RESEARCH

KAMPALA MARKET UPDATE

Q3 & Q4 2015

ECONOMIC UPDATE | SECTOR BY SECTOR ANALYSIS | Q3 & Q4 2015 REVIEW

HIGHLIGHTS

Uganda's GDP grows by 13% after rebasing of its GDP to 2009/10 from 2002

Commercial lending rates remained high at over 20%

Uganda shilling remained weak against major currencies

Occupancy rates for office space remained slow

Prime residential rents continue to fall as demand weakened

Decline in demand for middle income housing on the back of high lending rates

Retail sector remains bullish

Cover Image:
An artistic impression of Kingdom Kampala due for completion September 2019. Courtesy photo.

KAMPALA MARKET UPDATE
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Economy

The economy continued to recover from the low growth recorded since financial year 2011/12 which incidentally was the election year (Figure 1).

During the year ending June 2015, the economy grew by 5%, compared to 4.8% of the previous year.

However growth remained below expectation and was the slowest in the region compared to Kenya, Rwanda and Tanzania.

Inflation remained stable but the cost of commercial lending, though relatively high, remained stable thereby providing a much needed boost to private investment and consumption.

The government remains committed to addressing the country's physical infrastructure with progress especially in areas like road construction evidenced through road upgrades throughout the country

The main driver of economic activity in the private sector during the last half of 2015 was the increased credit from the banking sector as planned government infrastructure investments took off slower than anticipated and exports remained weak.

In addition, the country had experienced positive and negative factors which affected the economy in various ways, both in the past and a perceived threat of others in the near future.

Both positive and negative factors influenced economic growth in 2015 as follows:

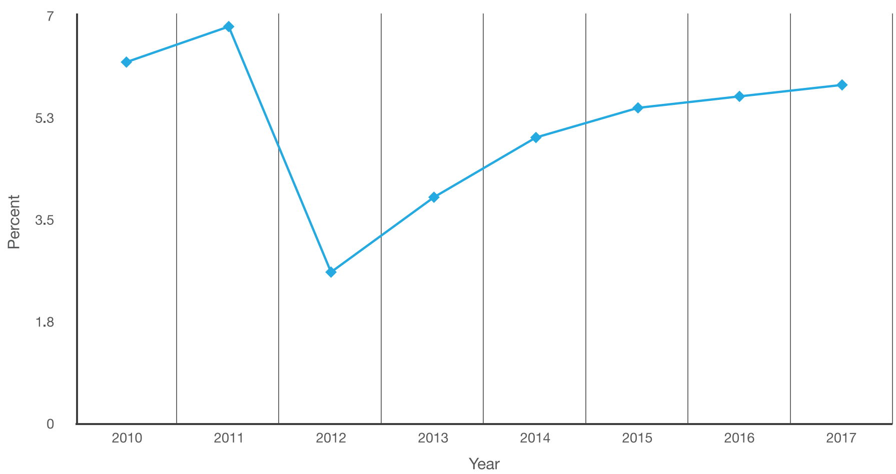
Positive Factors

• Increased public expenditure on infrastructure
• Recovery of private sector credit that boosted investment and consumption
• Improvement in aggregate demand
• Reduced oil prices on account of faster growth in supply compared to growth in global demand.

Negative Factors

• Depreciation of the shilling: According to the Bank of Uganda the Ugandan shilling depreciated by 17.5% from January to December 30, 2015 (Figure 2) compared to 10.8% in the same period in 2014. This depreciation is consistent with the low net flows of foreign

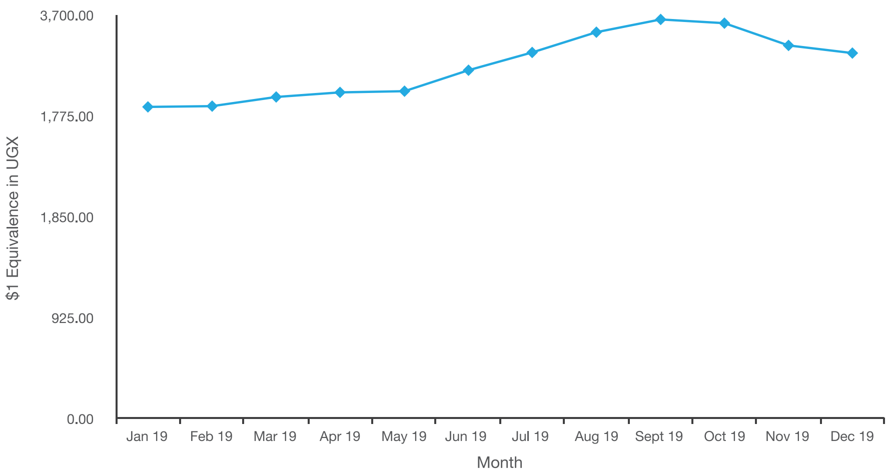
Figure 1
Uganda's Real GDP growth (%) for the period 2010-2017



Source: IMF, World Economic Outlook database, April 2015

Figure 2

BOU Monthly Exchange Rate of US$1 in 2015



Source: Bank Of Uganda (BOU)

exchange into the country; while this promoted competiveness, it increased pressures on domestic inflation.

• High lending rates from commercial banks: Central Bank's continued tightening of the monetary policy controlled inflation at a relatively low level, ensuring stability but also increased the cost of borrowing and reduced the rate of investment by the private sector. The Central Bank increased its benchmark interest rate, the Central Bank Rate (CBR), to 17% in October 2015 from 16% in August 2015 (Figure 3) and will further increase it if there are indications of the inflation worsening. The central bank believes that the current monetary stance will deliver its medium term core inflation target of 5% and support sustainable real economic growth.

• Reduced demand for exports.

• The investment market is more cautious due to the 2016 general elections.

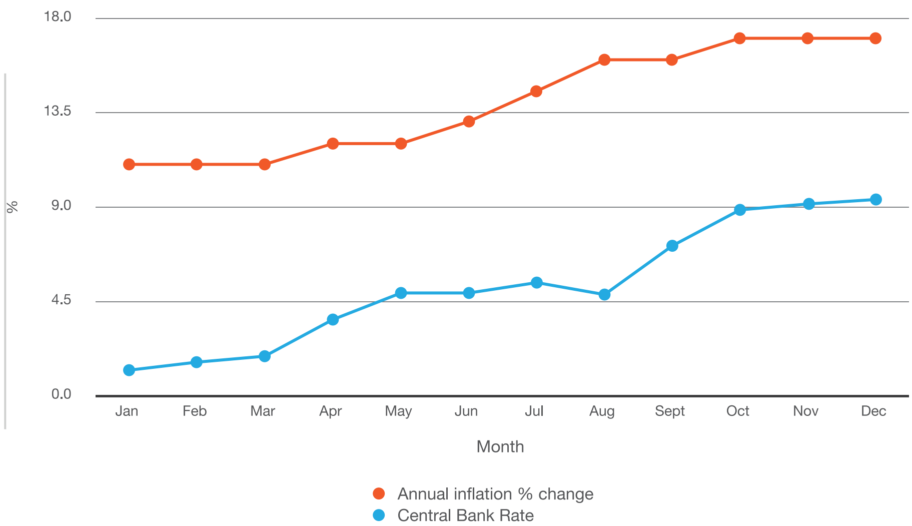
Political uncertainty and speculation continued to impact economic variables, a phenomenon which is not unique to Uganda, but is common world wide.

• The steadily falling international oil prices reduced the country's expenditure on oil imports and helped keep inflation low on domestic prices, but has been an important consideration in the decisions on investments related to production of oil within the country. In addition, foreign direct investment, majority of which is in this sector, declined during financial year 2014/15.

• At the regional level, the political turmoil in neighboring Burundi, and the civil conflicts in South Sudan and Democratic Republic of Congo, have major implications to Uganda's economy, particularly through lower exports of goods and services, lower tourism receipts, and lower FDI, if investors consider regional risks to be as important as country specific risk.

Figure 3

Uganda Annual Inflation and CBR in 2015



Source: Bank Of Uganda (BOU)

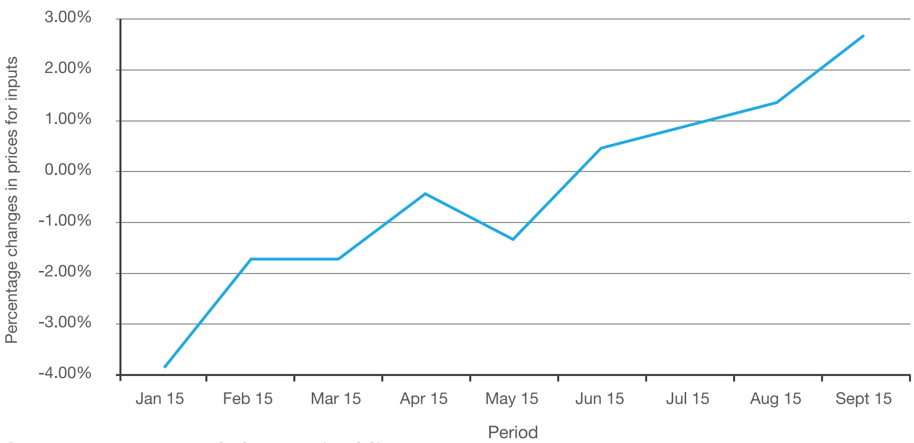
The Construction Sector

Annual changes of prices for inputs in the whole construction sector (covering material prices, wage rates and equipment hire rates) increased by 2.8% in the year ending September 2015 compared to the year ending September 2014. The increase was on account of a 7.7% increase in input prices of civil works and 3.6% increase in prices of inputs for non-residential buildings.

Figure 4 shows historical trends in price changes of inputs for the whole construction sector on a month-on-month basis.

Figure 4

Annual percentage price changes in prices for inputs in the construction sector



Source: Uganda Bureau Of Statistics (UBOS)

Infrastructure

A ten-year, multi-billion-dollar plan to upgrade Uganda's transportation network and power generation is poised to benefit the country according to the IMF.

"An $11 billion program over the next ten years through public investment and public-private-partnership arrangements will have positive spillovers on agro-processing, manufacturing, and trade."

Upgrading the transportation network and electricity generating capacity is now Uganda's top economic priority.

There is increasing evidence of work in progress on upgrades of various feeder and main roads in various residential suburbs of Kampala and Greater Kampala. The construction of the Entebbe Express Highway is also underway and completion scheduled for July 2017.

An extensive and improved road network and widespread access to electricity will connect farmers to trading centers, add value to production and improve the population's welfare.

Other notable infrastructure projects in progress includes the Standard Gauge Railway (SGR). The project is anticipated to cost approximately $13.8 billion and will ease transportation within Uganda and the region. A contract worth $1.7 billion was signed between the government of Uganda and Sinohydro Corporation Ltd for the construction of the Karuma Hydro Power Project (KHPP).

Above all, expansion works by China Communication Construction Company (CCCC) on Entebbe International Airport kicked off towards the end of 2015 with the intent to boost the airport capacity to handle three million passengers annually.

Residential

- Prime residential property rentals declined on the back of reduced demand
- Supply of prime residential apartments outstripped demand
- Tenants drove hard bargains on lease terms as they took advantage of slow market conditions
- Noticeable correction in prime residential sales prices.

The prime residential letting market recorded a decline in activity in the last two quarters of 2015 (Figure 5). This was majorly due to reduced demand from the oil and gas sector which were the biggest drivers of demand in this sector.

The downsizing within the oil companies led to early termination of leases, and renegotiated rentals (downwards) for properties retained.

Sales activity within the prime residential property market in 2015 declined compared to the same period in 2014.

Demand for middle income residential housing remains strong albeit stifled by high commercial lending rates.

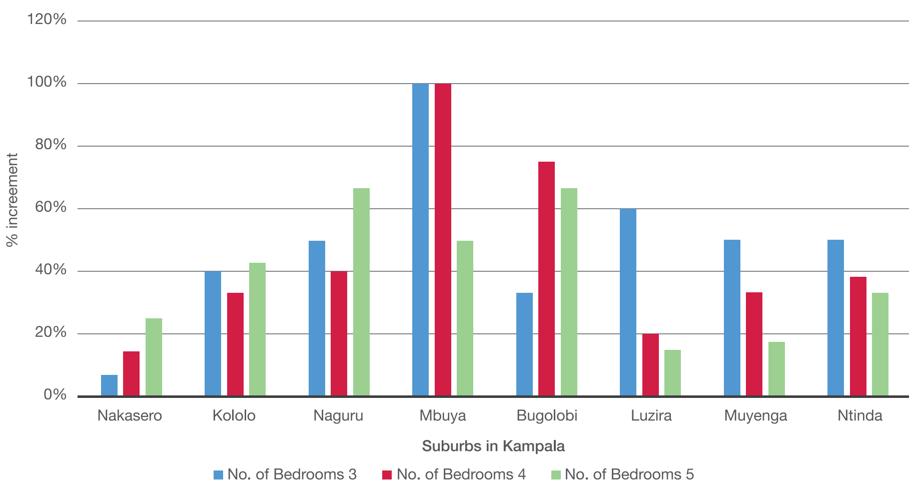
There were numerous residential projects in the pipeline, although very few were targeting the niche market where previous research has identified the highest demand and supply gap (Figure 6).

According to the Kampala Physical Development Plan (KPDP, 2012) up to 69% of Kampala's population live in rented accommodation. Herein lies a target market for home ownership.

In total Kampala has to gear up to provide between 700,000 to 800,000 new housing units, comprising over 400,000 middle to high income houses and 300,000 affordable standard over the coming decade.

Figure 5

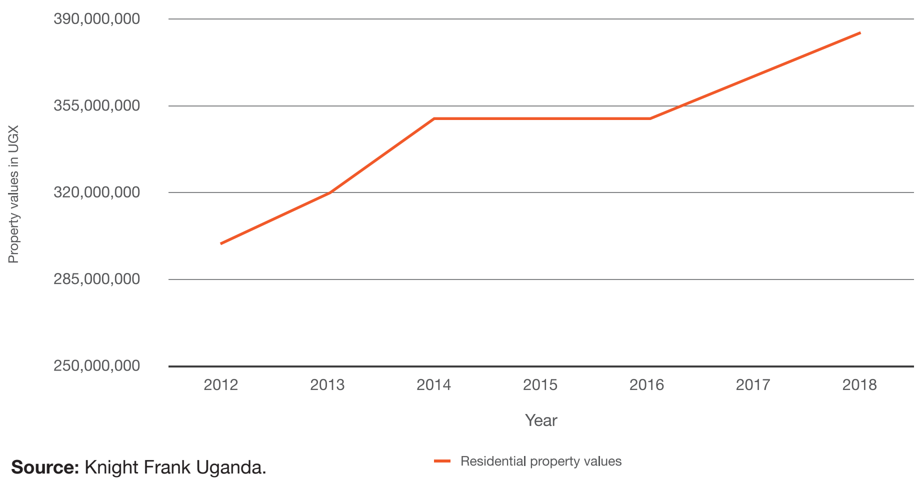
Prime Rental Variations by Location over a Five year Period 2010 – 2015



Source: Knight Frank Uganda.

Figure 6

Historic and Projected Property Values of Middle Income Residential Properties (Apartments and Town houses).



Source: Knight Frank Uganda.

Industrial

• Industrial sector projected to grow at 5.5% for financial year 2015/16
• Construction and relocation of owner occupied factories continues in earnest in the Kampala Industrial and Business Park (KIBP) Namanve
• Oversupply dampens growth of industrial property rentals
• Q3 & Q4 2015 showed weak demand and slow take up of Industrial land

The industrial sector was projected to grow at 5.5% this financial year.

The industrial and business parks at Namanve, Luzira, Mukono and Mbale continued to be operationalized to provide serviced areas for the development of manufacturing and other business enterprises.

Government has identified land in Kaweweta to develop Economic Processing Zones (EPZ's) in line with the Free Zones Act 2014 which will help in the drive to grow the industrial and export promotion sectors.

Government is finalising procedures to secure ownership of the land and conclude negotiations with prospective investors for its development. The Zone will consist of a world class modern abattoir, milk and fruit processing plants, modern farms, a textiles manufacturing plant and refining local medicinal & aromatic herbs.

The relocation of industrial buildings and factories from the traditional industrial areas of 1st - 8th Street has continued in earnest, as manufacturers are keen to meet the deadline for moving out of the current locations.

Construction has been delayed in some cases due to the high water tables at the business park that have necessitated extensive filling and dredging to make the sites ready for development.

The infrastructure within the park, with particular reference to the road network, is also not completed. It is believed this will commence soon.

Supply of warehousing space outstripped demand given the slow take up of industrial space in line with the slowdown of economic activity over the last two quarters of 2015.

The continued weakening of the shilling against the dollar resulted in reduced imports from traders and therefore less storage space required, as other big space occupiers in the oil and gas sector like Schlumberger relinquished their premises as they closed operations in Uganda.

The industrial sector continued to witness further challenges last year as a result of unreliable power supply, increased competition from imported goods, increased cost of electricity tariffs for manufacturers and the relatively weak purchasing power of the domestic market for locally produced products.

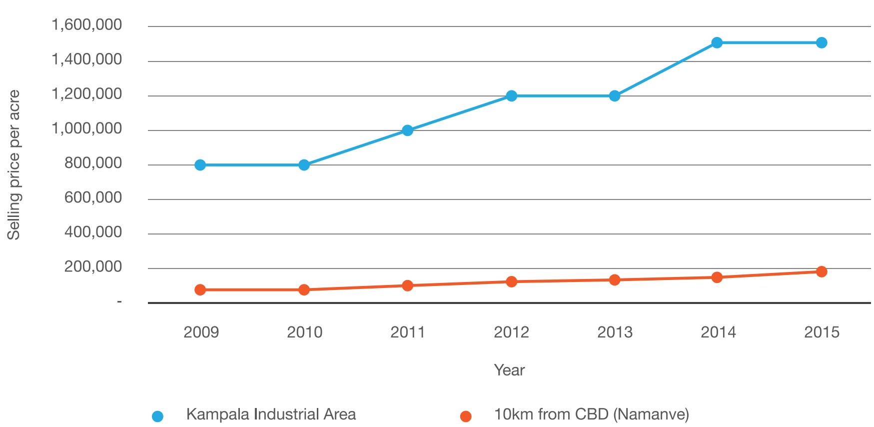
Prime Industrial rentals stabilized at an average of $6 per square metre per month closer to the CBD and $5 further away. Industrial land prices along Jinja Road remained steady as demand weakened over the whole of 2015.

Industrial land over 12km away from the CBD remained below the price of land for other uses like residential and commercial office use (Figure 7).

Furthermore, Knight Frank Uganda received numerous inquiries and registered significant interest in prime industrial land in the traditional industrial areas. Knight Frank Uganda successfully sold three large prime industrial properties (for redevelopment) in 2015 alone.

Figure 7

Graph showing the average sales price per acre for industrial land



Source: Knight Frank Uganda.

Retail

In 2015, Uganda experienced a rapid change in retail businesses, with numerous stores opening and closures of others, including but not limited to supermarkets, fashion, pharmaceuticals, telecom business, restaurants and bars.

Pizza Hut and Adidas are some of the notable brands that will start trading in Q1 2016.

The retail business in 2015 was boosted by a slightly improved economic environment that was heavily pushed by increased consumer spending and aspirational shoppers desirous of quality consumables but equally challenged by poor trading practices and the devaluation of the local currency by over 20% last year.

Retailers' performance in 2015 reflected the country's economic situation. Macro and socio-economic factors such as the rising cost of utilities and fuel, current political climate, together with the depreciating value of the Uganda shilling contributed to the challenging economic environment.

As a result of the aforementioned factors, consumer income and spending remained under significant pressure. This weighed heavily on retailers' performances as sales were reported not to have been less vibrant than had earlier been predicted.

Although accounting for only a small share of total retail sales (less than 10%), internet retailing proved to be an emerging dynamic channel within Uganda's retailing market. This can be attributed to improving technological infrastructure, declining communication costs, a high rate of mobile penetration and the availability of more payment options as opposed to the traditional brick-and-mortar method.

In an effort to align operations with evolving consumer trends, retailers started to invest in online presence over the review period. Leading players especially the international retailers within Uganda's retailing market also started to adopt multichannel approaches in an effort to supplement brick-and-mortar sales.

Internet retailers have grown which indicates the growing significance of this channel. This growth has come at a significant cost to traditional retailers who enjoyed vast profit margins. However internet retailing has negatively affected their profits thus causing the parity in the profit margins that had previously been enjoyed by them.

Knight Frank Uganda sees the traditional retail channel coming under pressure in the future as brick-and-mortar retailers realign their operating margins to create product price parity, better convenience and specialized non-locally available product.

Grocery retailing emerged as a strong channel within Uganda's retailing market in 2015. An increasingly complex competitive environment emerged in which grocery retailers, in a bid to compete to satisfy the evolving needs of consumers, had to strategically customize their product and pricing.

The dominance of grocery retailers can be attributed to the availability of greater brand variety in products that range from grocery to non-grocery items, and at competitive prices that offer cash-strapped consumers cheaper products as a result of discounts and products promotions.

The growth in the number of middle-income consumers also played a major role in stimulating value growth within this channel as well as the shopper transition to supermarkets as an attraction to find hygienic and convenient product.

Despite increased competition from the entry of international players, national retailers continued to compete aggressively and have looked at rapid foot print growth to sustain their market share.

Local retailers had an advantage over the new international entrants, as they had greater knowledge of the local market, customers and seasonal change, an established customer base, prime store locations and established loyalties.

It is anticipated that strategic partnerships between local retailers and international brands will likely lead to stronger retailing abilities with international retailers spreading their risk.

It is likely that the retail dynamics will be driven by the international retailers due to the appeal of their brands to the emerging middle class and their in-depth knowledge of international retailing trends.

Malls under Knight Frank Uganda Management experienced growth throughout 2015 of motor vehicle traffic (14%) and foot traffic (16%). This was purely from the aspect that customers steadily showed more interest in trading from suburban shopping centres due to the convenience and experiential outings that the malls offered.

Business was and is moving to suburban shopping centres and it is predicted that this trend will continue to produce transitions to suburban malls and adds to the experiential outings of such.

Take-up of space in the shopping centres in suburban Kampala was competitive with stores relocating, expanding or closing their stores in the CBD to enable them reap from the exodus of their customers from the CBD shopping centres.

Retailers have therefore been forced to widen their product range as they target more consumer groups to match consumers' needs and expectations that have rapidly shown an affinity for enlightenment and awareness of retail products and services.

There has been an average increase of 3.73% with regards to occupancy in the Knight Frank Uganda managed malls, this figure coming off a high occupancy base. Achievable rental levels (Figure 8) were showing great growth in the region of 30% in suburban centres as available space became limited.

Figure 8
Prime retail rental rates

Size	Current Rates	Projected Rates 2016/2017
<50 m2	$ 25 – $ 45	$ 30 – $ 60
<100 m2	$ 22 – $ 38	$ 27 – $ 50
<500 m2	$ 20 – $ 35	$ 24 – $ 42
>500 m2	$ 16 – $ 20	$ 20 – $ 24
Anchors	$ 12 – $ 15	$ 9 – $ 17

Source: Knight Frank Uganda.

However, office space take up in shopping centres was minimal given the fact that single use office properties on the market offered more attractive rental rates considering the glut of vacant office space in the market and hence the markets' hesitation to move to mixed use developments.

Inflation and rising utility costs exerted pressure on consumer spending thus negatively affecting spending volumes as consumers remained price sensitive and demanded products that reflected more affordable price points according to their income levels.

Office

According to a Reuters report on CNBC Africa.com, Uganda's GDP expanded by 13% after rebasing and we noticed that leasing activity in the Kampala office market significantly picked up in the 3rd and 4th quarters of 2015 compared to the same period in 2014 with increased office enquires and actual take up (mainly by way of relocations from older to newer stock) witnessed in the last two quarters.

Transactions that were placed on hold due to political uncertainty leading up to the general elections were revised with renewed interest and commitments from key investors especially Funds that are looking at growth out of Southern Africa markets.

An estimated 60,000m^2 of office space was under offer in Kampala during Q3 & Q4 2015. However few new leases were signed, with most other leasing's coming from relocations as aforementioned. In addition, a significant number of these transactions are anticipated to be concluded within Q1 2016.

A notable increase in vacancy rates for Grade A buildings was also witnessed in Q3 & Q4 2015 especially for properties with long running leases whose rental rates continued to remain above the current market rentals.

The biggest contributor to these vacancy rates was from the oil and gas sector, which used to generate a large percentage of demand, with the closing of Halliburton, Baker Hughes and Schlumberger as well as reduced activity by Total E&P owing to delays in the commencement of oil production.

The weakening of the shilling since mid-2014 also played a big role in the bargaining strength of sitting tenants at lease renewal. There was a noticeable increase in office enquires over the last two quarters of 2015 compared to the same period in 2014 but prospective tenants took advantage of the oversupply of office space on the market to drive hard bargains in their lease terms.

Throughout the second half of the year, the technology and financial services sectors remained the largest sources of demand for prime office space. This demand emerged from a mixture of new entrants, firms expanding and relocations to better quality spaces.

Demand for smaller spaces (50–70 sq m) emerged from consultancy firms as well as the transport and logistics companies who do not have a requirement for big space, yet need proximity to their clients in the corporate sector located in the prime office locations of Nakasero, Kololo and Bugolobi.

The performance of the office sector is further being affected by newly completed and pipeline developments which are putting downward pressure on prime rentals by adding to the supply of space on the market.

Other factors included the delays in the oil sector, weakening of the shilling to the US dollar and a cautious and risk averse attitude from stakeholders and players in the property market due to the general elections.

For landlords and developers of prime grade office space this combination has placed strong downward pressure on rentals especially within the Nakasero and Kololo areas.

Increasing interest in Uganda's growth story is also generating more interest from consultancy firms in the tourism and agricultural sector which we believe will be a potential market for office demand.

Virtual office space providers like Regus, who provide fully serviced office space for firms that require small office spaces (5 m^2 – 50 m^2) appear to be capitalizing on this and are expanding strategically to prepare for anticipated increase in demand expected over the next two to three years. In 2015, Regus opened two extra centers to match the growing demand for their products.

As was projected by Knight Frank Uganda two years ago, rental levels for prime and middle level office space has corrected itself and settled at $16 per square metre per month for both new and renewed leases (Figure 9) with rental yields stabilizing between 8% - 10% and average asking headline rents for Grade A buildings are between $14 to $16.

Leases coming up for renewal especially within the commercial office space have continued to attract hard bargains from prospective tenants asking for rent reductions as well as reduced escalations and this outlook is likely to remain the same for the first half of 2016.

Figure 9
Prime commercial rentals

Size	Rate
Grade A	US$ 14 – US$ 16
Grade AB	US$ 12 – US$ 13
Grade B	US$ 11 – US$ 10
Grade C	US$ 8 – US$ 7
Yields	9% – 10%

Source: Knight Frank Uganda.

Valuations

Bank lending activity remained slow in the last two quarters of 2015, with the Central Bank continuing to tighten the monetary policy with a view to subduing inflationary pressure.

The commercial banks responded by increasing their prime lending rates to an average of 24% – 25% per annum, further negatively affecting mortgage lending.

Besides mortgagors taking bold decisions to take on the high prevailing interest rates, property valuation instructions in this quarter were largely for financial reporting purposes as opposed to homeownership or construction.

Knight Frank Uganda believes that the slowdown in the volumes of valuation instructions for secured lending have also been to a large extent slowed down by a "wait and see" attitude adopted by the lenders and borrowers alike in reaction to the February 2016 elections.

The general outlook for much of the first half of 2016 remains bearish, with valuation activity only expected to pick up in the second quarter as credit restrictions by the banks begin to ease up. The prevailing market conditions are therefore projected to hold up to the general elections.

In our analysis we are not seeing huge uplifts in market values of residential or commercial properties and in some cases, there have been continued corrections in prices being paid even for prime properties in the CBD.

Land prices in the growth areas of Greater Kampala however continue to hold their value, even though transactions are taking longer to close for full cash considerations and acceptable payment terms.

Outlook For 2016

The general election in February 2016 has created negative sentiments from investors and developers alike, albeit with no real or justifiable reasons apart from speculation of election violence and political instability.

Past experience has shown that despite such speculation, elections do come and go and business continues as usual despite a few disruptions which soon come to pass.
We are hopeful, however, that the property market will see increased activity and performance in the retail and prime office leasing, once these speculative sentiments come to pass and that there will be increased activity from the bank lending sector which will stimulate interest from the home ownership sector.

Uganda's economic growth forecast for 2015/2016 has been lowered to 5% from the previous projection of 5.8%. This is hardly surprising given the sluggish private sector growth in the last half of 2015.

We forecast real growth towards the last quarter of 2016 driven by public infrastructure spending, bolstered private sector activity and increase in investments by local and international players that is characteristic of post – election cycles in Africa.

All this should bode well for the property sector in Kampala with investors freely able to commit resources for short and long term investments and developers taking a less risk averse attitude to property development.

There are a number of sizeable residential developments in the pipeline for completion in 2016/2017, which will increase the supply of residential units in the apartment and townhouse sectors for high and middle income earners.

We are yet to see serious investment in the affordable housing space, yet this is where the majority of demand for housing lies.

There are more commercial and retail developments which should be ready by Q 2 and Q3 2017, pointing to buoyant investor confidence for growth in the mid and long term for the commercial sector and projected demand driven by the growing middle class population for the retail sector.

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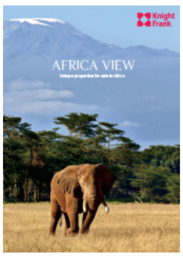

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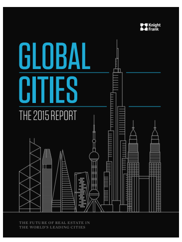

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