

RESEARCH



UGANDA MARKET UPDATE

H2 2016

Cover Image: A section of The Imperial Mall, Entebbe

ECONOMIC UPDATE

SECTOR BY SECTOR
ANALYSIS

2017 OUTLOOK

HIGHLIGHTS

Inflation declines to figures below BOU's policy target of 5% for the first time since May 2015.

The Ugandan shilling weakens against the US Dollar.

Private sector lending slows down.

CBR declines to 12% in December 2016.

International sports wear company Adidas opens its first outlet in Uganda at The Acacia Mall.

Office occupancy rates show signs of slight improvement.

UGANDA MARKET UPDATE H2 2016

Economic Update

Overview

Uganda's economy is expected to grow at approximately 5.5% compared to a 5.9% growth forecast by the World Bank in FY 2016/17. The reduction in anticipated growth is attributed to the impact of South Sudan's conflict on Uganda's exports, sluggish investments due to slower economic performance globally as well as uncertainty that still lingers over global economic activity that could constrain the demand for Uganda's exports.

Above all, on August 22nd 2016, the World Bank took a decision to withhold new lending to Uganda on account of outstanding performance issues in the portfolio, including delays in project effectiveness, weaknesses in safeguards, monitoring & enforcement and low disbursement of funds. This turn of events is expected to affect the projected economic growth as a result of reduced public infrastructure spending, which was expected to support economic growth.

Inflation

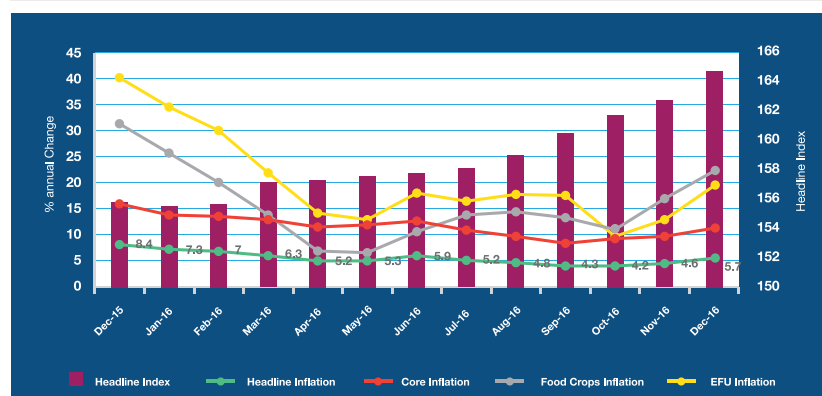
During H2 of 2016, annual headline inflation slowed down to figures below

Bank of Uganda's 5% policy target. Annual headline inflation was recorded at 5.7% year on year in December 2016, compared to 4.6% recorded in November 2016. This variance was largely due to an increase in annual food crops inflation from 7.2% registered in November 2016 to 10.8% year on year in December 2016. The rise in annual food crops inflation is attributed to an increment in fruit inflation from 13.6% in November 2016 to 24.8% registered in the year ended December 2016. [Figure 1]

Money Market

The Uganda shilling gradually lost its value against the US dollar during H2 of 2016 after a period of stability in H1 2016. Between July and December 2016, the shilling depreciated by 6.5% to an average rate of UGX 3,598.2 per US\$1:00 in December, from UGX 3,379.3 per US\$1:00 in July 2016. This exchange rate depreciation was mainly driven by high corporate demand for the US\$ especially from energy, telecommunications and manufacturing sectors as well as increasing demand for the dollar towards imported goods for the festive season. As of December 30th 2016 the Shilling had depreciated to a thirteen month low closing at a midrate of UG 3,610.5 per US\$. [Figure 2]

Figure 1
CPI and Inflation for Core, Food Crops & EFU* (Dec '15 - Dec '16)

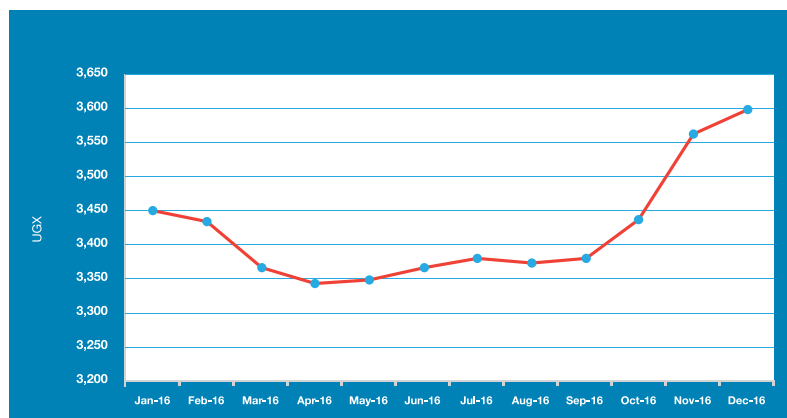


Cover Image:
Photo by Wembabazi Paul Steve

Source: Uganda Bureau Of Statistics (UBOS)

*EFU refers to Energy, Fuel and Utilities

Figure 2
Period average rate for UGX against US \$ (Jan '16 - Dec '16)



Source: Bank Of Uganda

Interest Rates

Bank of Uganda (BoU) reduced the CBR by 1 percentage point to 12% in December 2016 on account of an improvement in core inflationary outlook, which was projected to remain around the medium term target of 5% over the next 12 months. The current monetary policy stance is aimed at lowering the cost of borrowing and investing, providing a boost to consumers in order to spur domestic economic growth momentum. The CBR is now at its lowest since April-May 2015.

Commercial Bank Lending rates (weighted average) in UGX remained at 23.07% in November, up from 22.81 recorded in October 2016 despite the marginal easing of the monetary policy stance in October by the Central Bank;

reflecting the provision for bad debts, tight monetary policy stance and the structural rigidities in the financial sector, including the high cost of doing business. However, Commercial banks' lending rates in US \$ averaged at 10.09% in November, down from 10.38% recorded in October 2016.

Otherwise, interest rates remained high but relatively stable, with short term (6 months) and one year (364 days) Treasury Bills at 13.61% and 13.73% respectively as of December 2016. [Figure 3]

Private Sector Credit

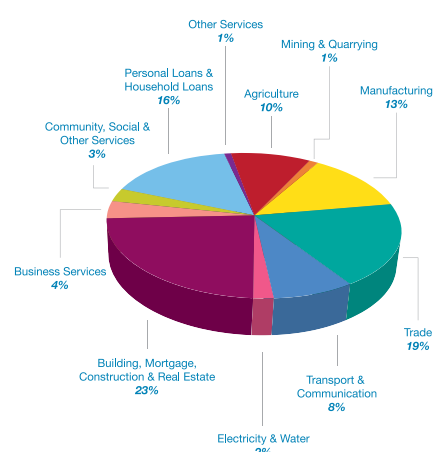
Commercial banks' lending to the private sector slowed down in the first half of H2 (July–October) of 2016 compared to the same period in 2015. This is partly attributed to increased borrowing by

government from the private sector, increased provisions for bad debts, a high interest rate regime and weakened domestic demand for goods. In addition, the decline in credit growth partly reflects commercial banks' aversion to risk amidst a decline in loan quality and a switch to investing in government securities, which are perceived to be less risky¹.

Year on year, there has been a reduction of approximately UGX 152 billion in total outstanding credit extended to the private sector by commercial banks for the period July–October 2016. As of November 2016, the outstanding stock of credit extended to the private sector increased to UGX 11.62 trillion, up from UGX 11.2 trillion in October 2016.

However, private sector credit is expected to gradually increase in the coming months as the lending rates are anticipated to continue falling, albeit months later following a reduction in the central bank rate. To date mortgages, building, construction and real estate loans comprise the largest share of commercial total lending, accounting for 23.3% of credit to the private sector in Uganda. [Figure 4]

Figure 4
Sectoral Shares of the Stock of Commercial Bank Outstanding Loans as at Nov '16

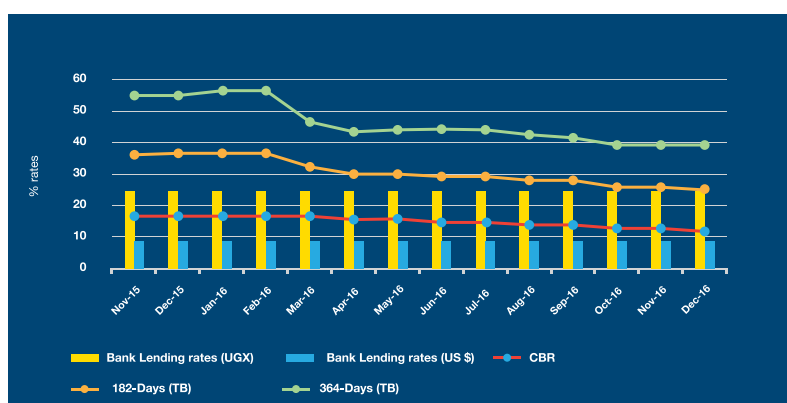


Source: Bank Of Uganda

Non-Performing Loans

The Bank of Uganda's financial stability report of June 2016 reveals that there was a rise in non-performing loans (NPLs) from 4% of total loans in June 2015 to 8.3% in June 2016.

Figure 3
Interest rate structure for the period Nov '15 - Dec '16



Source: Bank Of Uganda

Figure 5

Trends of Commercial Banks' NPLs to Total Loans, Return on Assets and Return on Equity (%) Jun '15 - Sep '16



Source: Bank Of Uganda

The construction sector was the largest single contributor to the rise in NPLs during 2015/16 of all sectors of the economy. The provisions necessitated by NPLs contributed to a decline in the banking systems' returns on assets and equity. [Figure 5]

The Construction Sector

Annual changes reveal that the input prices for the whole construction sector (that includes material prices, wage rates and equipment hire rates) increased by 0.8% year on year in September 2016. This increase was attributed to a 13.5% rise in prices of inputs for residential buildings.

On the other hand, monthly changes in average input prices for the whole construction sector, showed that there

was a decrease of 0.3% year on year in September 2016 compared to a 0.5% decline in August 2016. The decline in September was due to a fall in prices of iron & steel, lime and bitumen by 0.5%, 0.3% and 9.8% respectively. [Figure 6]

Residential Sector

It has been a relatively slow year for the prime residential lettings sector, although there was a slight improvement in the last quarter of the year. Demand for prime rental residential accommodation was from the oil and gas, diplomatic corps and corporate sectors.

Residential property sales activity has mainly been dominated by increased transactional activity as a result of

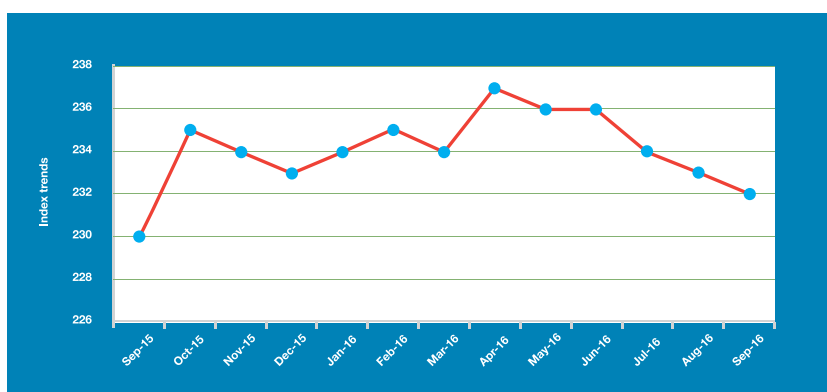
purchases of properties in non-performing loan portfolios of various banks. We have noted that interest in prime properties has been strong, and slow market performance notwithstanding, respectable prices are being registered for these properties, which further supports our long standing opinion, that the Kampala property market is resilient to major shocks in the long run.

Peaks and troughs are a reality of any property market in the world, the test is how quickly that market bounces back. It is also arguable, that perhaps the Kampala property market has been due for a correction, for sometime (for properties not under distress sales) which correction of between 10% - 15% has set prime property prices at a more realistic level for the first time in a decade. This is allowing the latent value and potential of redevelopment plots to be unlocked, since affordable land prices are a critical determining factor in the viability of property development.

Knight Frank registered an increase in the number of enquiries for properties in prime residential locations of Kololo, Mbuya, Naguru and Nakasero in H2 of 2016. The majority of these enquiries were for apartments as opposed to stand-alone houses. Apartments are attracting higher demand than standalone houses as they are perceived to be more secure, and relatively cheaper as a result of shared costs for common areas and facilities like garbage collection, common area lighting and security.

Figure 6

Trends of the whole Construction Sector Index Sep '15 - Sep '16



Source: Uganda Bureau of Statistics (UBOS)

There has been a noticeable increase in the supply and completion of prime residential properties under construction this year. These have tended to be mainly for rent, and offer 2 – 4 en-suite bedrooms. Most of these are situated in prime suburbs of Kololo, Nakasero, Bugolobi and Naguru. The proximity of these prime locations to the CBD as well as accessibility to social amenities is the major driver of demand for these locations.

It is evident however, that as the secondary suburbs grow, aided and abetted by a rapidly expanding central business district, increasing working



Serviced apartments at Plot 6, Makindu Close-Kololo.
To Let: Contact Knight Frank Uganda

Table 1
Prime residential rents and prices

Description	Rents	Sales (price range)
5 bed furnished detached houses on 1.00 acre plots	\$4,500 - \$5,000	\$2.0 - \$2.65 million
4 bed furnished detached houses on between 0.50 – 1.00acre plots.	\$4,000 - \$4,500	\$1.4 - \$2.0 million
3 bed furnished town houses (in a gated community)	\$3,000 - \$3,500	\$350,000 - \$375,000
3 bed serviced apartments	\$2,000 - \$2,500	\$300,000 - \$350,000
2 bed serviced apartments	\$1,750 - \$2,250	\$225,000 - \$250,000

Source: Knight Frank Uganda

populations, and improved road networks, these suburbs are becoming more self-sustainable, and are offering most amenities and services, which in the past could only be found in the CBD. As a result, proximity to the CBD as a major determining factor of residential location, is not as critical as it used to be.

[Table 1]

Office Sector

During H2 of 2016, demand for office space significantly picked up compared to the same period last year, although it largely remains a tenant's market especially against a backdrop of increasing voids being created within the Grade B and C segment of the office market. There has been noticeable

increase in take-up of Grade AB office space in modern, energy efficient buildings, with adequate parking out of the congested CBD area.

The precursor to this is that occupancy rates have been highest in newer buildings where voids have been higher, and rents have been discounted. Prime office property rentals for sitting tenants however, are still holding their values. New demand continues to be driven by factors like ample parking, better facilities and less traffic congested areas.

Yields for Grade A office space have remained stable at between 10% - 11%, and asking rentals averaging at \$17.00 per m² per month while Grade B office rentals are averaging US\$ 12.5 per m² per month.

Any further increase in speculative development of poorly designed, non-functional office buildings in poor locations will lead to an increase in supply of poor quality stock and put downward pressure on rents in the short to mid term. Demand for Grade A office space during H2 of 2016 was mainly driven by multinationals and Government institutions.

Occupancy rates for Grade A/AB buildings in Kampala have increased from 80% during Q1 & Q2 to 86% for Q3 & Q4 of 2016. Approximately 13,000 m² of prime commercial Grade A/AB office space was taken up during H2 2016. Most of this take up was derived from Government ministries and corporate companies.

Despite the bearish outlook on the office sector over the past two years, most Oil and Gas companies have increased their operations in Uganda following the issuance of production licenses and even reconsidered their office space reduction in anticipation of more activity in the months to come. This is likely to positively impact the demand for prime office space in the medium to long term.

We are seeing opportunities in two distinct niches of office demand in Kampala. The Grade A built-to-suit office buildings in prime locations such as Nakasero and Kololo for large corporations looking to consolidate their offices into one property, with the flexibility to have naming rights on the building facades and the full-serviced / virtual offices that give companies the advantage of entering the market or operating a satellite office without the burden of huge office capital fit-out costs.



Brand new office space with ample parking along Lumumba Avenue.
To Let: Contact Knight Frank Uganda

Retail Sector

The retail sector has been skittish compared to the same period last year. This sentiment is derived from the global consumer as the retail markets have been subdued throughout most parts of the world. The retail sector in Uganda has been challenged by the well-publicized woes of some leading retail stores as well as financial institutions impacting on consumer confidence and the greater retail environment. All this negative sentiment surrounding the local economy has had an impact on retail with most traders seeing no or very little sales growth on 2015 figures.

On the contrary, however, Knight Frank has noticed that in our managed malls, where footfall has been affected by the woes of the anchor tenants, there are stores that are trading exceptionally well nonetheless and showing double digit growth. These are mainly international branded stores that trade into the middle to upper income segments, as well as home grown / organic stores who have bedded down their trade and acquired a better understanding of their target market trends and shopping habits.

Overall, there was an average increase of 11.7% in the footfall to malls managed by Knight Frank year on year for the second half of 2016. This statistic is promising, particularly since consumer sentiment has been negative for most of 2016.



Retail space at Plot 1, Entebbe road.
To Let: Contact Knight Frank Uganda

The challenges of the anchor tenants' performance not aiding footfall should have impacted on the foot traffic at the various malls, but such has not been the case. This lends credibility to the argument that local consumers are still transitioning into experiential outings strongly biased to food and leisure with a dominant fashion offering. This speaks volumes to the international retailer appeal into the local market which continues to see a lot of interest from both South African and European based retailers.

The interest shown by multi-national retailers to enter the local market has driven demand for prime retail space within retail malls in Kampala which is also driving retail rental rates higher.

Table 2
Prime Retail Rental Rates

Size	Rates
<10m ²	\$185
<50m ²	\$45
<100m ²	\$25
<500m ²	\$22.5
>500m ²	\$10

The figures above are average rentals for ground floor space in Kampala shopping malls but do not take shop front to depth ratios into account and exclude service charge.

Source: Knight Frank Uganda

With regards to the development pipeline, the Imperial Mall in Entebbe opened in December 2016, and Knight Frank are currently finalizing leasing of the Mall. The Arena Mall, a 15,000m² shopping centre on Nsambya Road is currently in the final pre-letting stage, with earthworks due to commence in H1 of 2017.

And last but not least, leasing has also commenced on the proposed 42,000m² Kingdom Kampala development and will revitalize the inner city of Kampala which has experienced an exodus of retail to suburbia in the last three years and the associated degradation of properties in the CBD that go hand in hand with vacancies.

Industrial Sector

Industrial rental property in the traditional industrial areas within close proximity to the CBD (1st – 8th street, Industrial Area) and secondary industrial locations on the outskirts of the CBD like Banda, Ntinda, Nakawa and Kyambogo have also experienced low occupancy rates and take up over the past 6 months. This is partly attributed to supply of warehousing space outstripping demand, and a slowdown in the trading of imported goods and commodities which would require storage space for distribution to neighbouring countries.

However, we have registered an increase in demand for relatively-large warehousing space in premises along the Entebbe–Kampala highway. This demand is being derived from the logistics, transportation and UN agencies on account of proximity to Entebbe International airport. Prime warehouse rents in the core / traditional industrial areas averaged US \$5.00 per m² and US \$ 6.50 per m² for modern premises in secondary industrial locations of Luzira, Namamve, Banda, Seeta and Nakawa-Ntinda.

Valuations

There has been a reduction in bank lending activity as well as valuations of new instructions during H2 of 2016. This can partly be attributed to an increase

in domestic borrowing by government which has slowed down private sector borrowing, and crowded out private investments as well as the increase in non-performing loans, which increased from 4% of total loans in June 2015 to 8.3% in June 2016. The increase in NPL as a ratio of gross loans constrained credit growth.

As a sign of low economic activity since July 2016, we have also witnessed a noticeable reduction in real estate property transactions compared to the same period last year, as investors have decided to halt their investment plans and take a “wait and see” approach on the performance of the economy.

This has had a further impact on volumes of new loan applications, further suppressing private sector borrowing.

Outlook for Q1 and Q2 of 2017

In August 2016, Government of Uganda issued oil production licenses to Tullow Oil and Total E&P. In turn, this is expected to have a positive spin off on demand and take up of both office and residential space derived from oil and gas related businesses as they prepare to commence oil exploration activities.

The overall future of the real estate market sentiment is mixed with Bank of Uganda revealing that as domestic demand picks up, the economy is projected to grow at 5.0% in FY 2016/2017 compared to the World Bank estimate of 5.5% for the same period.

The implementation of the draft Landlord-Tenant bill (which insisting and advocating for the abolition of dollar denominated rentals amongst other things,) in its current state will without a doubt have a negative impact on the real estate sector, especially for developers whose financing is in foreign currency.

Above all, increased public infrastructure spending is expected to support economic growth. Unfortunately, over the past five years, about half of the resources allocated to Uganda's priority

infrastructure sectors has not been spent, resulting in under expenditure of the budget thereby forcing the World Bank to withhold new lending to government of Uganda in September 2016. This turn of events coupled with uncertainty over global economic performance due to many factors, could affect the projected economic growth and the exchange rate as well as constrain international demand for Uganda's exports respectively.

On a more positive note, despite what has been a turbulent year for the property market, Uganda was named as the fourth best tourism destination in the World and number one in Africa for 2017 by the Rough Guides, a leading travel publisher². Uganda is expected to attract more tourists in 2017 with its astonishing wildlife. Hence, foreign exchange earnings are expected to rise due to increase in tourist arrivals. This is important not only because tourism is one of the high revenue earning activities in the country but also generates substantial employment and related multiplier effects.

²http://www.newvision.co.ug/new_vision/news/1443329/uganda-global-tourism-spots



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Mirembe Business Centre



Office Space with ample parking along Lugogo Bypass Road.
To Let: Contact Knight Frank Uganda

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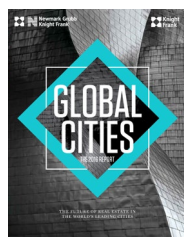
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