Market Commentary

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A Tale of Three Cities
The Cost of an Office

This is the first of a series of property articles about Nairobi, Dar es Salaam and Kampala, topical because a natural economic block is being drawn back together by the revived EA Community, even if Tax Treaties, leave alone a Customs Union, are still held up by size differences and trade inequalities.

Nairobi has enjoyed uninterrupted development since independence in 1963 and is a strong local market, measured and funded in Kenya Shillings. New office completions averaged 80,000 m2 per annum through most of the 1990s without serious vacancies and if demand is now muted and the CBD/Nairobi Hill struggling with unlet space, relocation pressures are still encouraging new starts in decentralised nodes. By contrast, the re-emerged modern sectors of Dar es Salaam and Kampala have been pushed towards over-supply by as little as 40,000 m2 over 3-4 years. The visible top end of both markets is high cost, dollar denominated and thus out of reach of much local demand. Economists may preach convergence, but Nairobi remains a high volume, low cost market, with the reverse persisting elsewhere. The challenge in Tanzania and Uganda is to improve and broaden the delivery system while lowering its price. Markets really do work and once the pendulum swings in the tenant's direction, developers will become fierce cost cutters to meet their return expectations.

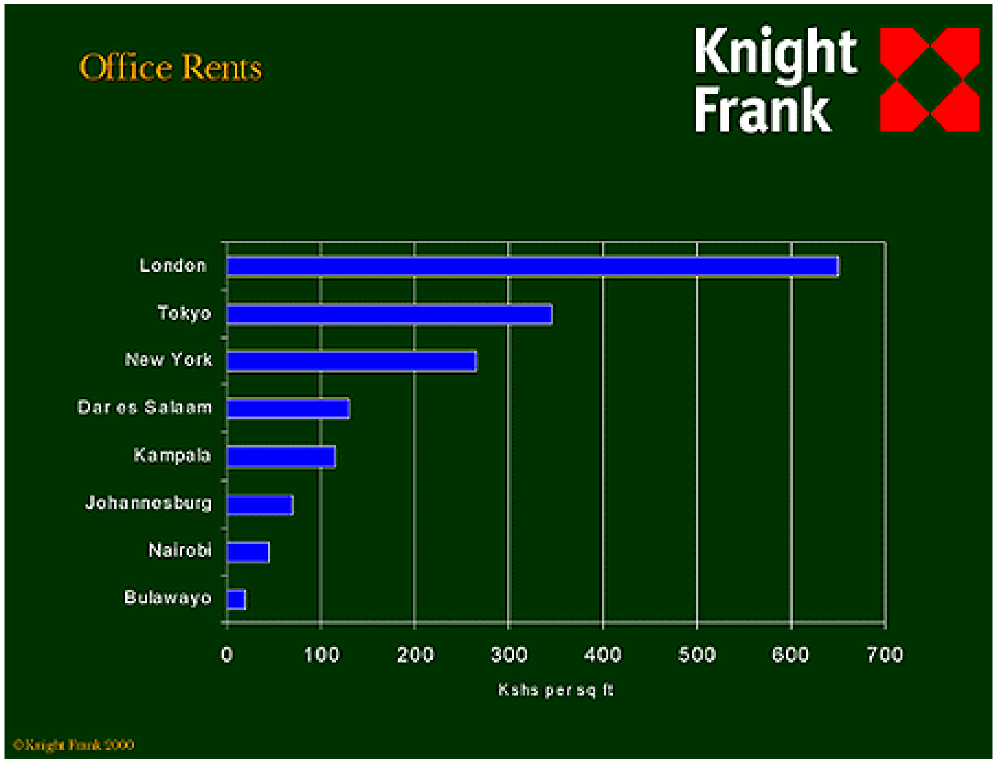
Headline figures are dangerous, but an international company taking 500-1,000 m2 of Grade A space, unpartitioned and ahead of parking costs and service charge, might budget as follows:

US$ per lettable square metre per month	
Kampala	14 - 17
Dar es Salaam	15 - 18
Nairobi	6 - 7

Not so long ago desperate new entrants were paying $25-30 for a toehold in Dar es Salaam and up to $20 in Kampala, against the same or lower Nairobi yardstick. The extreme distortions are gone, it must be remembered that Nairobi doesn't need air conditioning, which is a 20% cost increment, and that like for like building costs are very different.

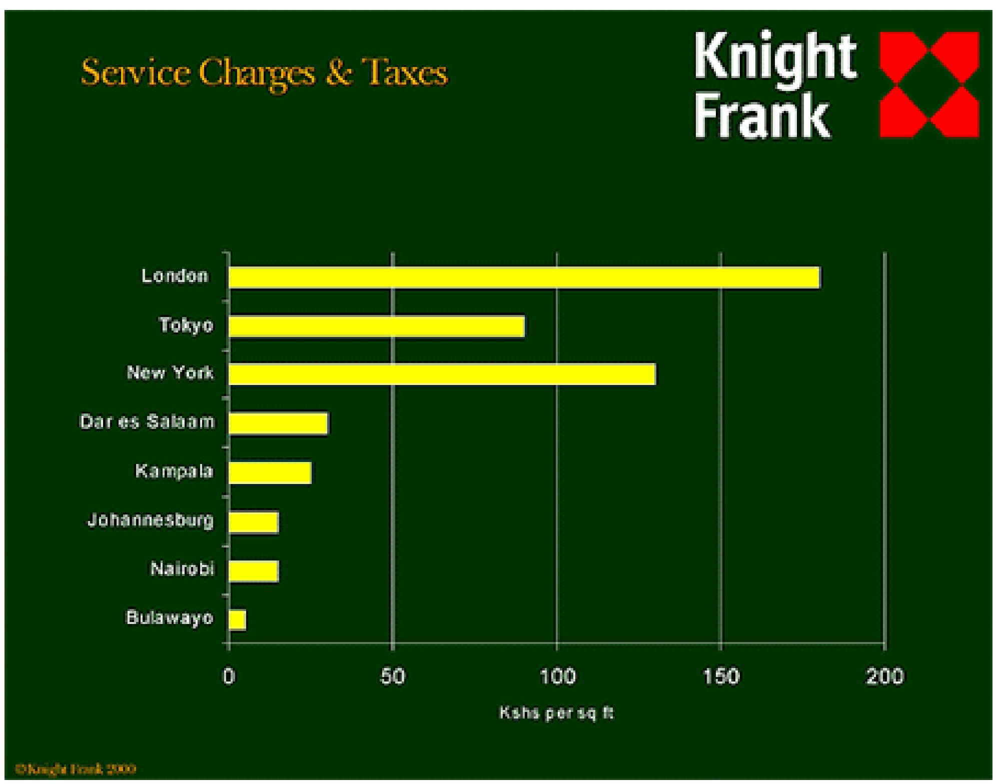
Typical Construction Cost (US$/sq m gross)			
Property Type	Kenya	Tanzania	Uganda
Office Block	400	520	640
Shopping Centre	295	385	475
High Rise Residential	465	605	745

It's at least interesting to see how EA stacks up against the wider African scene and to compare that picture with the world's top three business cities. The measure is in Kenya Shillings (about 78 to the $) because the charts were developed to prove a point - that Nairobi office costs are such a small element of overhead that even the parsimonious can argue in favour productivity gains from improved working conditions!

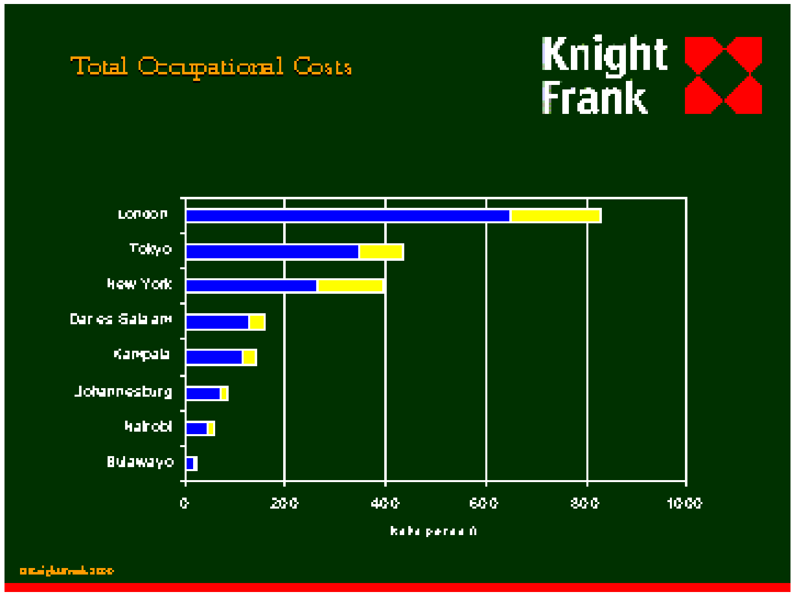


If London is mad and Bulawayo merely sad, there are two significant conclusions.
• As in many things, there are parallels between Nairobi and Johannesburg - an understanding of the one makes the other familiar.
• Modern-sector property costs are surprisingly high in Dar es Salaam and Kampala - reducing their appeal as regional centres.

The next chart shows the often silent impact of operating costs, usually passed on by way of a service charge that includes Rates & Insurance, Security & Cleaning, Repairs, Utilities and Management.



The two together provide total occupation costs, widening the difference between top and bottom:



Certainly in EA, the average conceals significant trends and anomalies such as: • The high and rising cost of energy, particularly in air conditioned buildings and tall towers with old lifts.

• The cost of parking, or more aptly, the cost of no parking. A first budget of 10% of rent could be reasonable, but the old rule of thumb ratio of one bay per 100 m2 of CBD space is hopelessly inadequate and long sighted Office Park promoters are trying to achieve four per 100 m2.

• The cost, amortisation and tax treatment of tenants' fit-out. This is a subject in itself, but the nature of a given building and the level of landlord's finish are influences beyond the occupier's control. The spread, with furniture and CIT wiring included, can range from $200 to as much as $800 per m2 of usable space; very significant, even over 10 years.

• The impact of VAT. There is no VAT on Nairobi rents, but no recovery of inputs either, while in Kampala and Dar es Salaam rents are fully vat-able and if the tax is generally a pass-through, Banks and Financial Institutions (providing generally exempt services) have to absorb VAT as a straight operating cost and that's another 20% in Tanzania.

• The method of measure and the differences between gross, lettable and usable areas. Thanks to SAPOA (South African Property Owner's Association) we are moving towards standardisation, but do remember the old East End of London Jewish joke "My boy, get wise, agree the area before you fit the skirting board!"

• Lease Length & Upward Only Review Clauses The conclusion is clear: tenants should look beyond the headline rent to establish total occupation costs, then compare apples with apples and take an informed value decision.