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H1 2021 Kampala Market Performance Review

July 2021

knightfrank.ug/research

Lugogo One: Modern Prime Condoinium Office Space Available for Sale and Rent.

Key Insights

- Annual Headline Inflation rose to 2% in June 2021
- Bank of Uganda reduced the Central Bank Rate to 6.5% in June 2021
- The prime office market registered a 3% y-o-y drop in occupancy
- Increase in demand for showroom space within the city center
- Prime residential rents remained relatively stable
- Metroplex Mall's phased opening commenced

Lugogo House. Space available to let.

ECONOMIC OVERVIEW

Table 1: Trends which the Knight Frank H2 2020 report highlighted for H1 2021.

Outlook	Comment
Subdued performance of the office leasing market, attributed to the uncertainties that surrounded the general elections and impact of the lockdown in 2020	Q1 2021 started off at a rather slow pace, with a reduction in the number of inquiries and interest in occupier services. This was to be expected given that most businesses were more focussed on stabilising cash flows than rolling out expansion plans.
Continued emphasis on health and safety especially in the office and retail asset classes.	Throughout the prime office and retail asset classes, OH&S protocols became a heightened priority for most landlords and occupiers alike. Some of these included, safety signage, hand sanitisers, temperature guns, increased and improved cleaning frequencies and masking, which underpinned office re-occupancy protocols in 2021.
Technology to continue playing a vital role as a means to facilitate workflows, and reduce physical contact.	With the office as a focal point, key in collaboration, training and cohesion of teams, technology was a great facilitator of workflow processes in H1 2020, through virtual communication platforms like zoom, teams, google meet, etc. Some big corporate organisations have taken the decision to permanently reduce the headcount in office at any one time for the foreseeable future.
Landlords to be less accommodating of any more requests for further rebates.	Landlords continued to face requests for rent reductions and delay in escalations from prospective and existing tenants. These however did not materialise for many considering that several landlords had already offered discounts to their tenants during and after the March 2020 lockdown. We are still seeing a continued reluctance from landlords to these demands, current lockdown notwithstanding. Instead, negotiated rent payment plans are becoming the compromised position for both parties.
Working from home and in shifts to continue to complement the office, as opposed to taking a binary decision on the matter.	As employers and organisations worked to establish and refine workplace strategies that favoured their employee's welfare, working from home and in shifts continued to complement working from the office in H1 2021.

Introduction

The economy in general and the real estate sector specifically, remained subdued over the past one and a half years due to the lockdown restrictions that affected different sectors of the economy. In the previous property market report (H2-2020), the outlook for 2021 pointed to GDP remaining below expected levels, as per the Bank of Uganda State of the Economy Report for December 2020, coupled with continued subdued performance of the real estate sector, with investors adopting a wait and see approach to the outcome of the February 2021 general election.

Hope for improvement in performance was hinged on several factors among which included; vaccine acquisition and rollout, monetary and fiscal policy stimuli, relaxation of curfew and other restrictions, and increase in return of expatriate numbers.

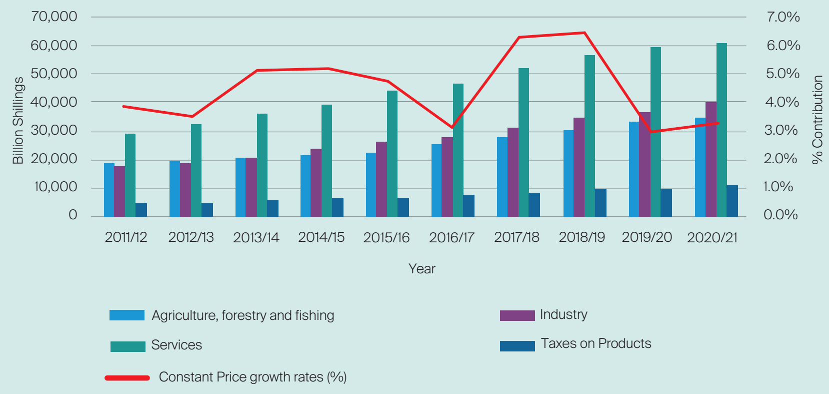
The debate as to whether 2021 would be a year of recovery from the total disruption and destabilization faced in 2020 has been put to sleep with the current lock down which has dampened any hope of recovery and stifled the little momentum that had been gained.

General Economic Performance

Preliminary annual GDP statistics released by UBOS in May 2021 indicated that the performance of the general economy was on a slow but positive trajectory as compared to earlier projections. GDP had grown by 3.3% in FY 2020/2021 as compared to earlier projections of 3.1%. This was attributed to improvement in general economic activity and aggregate demand as a result of the ease of restrictions imposed in March 2020 due to the pandemic.

The economy in general remains subdued due to the lockdown restrictions that affected different sectors of the economy.

Figure 1: GDP Contribution by Sector



Source: UBOS

The services sector accounted for the highest contribution to GDP at 41.5% despite its declining share contribution when compared to the 42.8% recorded in financial year 2019/2020. The Industrial sector contributed 27.4%, the Agricultural sector contributed 23.7% while the taxes on products contributed 7.3%.

COVID-19

In May 2021, the economy was hit by a second wave of the COVID-19 pandemic. The Ministry of Health (MOH) recorded a surge in the number of COVID-19 cases, reporting a daily average of 1,114 cases in June 2021. This necessitated various interventions by the government to curb the spread of the virus which included initial closure of schools and ban on inter-district movements for a period of 42 days effective 7th June 2021. However, due to the persistent increase in daily new cases, the government reinstated a second national lockdown for a duration of 42 days from 19th June 2021 to limit mobility and control the spread of the virus. Other lockdown measures instituted included closure of schools and institutions of higher learning, restrictions on public gatherings, sports activities, funerals, weddings, a ban on public and private transportation, and suspension of weekly non-food markets. It is yet to be seen how effective the measures will be.

The surging number of COVID-19 cases resulted in increased turnup for Covid-19 vaccinations by the population at the different vaccination sites. This provides hope for a quicker return to normalcy, although the failure of many African governments, Uganda inclusive to secure the required doses due to global shortages, coupled with the mutation of the virus into other variants such as the Delta and Delta plus which are resistant to some vaccines has presented major challenges to this end.
As of 30th June 2021, the country had recorded 82,082 cases, 1,111 deaths and 861,645 people had been vaccinated. Approximately 41% of the total cases and 66% of total deaths were recorded in June 2021.

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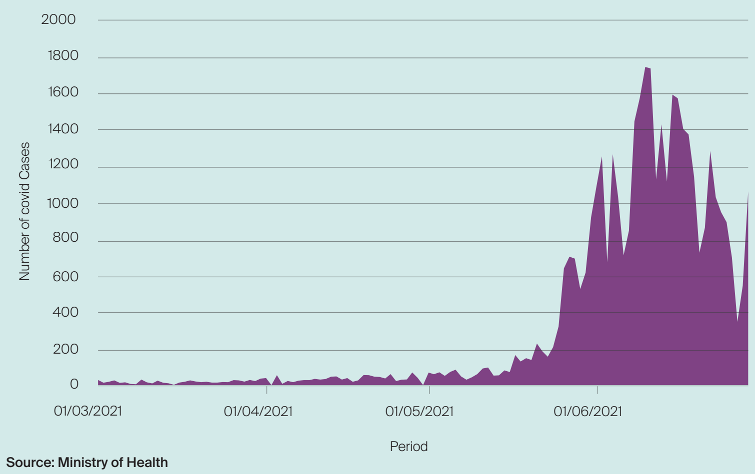
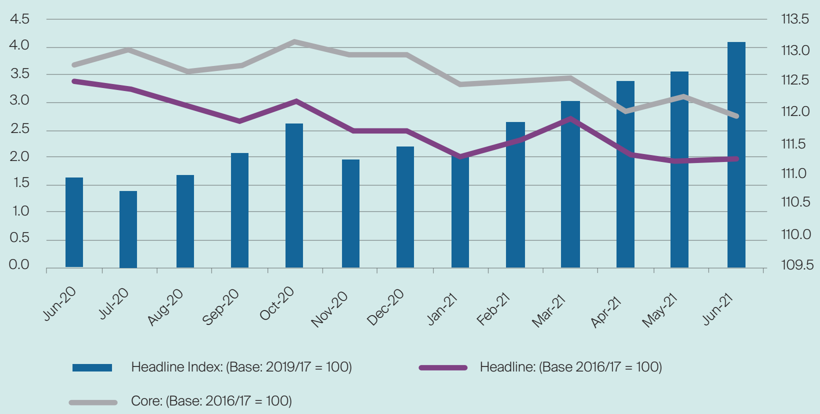
Figure 2: Uganda Covid-19 Cases



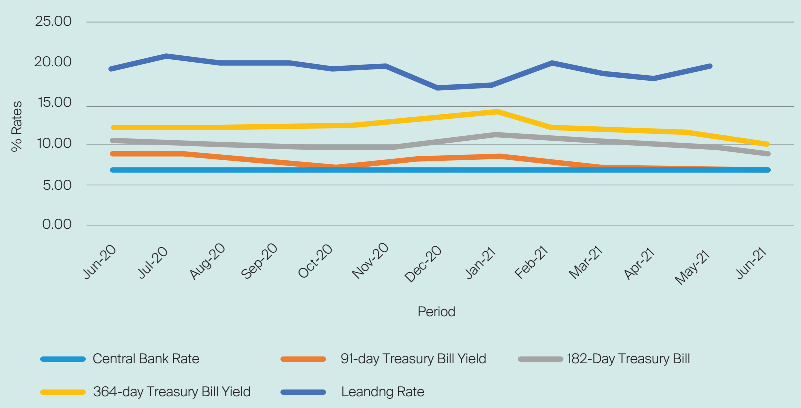
Source: Ministry of Health

Figure 3: Annual Inflation Developments



Source: Bank of Uganda

Figure 4: The Money Market



Source: Bank of Uganda

Inflation

The annual headline inflation for the year ended June 2021 increased to 2% as compared to the 1.9% recorded for the year ended May 2021. The rise was attributed to an increase in the annual food and other nonalcoholic beverages inflation to -1.6% from -3.5% recorded in May 2020, coupled with an increase in annual inflation for, 'Housing, Water, Electricity, Gas and Other Fuels'.

Annual core inflation for the year ended June 2021 decreased to 2.7% from 3.1% recorded for the year ended May 2021, majorly driven by a reduction in annual service inflation which decreased to 5.3% for the year ended June 2021 from 6.7% recorded in the year ended May 2021.

Money Market

The increasing COVID-19 induced uncertainties which are likely to slow economic recovery prompted Bank of Uganda to reduce the central bank rate by 50 basis points from 7% reported since June 2020, to a record low of 6.5% for June 2021. This was aimed at keeping the monetary conditions flexible, to hedge against uncertainties and risks surrounding growth and inflation that would slow down economic recovery and delay return to normalcy.

Lending rates for shilling denominated loans declined by 0.7% to an average of 18.1% in April 2021, as compared to 18.8% recorded in March 2021, reflecting the continued accommodative monetary policy.

Yields edged downwards for the 91, 182 and 364-day tenors being recorded at 7.0%, 9.3% and 10.1% respectively for June 2021 from 7.1%, 9.9% and 11.1% recorded in May 2021. This was attributed to the low central bank rate, and increasing investor confidence following the concluded national elections.

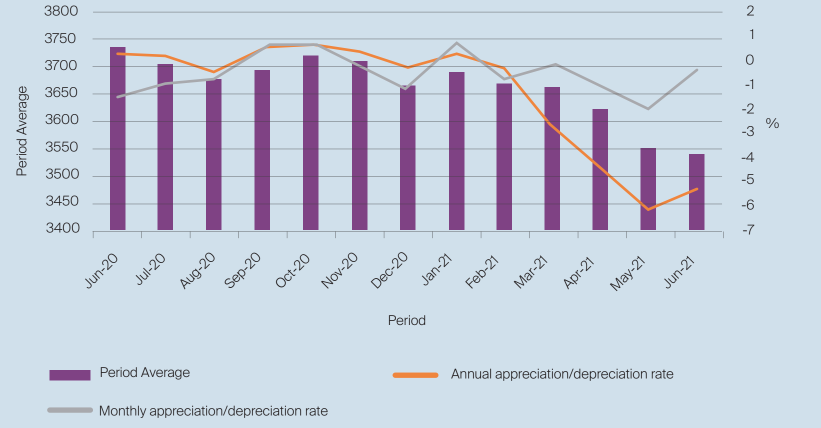
In order to cushion the economy from the effects of COVID-19 and moderate the rise of non-performing loans, Bank of Uganda approved requests from Supervised Financial Institutions, and granted them delegated authority to handle a third restructure of credit facilities to their customers faced with exceptional circumstances due to COVID-19.

Credit relief measures to mitigate adverse effects of COVID-19, issued on 14th April 2020 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 April 01, 2020.

Exchange Rates

The Uganda Shilling appreciated by 0.35% in June 2021 against the USD to an average of 3540 as compared to 3553 recorded in May 2021. On an annual basis, the Uganda shilling recorded an average appreciation of 3.1% in H1-2021. This was attributed to increased foreign exchange inflows from offshore investments, the exports sector, and non-financial institutions amidst demand from oil, manufacturing and telecom sectors.

Figure 5: Exchange Rates



Source: Knight Frank

Spotlight on Emerging Markets: Data Centers

The technology sector has experienced tremendous growth over the years, necessitating digital infrastructure to accommodate different critical applications, big data and ensure faster speeds for users. With African countries comprising a large proportion of the growing global internet market, the need for facilities to accommodate technological hardware and software and reduce latency has risen, hence the increased interest in data centers.

A data center is a facility that accommodates and centralises different IT operations and networking infrastructure for the purposes of storing, processing, and disseminating data and applications.

Different businesses and corporate organisations have been known to have individual servers (on site datacenters) where they store, process and share their company information. These have proved to be quite expensive in terms of set up and maintenance as opposed to third party data centers that provide the option to rent out capacity, allow networks to interconnect and exchange data hence, ensuring cheaper, faster and more reliable internet.

The increase in data generation in Africa, coupled with the need to ensure Africa's internet traffic stays within the region has become a major point of discussion, driving demand for fast and reliable processing computer infrastructure.

As a result, Raxio Group opened its first enterprise grade data center in the Kampala Industrial Business Park in May 2021, with the aim of supporting industries that are facing increasingly complex and unique IT and regulatory challenges, by providing secure colocation space of up to 400 racks that will house servers, networking devices and cables while providing 1.5MW of IT power to ensure the equipment housed within it operate optimally.

It is anticipated that the data center will help drive economic growth and digital transformation through providing technology infrastructure that will attract opportunities for colocation both locally and internationally.

Factors such as government support boosting the digital economy and increased investment in fibre connectivity e.g. Liquid Telecom, Africa's largest independent fibre network, among others are likely to boost growth of the Africa data centre market.

Raxio Group plans to establish 12 carrier-neutral facilities across Africa in a three years' timeframe with the aim of driving economic growth, social development, and digital transformation throughout Africa.

Raxio: Uganda's first enterprise grade data centre

REAL ESTATE OVERVIEW

Office Market

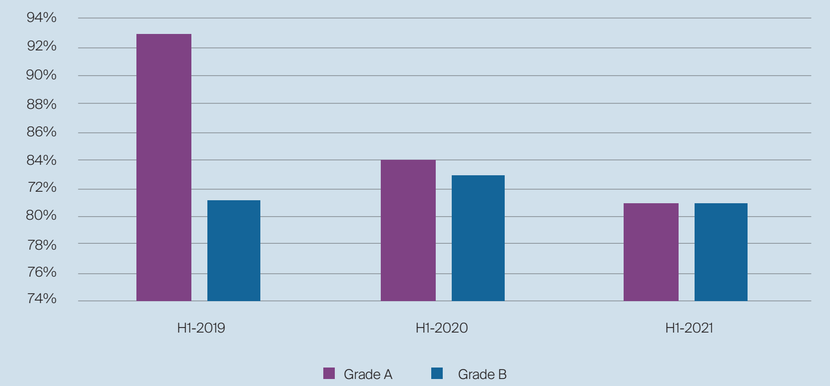
The start of 2021 came with optimism not just for the general economy but the office property market in particular. With slow performance recorded in 2020, projections indicated a slow but steady recovery, especially with a pick-up in leasing activity after the ease of lockdown restrictions in June 2020.

Q1 2021 started off at a rather slow pace as compared to Q1 2020, with a reduction in the number of inquiries and interest in office space for rent, until March when the sector started to slowly pick up. The signing of the Shareholder's agreement of EACOP and the Tariff and Transportation Agreement which opened the way for the development of the Lake Albert development project in Q2 2021 resulted in a marked increase in inquiries across asset classes (office, residential and industrial space), largely driven by the oil and gas sector and private consultancy firms with space requirements in the range of 150 -1,500 square meters.

Downsizing, merging and relocation to owner occupied premises was a major aspect that carried on in H1-2021. A return to relative normalcy in terms of inquiries which had been observed in Q2-2021 was affected by the 42-day national lockdown announced on 18th June 2021.

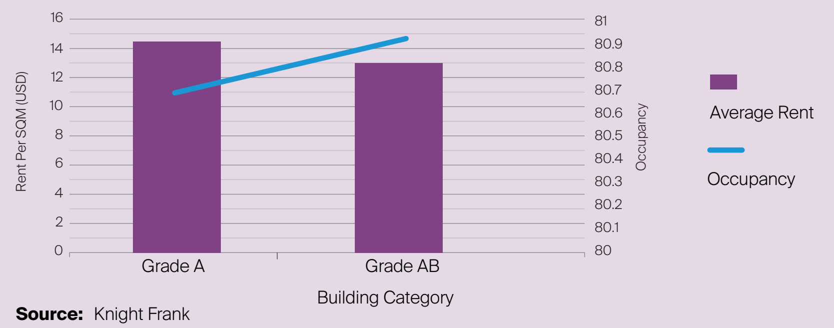
This came at a time when several organisations were still reconfiguring their workplace layout and strategies to incorporate the SOP's and social distancing requirements. Flexible working in terms of working in shifts had been largely adopted in several organizations due to the inability to contain all staff members at once while adhering to set SOPs.

Figure 6: Annual average occupancy for prime commercial offices



Source: Knight Frank

Table 7: Average Prime Office Rents & Occupancy



Source: Knight Frank

Knight Frank registered a 3% drop in occupancy of Grade A/AB office buildings from 84% in H1 2020 to 81% in H1 2021. This decline was attributed to downsizing of space requirements, relocation, increased supply of prime office space and working from home.

The addition of approximately 6,000 sqm. of Grade A lettable space onto the market in H1 2021 increased the amount of stock hence occupancy rates in the first half of the year, on the backdrop of demand that had been negatively affected by the effects of the pandemic. Whereas some Grade A office buildings experienced upward movement in take up over the last 6 months, vacancies were registered for lower grade offices, especially where tenants opted to relocate and upgrade to newer or more modern office buildings and in some cases owner-occupied premises.

However, following the signing of the key oil and gas agreements in April 2021 which paved the way for the construction of a 1,440 km crude oil pipeline from Uganda's Albertine region to the Tanzanian seaport of Tanga, opportunities for a revitalisation in office activity are envisaged which should stimulate demand for office space and boost confidence in the future of the office market performance.

Despite the decline in occupancy, office rents remained relatively stable for Grade A and AB Offices, albeit grade A office average rents registered a slight reduction of 3% in H1 2021 as compared to H1 2020 as a result of rent reductions that were enforced in some buildings in the period after the May 2020 lockdown. Prime office yields averaged between 8% and 9% in the period under review.

General market sentiment indicated that landlords continued to face increasing requests for rent reductions and delay in escalations from prospective and existing tenants.

These however did not materialise for many, considering several landlords had already offered discounts to their tenants during and after the March 2020 lockdown. However, in a bid to prevent a further drop in occupancy, some considerations were made by a few landlords.

All things taken into consideration, current lockdown situation inclusive, our outlook is that prime rents will remain stable depending on the bargaining strength of each tenant, as landlords strive to maintain their occupancies resulting from relocations and downsizing. This will be further supported by the increase in oil and gas activity which is slowly reviving activity in the various asset classes and sectors of the economy.

With the development pipeline consisting of projects such as the Pension Towers, Twed Heights, IGG Building, NDA Laboratory Tower and the The Pearl Business Park, we estimate that approximately 130,000 square meters of lettable office space will come in to the market over the next 24 - 36 months. Some of the upcoming developments are for owner-occupation ranging between 1,500-5,000sq.m while the bigger developments are for investment purposes. Projected supply will be concentrated in areas of Nakasero, Kololo and Bugolobi.

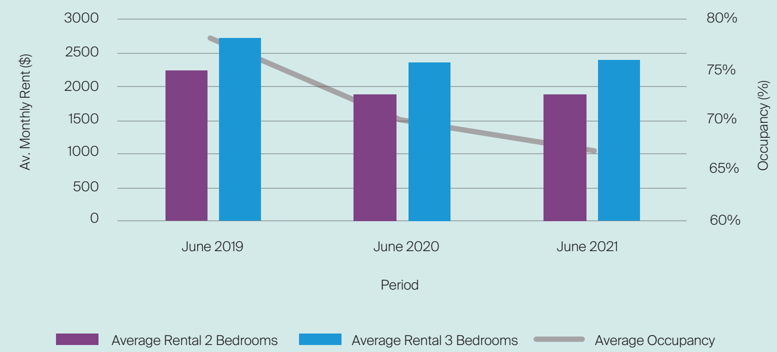
Residential Market

The residential property sector performance registered increased activity in H1 2021. Initially, there was a slowdown in acquisition and lettings in the time leading up to the general elections, with expats choosing to leave the country until the electoral process was complete. An increasing number of expats returned, after the rollout of the COVID-19 vaccine, in their respective countries and the positive reception it received in various parts of the world. This provided reassurance to many especially with regards to health and wellbeing and a quicker return to normalcy.

With the signing of key oil agreements in April 2021, Knight Frank registered an uptick in development activity among the property developers with landlords hoping for increased take up and improved rental offers for prime, private rented accommodation.

An increase in sales inquiries was recorded in H1 2021, despite delayed conclusion of transactions due to the pandemic and its impact on earnings and travel. Landlords maintained discounted asking rents that were put in effect in H1 and H2 2020, in an effort to maintain occupancy rates. Prime residential occupancy rates reduced by 2% in H1-2021 as compared to the same period in 2020 when occupancies were recorded at 70%. Prime rents for 2 bed apartments maintained relative stability as shown in Fig. 7.

Figure 8: Average rents for 2 and 3 bed apartments in Kampala's prime residential suburbs



Source: Knight Frank

Lubowa Apartments. Space available to let.

Knight Frank recorded a 6% increase in the supply of prime apartment units, especially in the areas of Kololo, Bukoto and Naguru . The increase in stock vs low demand forced some landlords to discount their rents in order to be more competitive in the market. It is expected that over 161 apartment units will be added to the market over the next 18 months in Kampala's prime residential suburbs.

Demand drivers in occupancy for high end residential apartments were amenities such as gyms and swimming pools, proximity to supermarkets, shops, green spaces, and large indoor living spaces. Due to the lockdown that necessitated working from home in Q2 2020, Knight Frank observed an increase in the requirement for a home office in residential houses in H1-2021.

Industrial Market

H1 2021 registered an increase in demand for showroom and industrial spaces within the city center with most demand coming from sub-sectors like furniture, agriculture-based firms, food and beverages and automotive affiliated companies.

Demand was mainly from companies seeking proximity to clients, those seeking to diversify their nature of business, new automotive entrants into the market, chemical companies looking to expand, international companies looking to set up local franchises and companies looking for short term storage space.

H1 2021 registered an increase in demand for showroom and industrial spaces within the city center.

There was a noticeable relocation of large industrial firms out of industrial areas within Kampala i.e. Luzira, 1st to 8th Street, Ntinda Industrial area to the Namanve Industrial Business Park, with majority moving to owner occupied premises. This resulted in increased availability of space in the traditional industrial areas of Kampala which fortunately was also taken up by other occupiers in the agriculture, food and beverages market, automobiles, and furniture markets.

Movement of industries to the KIBP was attributed to, among other reasons, the incentives offered by UIA to different local and international investors, some of which include; tax holidays, exemption from payment of stamp duty for land owned by the Authority, unrestricted remittance of profit after tax, rent free land for a specified period, etc.

Table 2: Average Net Rents (US$) for warehouses in H1 2021

Description	Rent per square meter (US$)
Traditional Industrial Areas (1st -8th Street, Luzira and Ntinda)	$6
Namanve Industrial Area	$4

Source: Knight Frank

Retail Market

The period under review saw subdued trade within the retail sector, as the world struggled to deal with the extended pandemic, stringent operating procedures to limit human to human transmissions, impacts on supply chains, dwindling consumer confidence and spending. This was further exacerbated by the general election in Uganda which saw significant down time in general trade and internet services being disconnected, further impacting on the ability to trade. Bars and nightclubs remained closed from the 20th March 2020. The leisure and lifestyle sector has been the most impacted due to curfew and well-founded consumer fear of socializing.

Enforcement of Covid-19 restrictions following a spike in the number of cases saw public and private transport prohibited with retail only permitted to trade until 7:00pm, thus negating a force majeure event.

As a result, increased activity was recorded around neighbourhood convenience centres. These are developments that are within close proximity to suburban residential nodes, making them easily accessible to households and those that work from home. These developments are generally tenant mixed, with essential daily requirements and services. On the other hand, regional malls were greatly impacted by the restrictions enforced, recording lower footfall levels compared to the pre pandemic levels.

Occupancy levels in Knight Frank managed malls increased by 1.63% in June 2021 to an average occupancy level of 86.72%, which was 0.42% above the same period in 2019. This increase was attributed to increased retailer activity as highlighted in the subsequent paragraphs, and stimulus measures introduced by landlords in a bid to attract and retain tenants. We anticipate that occupancy levels will remain subdued throughout the year with the current lockdown already impacting on tenants as landlords are unable to issue any further concessions.

Metroplex Mall's phased opening commenced during the period under review with Carrefour opening their new store and Woolworths opening their refurbished store therein. Arena Mall in Nsambya which is due to open on the 29th July 2021, has gained traction on pre-opening letting, with retailers such as LC Waikiki, Cafesserie and Frango, Great Burger set to debut in the mall. Further, retailers' expansion continued to be recorded in the market with Woolworths also set to make entry into Village Mall and Hi-sense into Victoria Mall.

Average footfall figures across Knight Frank managed malls contracted by 28% growth in 2021 as compared to a similar period in 2019. These were however approximately 50% above the 2020 average footfall figures recorded in the same period, attributed to the extended lockdown in March to June 2020 which saw only essential services trade.

Turnover rents recorded varied results, with service and fashion retailers showing single digit growth in 2021 as compared to 2019 numbers. General food and grocery traders were still approximately 12% below 2019 numbers due to depressed spending by consumers and the restaurant sector still showing negative growth of some 38% due to curfew. Average supermarkets turnover recorded a 3% decline y-o-y during the period under review and a further 20% decline compared to a similar period in 2019.

Table 2: Prime Retail Rental Rates in Kampala (Covid Impacted)

Size	Rates
<10m2	$200
<50m2	$36
<100m2	$22
<500m2	$17
>500m2	$15
>1000m2	$11

Source: Knight Frank

These figures are average rentals for ground floor space in Kampala shopping malls but do not take Shop front to depth ratio into account and exclude service charge.

Prime retail rents remained subdued as a result of the pandemic with landlords issuing various incentives and discounts in a bid to attract and retain tenants.

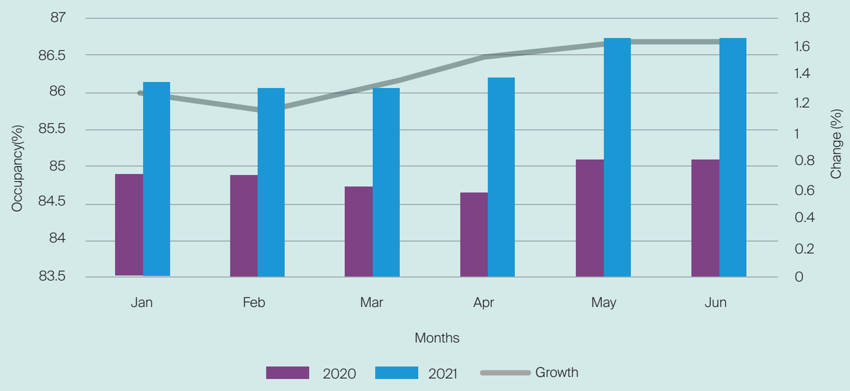
Valuation & Advisory

When the pandemic was declared by the World Health Organization (WHO), it culminated in an unprecedented set of circumstances and the absence of sufficient market evidence. The Royal Institution of Chartered Surveyors (RICS) alerted its regulated members to consider whether valuations with effective dates following March 11, 2020 should be declared subject to "material valuation uncertainty". This was to ensure transparency with clients and emphasize the importance of the 'valuation date', against the backdrop of rapidly changing market conditions due to the pandemic. However, with resumption of transaction activity in some sectors, it is now within the discretion of each member to include a material valuation uncertainty clause having regard to the specific attributes and the performance of the individual asset and its market.

In a June 2021 interview on the State of property valuations in Uganda, Herbert Okello, Knight Frank Uganda's Head of Valuation and Advisory stated that, "the COVID-19 pandemic impacted valuations in various ways, from inspection of property to availability of reliable comparable information. In view of this, it is prudent that we act in a transparent and professional manner. Any limitation on information or ability to investigate has to be made clear and reported. Where a valuation relies on information such as rental income, it is vital that such evidence be accurate and up to date because this has a bearing on the outcome of the valuation. Not to be overlooked is the importance of maintaining confidentiality of any data relied upon".

Full interview can be found here:
http://y2u.be/8gfWqN8WhNY

Figure 9: Retail Occupancy for KF managed malls H1 2021 vs H1 2020

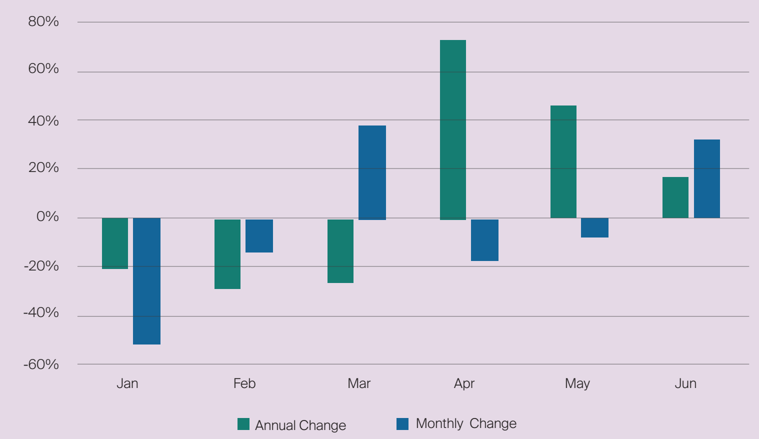


Source: Knight Frank

Figure 10: Average Footfall Growth for Knight Frank managed Malls

Source: Knight Frank

Figure 11: Average Turnover Growth for Knight Frank Malls



Source: Knight Frank

OUTLOOK

The office sector is anticipated to have a slow recovery to pre-pandemic performance levels especially due to the current lockdown necessitated by the second wave of the pandemic. Tenant covenant strength, length of lease term and building occupancy levels have become particularly important criteria for office investors.

Employee health and wellness will continue to be a key concern with the trend towards remote working expected to remain rife throughout 2021 into 2022. In locations such as Nakasero and Kololo where space availability, is already quite high, upward pressure on vacancy will continue to intensify.

The recent signing of the oil agreement and rollout of the COVID-19 vaccine still provides hope for improvement in general economic performance, albeit at a slower pace with particular improvements in the residential and office sectors.

However, downside risks surround economic growth especially due to the evolving COVID-19 variants and the limited vaccine doses. It is yet to be seen how the current lockdown will influence rents and occupancies, although these are likely to be relatively subdued in the months to come.

Following the resurgence in COVID-19 cases, which resulted in a second national lockdown, the general economic performance is projected to be negatively impacted, albeit to a lesser extent factoring in the economic resilience built from the first wave. This is anticipated to take a toll on the property market with reduced investor confidence, delayed completion of pipeline development projects, increased vacancies and pressure on occupier businesses in terms of business continuity. We expect investor will adopt a 'wait and see approach' before undertaking any considerable capital investments in the market.

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