by developers who believe the property market will have recovered within the next 24 months, and entry of private equity investors with long term funding as well as access to financing from commercial and development banks.

Macroeconomic indicators have not been very supportive of the property market, particularly over the last three years which have been characterized by the weakening shilling against the USD and rising interest rates, this trend is likely to continue especially with the upcoming elections in 2016, something that will see reduced activity in the sector in the short to mid-term. Many of the pipeline developments are going through planning phase and are scheduled to break ground in the second half of 2016 after the general elections.

Figure 4.0

Commercial Property Rental Rents (Net) 2010 – 2015



Source: Knight Frank Uganda. July, 2015

The above not withstanding, direct supportive policies such as improving infrastructure driven by KCCA have underpinned most of the recent acceleration in residential property development in many of the Greater Kampala suburbs.

Office Space

The slow economic activity since 2012 has continued to 2015 and the over supply of office space in Kampala has negatively affected this sector of the commercial real estate market as businesses strive to reduce costs by downsizing, relinquishing office space and others winding up altogether, also as future accommodation take up softens.

Passing rentals in the commercial property sector are on a down ward trend (See Figure 4.0) with prime office rental yields stabilizing between 8% - 10% and net headline rents between $ 9 to $ 14. Some Grade A properties are offering net rents as low as USD 10.00 per m². (See Figure 5.0 below)

Figure 5.0

Commercial property rentals

Grade A	$ 12 – $ 15
Grade AB	$ 10 – $ 13
Grade B	$ 8 – $ 10
Grade C	$ 8 – $ 7

Source: Knight Frank Uganda. July. 2015

The pipeline projects expected to be completed by 2016 may further result in an increment of office space in an already “bearish” office segment, which will most likely put downward pressure on commercial office rents especially for older standing stock, and less prime stock coming onto the market as well as lease renewals.

Recently completed stock of office space has continued to see harder bargains being driven by prospective tenants against a backdrop of oversupply and this is expected to remain so for the rest of the year. It remains evident however, that there is a shortage of prime office space at the right price in the market. This shortage will increase if no developments in this niche come onto the market in the next two years.

In addition, the "shell and core" concept has become a deterrent to swift up take and discontinuing this practise should be carefully considered by developers who still offer such office space in today's market.

Tenants are looking for an all-inclusive rent, without having to spend more time and money on finishes. We envisage that good quality office space in terms of design, functionality and finishes to a high specification, will continue to attract good caliber tenants and offer attractive yields and growth prospects for the mid to long term period.

Another noticeable trend in demand for office space is for smaller stand-alone buildings of between 1,500 – 3,000 m^2 for corporate organisations, foreign missions, and other agencies who are opting to purchase and owner occupy their office premises in light of the depreciating shilling against the dollar and increasing costs of occupation.

Other reasons justifying this preference are that these tenants tend to be more sensitive about their security requirements and want to manage and control their own security which is not possible with multi occupancy properties. Availability of parking and services at the property are other considerations driving this option.

Valuations

The slowdown in economic activity since 2012, has negatively impacted the vibrancy of the property market, and seen a correction in property prices particularly in the upper end of the property sector. This situation has been exacerbated by the depreciation of the local currency against the US dollar prompting upward adjustment of the Central Bank Rate (CBR) by Bank of Uganda and consequently upward adjustment of prime lending rates by commercial banks. The current CBR is 13% with Commercial Banks' prime lending rates averaging 21% – 23%.

Uganda has not fully recovered from the 2011/2012 property depression, and this has met with an investment market which is being cautious in the run-up to the 2016 general elections. A number of investors have deferred borrowing for development or house purchases until after the elections.

There has also been perceived caution among investors to the recently announced 2015/2016 national budget. Investors have been stalling big capital outlays and deferring investment decisions as they assess possible tax implications of the budget on property investments and development.

Compared to this time last year, there has been reduced volume of property valuation instructions for mortgages from banks. This means that fewer borrowers are taking mortgages for investment or purchasing property, a trend we envisage continuing until the first 6 months of 2016.

Outlook

In line with the 2015/2016 budget allocations of up to UGX 3.3 Trillion on infrastructure, we are likely to see more residential suburbs opening up following improved road networks especially in the Greater Kampala Metropolitan Area.

The currency depreciation will cause impediments to economic growth due to negative sentiments and uncertainty holding back investment activity. It will take a combination of fiscal and monetary policies to bolster the resilience and vibrancy of the economy.

If the last post-election history is anything to go by, the 2016 general elections may pose risks for a rise in inflation in the short to mid-term. In addition the focus on accelerating infrastructure development to address the constraints to private sector growth and increase efficiency in service delivery will have a positive effect on the real estate as property values will respond to better accessibility and increased demand for land in these locations, and in turn appreciating land prices.


Apartments, Kampala

Uganda's informal sector (agriculture, wholesale & retail trade, construction and transport) accounting for an estimated 49% of Uganda's GDP, has been earmarked for tax collection to improve on its contribution to revenue. This will see an increase in the price of goods and services to cover the tax increment and this will be passed onto the consumers.

According to 2015/2016 budget, Uganda's economic growth is projected at 5.8% in 2015/16 compared with 5.3% in 2014/15. This modest improvement looks stark due to the dampened investment outlook as a result of the impending elections and currency devaluation.

In conclusion however, it is not gloom and doom forever. We believe the Ugandan economy in general and property market in particular is resilient and will bounce back in the mid to long term. Commencement of oil production as and when it starts, will still bring with it economic growth regardless of the scale or magnitude. There will be a trickle down effect which can only increase activity in the property market. Our population growth and rapidly increasing middle class is also a positive sign for the property sector and retail in particular.

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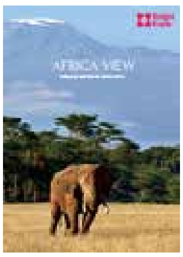

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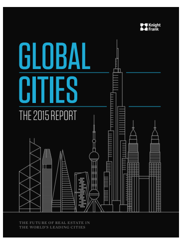

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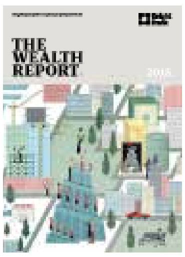

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