1 Economic Update

2 Sector by Sector Analysis

3 H2 2020 Outlook

Knight Frank

Kampala Market Update H1 2020

knightfrank.com/research

Research, June 2020

Key Insights

- Inflation averaged at 3.2% by financial year ended April 2020
- The Central Bank Rate reduced to 8% in April 2020
- Supply of residential apartment units increased by 11%
- Office space registered a 4% year on year decline in occupancy
- Residential occupancy rates declined by 10%
- Retail rental rates remained stable in the first quarter of 2020

Cover Image: Rwenzori Towers, Nakasero. Space available to let.

The Village Mall, Bugolobi, 7-9 Luthuli Avenue, Kampala. Space available to let.

ECONOMIC OVERVIEW

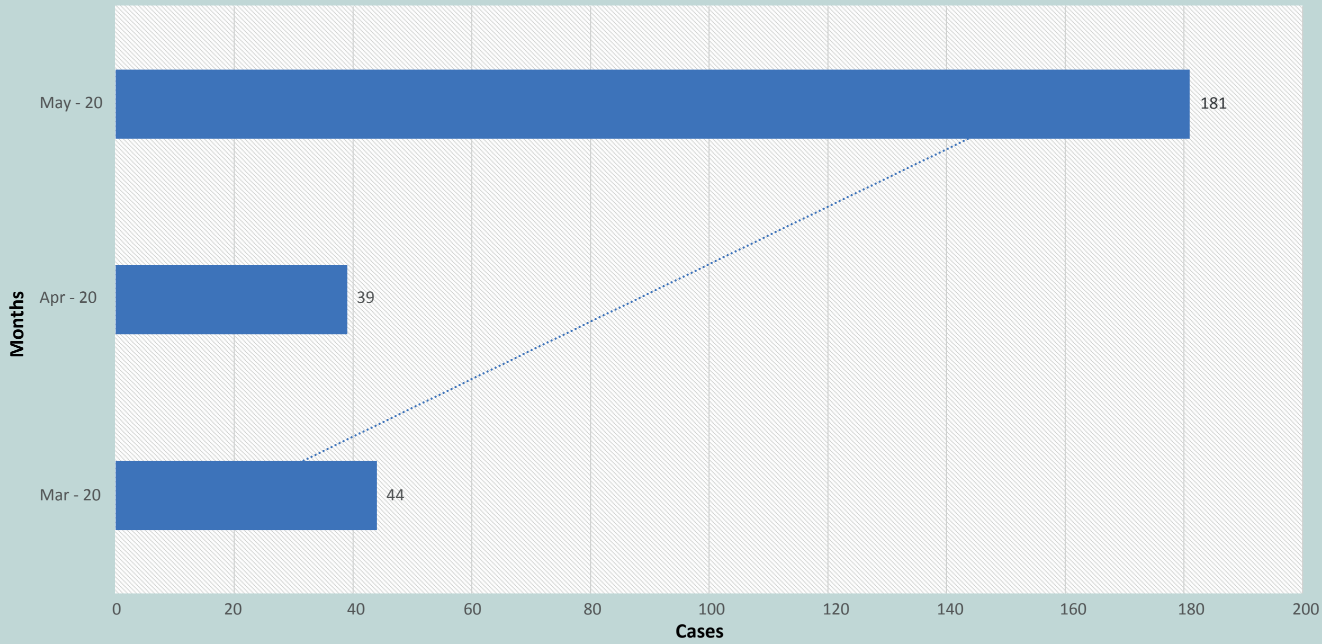
The Covid 19 pandemic has had a huge impact on the global economic performance and its effects on Uganda are progressively evolving. Whether the current economic slowdown will result in a recession of unprecedent proportions is to be determined by how different affected economies strategize to deal with the virus. Uganda first experienced effects of Covid-19 in March 2020, just after its declaration by WHO as a pandemic on 11th March 2020. On 18th March 2020, the Government instituted measures like travel restrictions, social distancing directives and full lockdown of the country except for essential services to reduce the spread of the virus, resulting in a wave of events that have led to diverse alterations to the different economic indicators. As of 20th May 2020, the country had reported 264 cases, 65 recoveries and no deaths, but with an increasing monthly case tally, mostly attributed to truck drivers from neighbouring countries as illustrated- Fig.1.0

According to Bank of Uganda, the effects of the virus have led to unanticipated economic slowdown, with GDP growth projections for the second half of the year 2020 expected to be as low as 3.4%, which is almost half of the earlier projection of 6%. The downward projections in economic growth are attributed to global economic slowdown and decline in aggregate demand caused by the full lockdown of the country to avoid the spread of the pandemic

Inflation

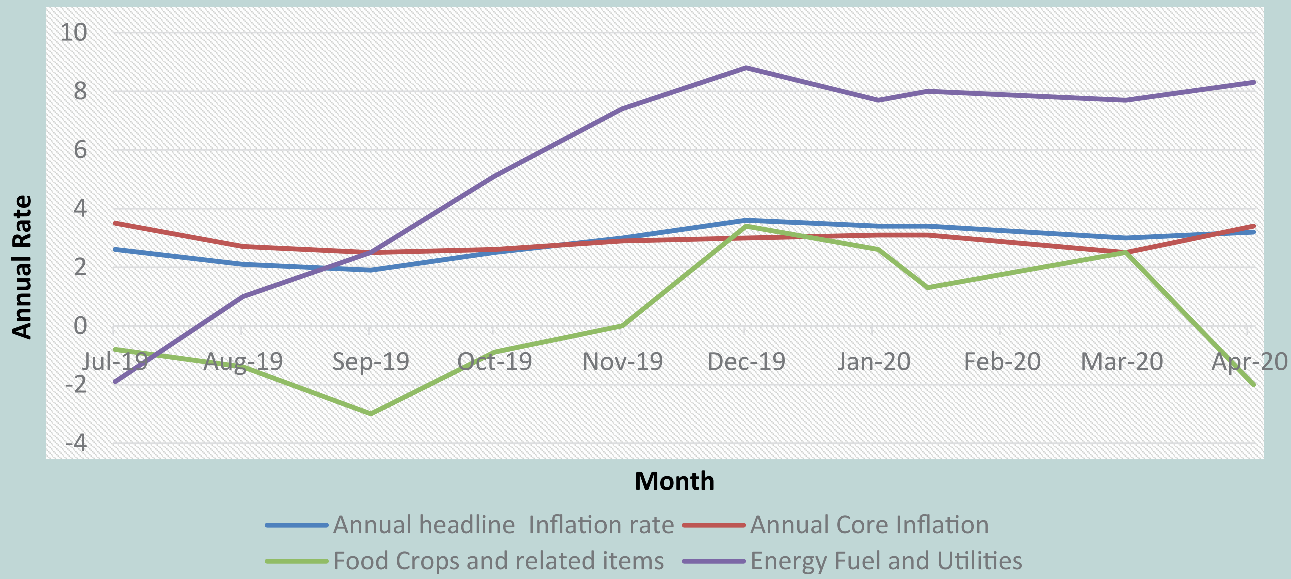
Headline inflation which had dropped 40 basis points to 3.0% in March as compared to 3.4% in February averaged at 3.2% as of the financial year ended April 2020. This is attributed to the core inflation which declined from 3.1% in the financial year ended February 2020 to 2.5% as of March 2020, increasing again to 3.4 % in April 2020. The annual food crops and related items inflation fell to -2% in the year ended April 2020, down from 2.5% recorded in the year ended March 2020. This decline was attributed to annual fruits Inflation that recorded -12.6 % for the year ended April 2020 compared to the - 3.7% recorded for the year ended March 2020. The Annual Energy Fuel and Utilities (EFU) Inflation increased to 8.3 % for the year ended April 2020 compared to the 5.4% recorded for the same period last year.

Figure 1.0: The Uganda Covid Situation as of 20th May 2020



Source: Ministry of Health

Figure 2.0: Inflationary Rate developments as at April 2020



Source: Bank of Uganda

It is therefore projected that the widening output gap, declining prices of goods and services and declining wages envisaged by the increased recent cutbacks will result in core inflation remaining below average over the next twelve months.

Exchange Rate

The Uganda shilling recorded an appreciation against the US dollar of 0.11% averaging at 3677 USD in the financial year ended February 2020, as compared to an average of 3681 USD recorded in January 2020. However, this has since changed with downward shifts of 2.2% and 0.34% in financial years ended March and April 2020 respectively. On average, the Uganda shilling depreciated by 0.81% in Q1 2020.

This can be attributed to the volatile global financial conditions and the panic buying and hoarding of the US dollar by speculators. Fig.2.0

Central Bank Rate

Declining economic conditions prompted Bank of Uganda to reduce the central bank rate from 9% reported since October 2019, to 8% for April 2020, as a measure to reduce the Covid-19 effects on lending institutions and the economy at large. This resulted in reduced cost of lending by the banks, encouraging operation of financial markets, and enabling access to credit hence stimulating economic growth in the wake of the slowdown caused by the pandemic. Additionally, commercial bank lending rates reduced from 19.88% in January 2020 to 17.78% in March 2020.

The band on the CBR will remain at +/-3 percentage points, and the margin on the rediscount rate and bank rate will remain at 4% and 5% percentage points on the CBR, respectively.

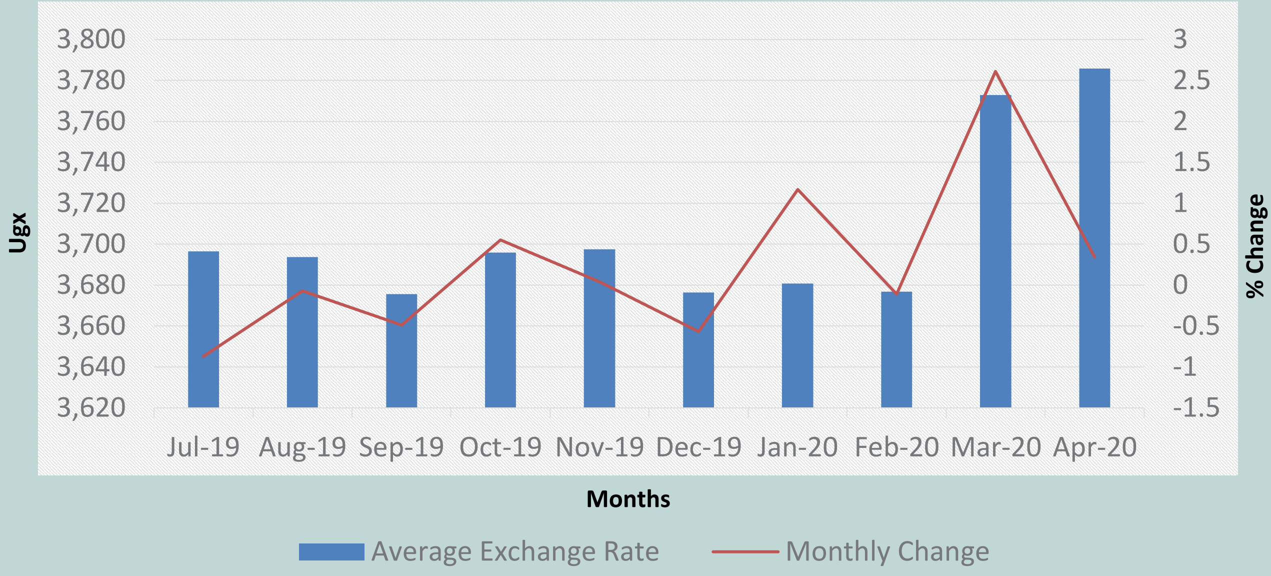
In its monetary policy statement, BOU made reference to credit relief measures to mitigate the adverse effects of COVID-19, some of which included; 'repayment holidays for a maximum of 12 months, loan tenor extensions, and any other forms of debt restructuring covered in existing regulations; postponement of prepayment of arrears as a condition for restructuring a credit facility for 12 months with effect from 1st April 2020.'

Yields on Treasury Bills

Yields on treasury bills for the 91-days tenor have generally been constant since January 2020 to April 2020, averaging at 9.63%. However, the yield has dropped compared to the same period last year, where the weighted average recorded was 10.1%.

The 182-day tenor recorded a slight improvement as compared to the same period last year, averaging at 11.3% in the first four months of 2020 compared to 11.28% in 2019. The 364-day tenor increased, averaging at 13.13% from January to April 2020 as compared to a weighted average of 12.15% recorded in the same period last year.

Figure 3.0: Money Market for the Period July 19 to April 2020



Source: Knight Frank Research

H1 2020 Property Sector Review and Outlook

No sooner had the new year brought hope of a relatively bullish property market for 2020, than news of the Covid 19 pandemic broke. The effects of the Covid 19 pandemic did not spare the real estate sector of Uganda which has been at a standstill for the last 8 weeks in response to the full lockdown measures the country was subjected to, until this was partially eased a few weeks ago. Many investors, property owners, potential home buyers and landlords are therefore asking: to what extent has the corona crisis affected the real estate market? what is happening to rents and property prices as a result?.

There is no statistical data to back any current trends in the property sector because it has not been fully active, but some unusual developments have been noted which will be addressed in detail. It is also fair to say that different sectors of the property market have been affected in different ways, with the retail sector being hardest hit as they couldn't quite capitalize on the "work from home" option that office occupiers did. This is discussed in detail in subsequent sections.

Office Sector

The start of 2020 seemed promising with regards to increased inquiries and interest in office space for rent on the back of a tight demand side that had been experienced by the market in this sector throughout 2019. Most of these inquiries were from local and multi-national corporate organisations headquartered in countries which were affected by the pandemic earlier than most. As a result, many of these inquiries have been put on hold as countries emerge from lock down.

We have not seen any downward pressure on prime office rents yet, although it may be too early to tell. However, we are certainly seeing liquidity pressure on tenants which has in turn led them to request for lease concessions with particular reference to rent payment or abatement of their contractual obligations. In response to this, landlords are considering factors such as price point in the market, covenant strength, tenant-renewal and default probability, local regulations, building appearance due to vacant spaces, and potential reputational risks in arriving at the decision for individual tenants' requests. Similarly, they are reluctant to reduce headline rents, but are offering short term remedies by way of rental discounts and or deferred payments. As a result, we envisage a worst-case scenario of approximately 10% - 20% reductions on net annual rent collections for prime office properties this year.

Table 1: Average Net Rents for Office Space in Kampala for H1-2020

TYPE	AVERAGE NET RENTS (PER SQM)
Grade A	US$16
Grade AB	US$15
Grade B-	US$12

Source: Knight Frank Research

With regards to the occupational side of the office sector, we foresee that potential tenants will most likely put a pause on their expansion or take up decisions for the next half of the year, as they wait to see how business performs after lockdown. Similarly, occupiers are likely to reduce commitments to capital expenditure which will put fit outs and other projects on hold as most corporate attention turns towards building financial resilience to ride out the storm. Client strategizing concerns are now turned towards re-occupation of offices, and who to bring back to the formal workspace and how to ensure the formal environment is safe, secure and respectful of the social distancing requirements that will be put in place. This will be particularly challenging, given the increasing density of occupation which has characterized the evolution of the office over the last decade. If strictly adhered to, social distancing requirements in offices which require a minimum distance of 2m between occupiers will lead to a low density use of buildings down to 40% - 50% of total space max.

Moving on to H2 2020, we envisage the office sector being impacted by Covid 19 as follows. Firstly, low density use of buildings as a result of social distancing could mean constricting margins and lower profitability for businesses, particularly SME's. This will in turn affect capital values. Secondly, the pandemic will certainly impose challenges on rental and capital growth, and it is highly likely that we will see falling rents and capital values over the short to mid-term; particularly in sub – prime properties where majority of tenants are from the SME sector and are unable to leverage off the balance sheets or financial support of global parent companies.

Thirdly, it is probable that the pandemic will have a long-term impact on real estate debt given that the commercial real estate market is heavily debt dependent. It is questionable therefore, how the impact of non-performing loans will impact on loan to value ratios and pricing of bank lending. It has already been forecast by the financial institutions in Uganda that non-performing loans are going to increase from 4.5% to 10%.

Table 2: Average Occupancy Rates for Prime Offices in Kampala H1-2019 Vs H1-2020

TYPE	OCCUPANCY H1 2019	OCCUPANCY H1 2020
Grade A	93%	84%
Grade AB	81%	83%

Source: Knight Frank Research

Working from Home and The Future of Commercial Office Space.

In a survey conducted between 11th and 20th May 2020, Knight Frank Uganda sought to understand occupier sentiments towards the future of Commercial Office Space in Uganda. The survey, which garnered a 97% response rate, focused on understanding sentiments ranging from the working from home experience, social distancing to occupier sentiment with regards to commercial office space post COVID-19. The findings were as follows:

KEY TAKEAWAYS

85.55% of office space users are aged between 20 to 50 years.

50.22% run their own businesses.

31.07% of the respondents employed between 1-5 employees while **25.24%** hired more than 100 employees.

68.28% of all respondents are in rented office accommodation.

81.5% are in the private sector
76.52% of the respondents own private cars, **15.22%** use public means, while **7.83%** use other means such as UBER, Bolt etc. **51.98%** of the respondents spend at least an hour commuting to work, **37.89%** spend less than 30 minutes while **10.13%** spend over 2 hours to commute to work.

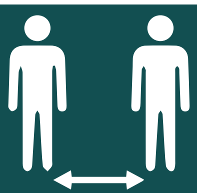
82.95% Of all respondents worked from home during the lockdown.

41.92% of these respondents rated the "Wfh" experience as comfortable, **20.96%** felt it was not convenient, **24.02%** found it conducive while **13.1%** felt the experience was not ideal
35.09% of all respondents rated their output whilst "wfh" as average. **32.89%** felt it was good, **24.56%** reported very good output. And **7.46%** said their output was excellent.

Given the option between home and the office, **60.87%** preferred a balance between "wfh" and the office, **23.48%** opted to go back to the office while **15.65%** would rather work from home.

The future of commercial office space;

41.74% believe the future of the office as a workplace will remain an important part of the business.
38.26% want an either-or option to "wfh" or office.
15.22% think the future of the office is diminishing. **4.78%** strongly believe the office as a workplace is here to stay.



Social distancing impact on office requirement

11.84% of respondents will require more office space, **17.98%** will need to downsize their office space
30.70% believe they will reduce the number of employees, and **39.47%** envisage status quo remaining the same.
46.39% will downsize to cut cost, **21.08%** believe that downsizing will be as a result of reducing staff count, **1.2%** responded that downsizing will be as a result of closing the business and **28.31%** believe that working from home as a permanent option will be a cause for downsizing.

The working from home experiment during lock down has proven to be a viable option, with the increased use of technology to facilitate workflows. The experiment illustrated that it is possible for people to work remotely unsupervised and still perform efficiently and to a high standard. The days of the office as an integral place to work are far from gone, and we can confidently say, that working from home will remain an alternative to working from office. Likewise, organisations may use working from home as a temporary fall back option to adhere to social distancing guidelines. Much as remote working has normalized the notion of leading virtual teams, it is far from the optimal way of collaboration and team building, since it is very difficult to nurture virtual teams. Norms which emerge during face to face interaction take long to establish online, if at all.
It can therefore be concluded that the future of the office as a place to work is still bright albeit a different workspace.

Flexibility of office space will become the new norm as occupiers look at ways of balancing available space with social distancing guidelines. Employers and their staff are going to need a balance to ensure optimal output both in work and meetings.

A key factor will be when, and on what scale, business confidence returns and how much this will positively impact the office rental market. It is anticipated that technology to facilitate digital workflows may become a more frequent aspect of the workplace, and that future office designs will definitely change to incorporate contactless technologies as part and parcel of health and safety measures moving forward.

Residential Sector

The residential sector performance over H1 2020 was not spared the effects of the lockdown. As everyone sheltered and worked from home albeit forcibly, leasing and sales activity literally ceased, as viewings were not possible. The residential sector which already suffered from weak demand found it difficult to launch new projects and/or complete the ongoing ones due to construction halts and labour shortages. The transactions which were in the process of being concluded were put on hold, but are slowly being revived by interested parties. The mass exodus of over 1,000 foreign nationals back to their countries at the announcement of lockdown in Uganda left the fate of many tenancies for private rented accommodation in limbo.

Table 3: Prime Residential Rental and Occupancy Rates in Kampala, H1-2019 Vs H1-2020

DESCRIPTION	H1-2019	H1-2020
2-Bedroom Apartments	$2,250	$1,860
3-Bedroom Apartments	$2,750	$2,360
Average Occupancy	78%	69.9%

Source: Knight Frank Survey

H1-2020 recorded an 11% increment in the supply of residential apartment units from 2006 units in H1-2019 to 2230 units in H1-2020. The increase in stock vs low demand forced some landlords to discount their rents in order to be more competitive and reduce voids given the slow economic trend.

Our outlook for the residential sector forecasts the next six months as one of the worst phases in terms of demand, particularly in light of closed airports and restricted air travel globally which will stifle demand for prime rental property from expatriates. It is most likely that leasing activity will remain below par during this period. Similarly, our outlook on future rental appreciation is bleak and we expect rents to either remain stagnant or slide under the current uncertain economic scenario. The pandemic has impacted investor confidence and cashflows, which will defer real estate purchase decisions to the distant future. The net cash flows of residential developers will witness some decline on account of the Covid 19 pandemic.

Retail Sector

The period under review, H1 2020, has seen a contradiction in trading patterns and consumer spending in the Knight Frank managed malls in Uganda. The first quarter of the year showed significant turnover growth across all sectors, significantly higher than GDP growth and inflation. Retail in general was buoyant and the sector was anticipating a great year ahead. Then as the world succumbed to the Covid-19 Pandemic, with manufacturing closed, supply chains affected, retailers struggled to get product on shelves, and in early March, stock gaps started to impact on sales. The back end of March conversely saw sales increase significantly due to panic buying and stock piling by consumers foreseeing the impending lockdowns. The retail industry as a whole was closed down in phases from 20th March 2020, starting with leisure and entertainment operators being shut down. On the 1st April 2020, all retail was shut down, save for essential services such as supermarkets, financial institutions, pharmacies and medical facilities.

At the time of writing, general high street retail and shopping malls have been allowed to open. Public transport will also start operating on 4th June 2020. Shopping malls by their very nature are developed at considerable cost specifically to enhance the consumers experience whilst shopping. They have large and wide corridors, interlinking stores, single tenant occupancy per store, ample parking and are well secured, cleaned and operated. They have ample ablution facilities and by their very nature create a decongested shopping experience, so they are perfectly set up to deal with social distancing policies and create a Covid-19 risk averse shopping experience. This in itself supports the social distancing and other guidelines which have been passed to try and contain human to human transmission of the Covid 19.
The significant increase in March sales can be attributed to panic buying and stockpiling of essential goods prior to the lockdown.

Table 4: The Growth Year on Year for Turnover in Knight Frank Managed Malls on a Like for Like Basis.

MONTH	GROWTH IN SALES 2020/2019
January	12%
February	16%
March	20%
April (only essential services traded)	-52%

Source: Knight Frank Survey

The reduction in sales for April (total lockdown and curfew) for essential services can be attributed to the restriction on all forms of transport, making it very difficult for consumers to get to the malls, and also reflects the state of the economy with consumer incomes under pressure due to furlough, reduced salaries and redundancies leading to reduced spending.

Table 5: The Growth Year on Year for Footfall in Knight Frank Managed Malls on a Like for Like Basis.

MONTH	GROWTH IN FOOTFALL 2020/2019
January	13%
February	17%
March	-8%
April (only essential services traded)	-80%

Source: Knight Frank Survey

As per the table above, one can draw direct correlation between footfall and sales as depicted in the previous table. The anomaly relates to March where footfall was impacted by the closure in leisure and entertainment traders on 20th March 2020, and the increase in sales over the same period attributed to stockpiling and panic buying.

Pipeline activities in the retail sector saw Turkish based international fashion chain LC WAIKIKI confirm their entry into the Ugandan Market with a $2000m^2$ store at Acacia Mall (the largest LC WAIKIKI store in Africa). The store was due to open in July, but has been pushed back to later in the year due to the pandemic. Skechers and Clarks, two international footwear brands also confirmed entry in Uganda with stores to open in The Arena Mall, which is projected to officially open on the 3rd December 2020. Metroplex Mall which was earmarked to open its first phase in April 2020, will also be delayed to later in the year. Woolworths, the South African based clothing retailer also confirmed their entry into Bugolobi Village Mall which will take their store count in Kampala to 4.

The demand for retail space in the CBD malls peaked in January and February 2020 on the back of good retail trading figures. This led to increased interest from retailers looking to expand and potential new retailers into the market carrying out their due diligence exercises. This has seen a dramatic change of strategy both locally and internationally, as retailers try to stay afloat during these uncertain and unprecedented times.

Both retailers and retail landlords have seen the lockdown measures heavily impact their businesses negatively, and the outlook for the rest of the year is bleak and uncertain. During the lockdown period rental payments have not been forthcoming for obvious reasons, and Force Majeure clauses are being invoked for those who have them in their tenancy agreement. When tenants choose to invoke this clause, contractual obligations are put on hold for the force majeure period. Force Majeure is not a common law right, and where it is not present in a tenancy agreement, the parties need to discuss a way forward regarding commercial terms, as the rent is payable from a contractual perspective.

The outlook after lockdown for retail trading is uncertain, and most landlords have undertaken to give stimulus solutions to their tenants on a case by case basis, so as to allow deferred rentals for up to 6 months. The main purpose being to achieve an optimum outcome which balances the consequences of the lockdown on both parties, against the symbiotic and mutual relationship needed for retail business to succeed. At the time of writing, Government of Uganda has not proposed any stimulus package for the economy as has been done in many other countries impacted by lockdowns.

Retail rental rates remained stable in the first quarter of 2020, but such will probably contract by approximately 30% post lockdown, depending on the ability of the general economy to bounce back, and consumer spending to return to pre-Covid 19 levels.

Table 6: Prime Retail Rental Rates in Kampala

SIZE	RATES
$<10m^2$	\$200.00
$<50m^2$	\$48.00
$<100m^2$	\$28.00
$>500m^2$	\$20.00
$>1000m^2$	\$14.50

Source: Knight Frank Survey

These figures are average rentals for ground floor space in Kampala Shopping Malls but do not take Shop front to depth ratios into account, exclude service charge and don't take into account the impact of Covid-19 at this point in time.

Table 7: Market Sentiments for Uganda's Commercial, Retail and Residential Markets

MARKET	Commercial	Retail	Residential
FIRST REPORTED CASE OF COVID-19	22/03/2020	22/03/2020	22/03/2020
ACTIVE OCCUPIER REQUIREMENTS	↓	↓	→
COMPLETED TRANSACTIONS	↓	↓	↓
POSTPONEMENT OF DEALS	↑	↑	↑
OCCUPIERS SEEKING SUBTENANTS	→	↑	N/A
ASKING RENTS	→	↓	↓
TOTAL OCCUPANCY COSTS	↓	↓	→
PREVAILING MARKET CONDITIONS (OCCUPIER, LANDLORD FAVOURABLE OR BALANCED)	Balanced	Tenant	Tenant

Source: Knight Frank Survey

Industrial Sector

The Covid 19 pandemic led to supply chain disruptions in the Industrial sector which has further impacted on performance. Like all other property sectors, industrial property has been experiencing suppressed demand and steadily falling rents over the past few years. When China closed for business at the beginning of the year in their fight to contain the pandemic, imports into the country stopped, affecting traders wholesale and retail business which is the biggest source of demand for storage space. Entire logistics and supply chains were affected and are yet to recover as trucks from neighboring East African countries pile up at the border as they go through the testing and tracking process before being allowed to proceed.

Similarly, some big manufacturing companies have closed their facilities and others have laid off staff as a result of reduced demand for their goods during lockdown; while others closed in a bid to stop the spread of the virus. The manufacturing sector of Uganda, will be severely impacted during the pandemic, because their activities must be performed on site and cannot be done remotely. Additionally, reduced disposable income as a result of poor economic activity has reduced demand for manufactured goods and services. We envisage this status quo continuing for the rest of the year. This will certainly have an impact on rents and capital values in the mid - long term.

Valuations

As can be seen from the various sector reviews and outlook above, it is evident that the property sector will be impacted by Covid 19 although to varying degrees across sectors and property types. Needless to say, the impact on good quality assets will be less than the poorer quality assets. The land registry office was closed throughout the lockdown period and were therefore unable to record any transactions. At this point there is no data to back any trends; we can however make more accurate projections for the office and retail sector where rent discounts, but not waivers or reductions to headline rents have been given to various tenants and this seems to be the norm with many landlords in the segment of the commercial sector. This will invariably have an impact on the net rents collected as they will reduce and have a slight impact on capital values, and indeed valuations returned.

The next half of the year will give a clearer indication on this as businesses will have had a chance to stabilise and make decisions on their space requirements. It is at this point that more accurate forecast can be made. Whilst Bank of Uganda has been proactive in issuing guidelines on Loan To Value ratios not exceeding 85% which is reasonable, it is important to note that without real data to back our forecast and projections, such pronunciations run the risk of negatively impacting market sentiment, this would in turn cause more fear and uncertainty in the property sector and lead to a worse outcome than would have perhaps been the case.

Moving Forward

With the lockdown now eased considerably save for public transport which is still restricted, the country is now keen on saving livelihoods. Economic activity, trade and business has been at a standstill for the past 2 months thus having a huge impact on every sector of the economy. Real estate is a good / service like any other and will also be impacted both at an asset class and property sector level.

Offices are being re-occupied but landlords and occupiers will incur additional costs on Health and safety which are now at the forefront of the post lockdown workplace environment. This response which is an immediate consequence of the crisis will have an impact on occupancy and maintenance costs of the buildings as occupiers are demanding it, and landlords have a moral and regulatory authority to deliver these outcomes. We will see the role of flexible offices offering a stop gap solution to businesses especially for those looking at reducing their staff density ratios in the wake of Covid 19. This solution will allow for the flexibility of short leases for plug and play space.

Residential sales transactions have slowed down considerably due to lockdown, and appetite for new developments seems to also be on a low for now. The mortgage market will also be impacted even with reduced bank lending rates as borrowers for house purchases stabilise cash flows and business before committing themselves to new debt liabilities.

Tenants will without a doubt be looking for rent concessions and or deferred rent payments to allow them the breathing space to reopen and revive their businesses after lockdown. We may well see possible occupier fallout for the weaker businesses which are more cashflow dependent than others. Similarly, retail sales will remain under pressure for some time as the consumer has been hugely impacted during the pandemic. In addition to this, it is questionable whether consumer demand will bounce back to what it was pre-Covid 19 with social distancing guidelines in place. This will compromise the whole shopper experience which is critical for vibrant shopping centre trade.

Whilst the short to mid-term outlook paints a rather bleak picture, this is a health pandemic which has impacted the economy and not an economic crisis per se. The traditional crisis' and their knock-on effects on the real estate sector are normally driven by a combination of undercapitalised banks, over leveraging, oversupply and market sentiment, and the shocks tend to be more aggressive and take longer to overcome for this sector. Similarly, it is not a typical crisis, and there are no typical outcomes, but there is a strong possibility that the Kampala real estate sector will return to normalcy and regain its posture sooner than we imagine. Our real estate market is known to be resilient to even the most aggressive shocks as seen after the 2009 global financial crisis and property depressions of the recent past.

To let: Warehouse in Ntinda

Please get in touch with us;

Judy Rugasira Kyanda
Managing Director
+256 414 344 365
judy.rugasira@ug.knightfrank.com

RETAIL
Marc Du Toit
Head – Retail Property Management
+ 256 414 344 365
marc.dutoit@ug.knightfrank.com

VALUATION
Arafat Katugga
Head - Valuation
+256 414 341 391
Arafat.katugga@ug.knightfrank.com

AGENCY
Sharon Kamayangi
Head - Agency
+256 414 341 391
sharon.kamayangi@ug.knightfrank.com

RESEARCH
Judy Rugasira Kyanda
Managing Director
+256 414 344 365
judy.rugasira@ug.knightfrank.com

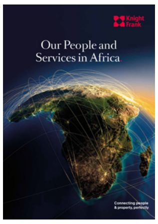
Recent Publications

Kampala Market Report H2 2020

Healthcare in Africa Report

Africa Report 2020

Our People and services in Africa Report 2020



Knight Frank Research Reports are available at knightfrank.com/research

Knight Frank