

Lagos, Nigeria Real Estate Investment Report

Q3:2016

How is the real estate market doing?

With the Nigeria economy experiencing its lowest annual GDP growth rates since 1999, the naira in a depreciating spiral and inflation at record levels, there is an overriding mind-set that the Nigerian growth story is over and it is time to move on. However experienced investors know that economic cycles rise and fall and the time of gloom and doom is the time for brave investors to take positions in expectation of a turnaround in the market.

Hence we are continuously asked the question, "How is the Real Estate market doing?" - how is the real estate market holding up as a store of value in this currently challenged high inflationary asset value depreciating environment. It's a simple question and a question we get asked quite a few times. Hence the focus of our Q3 2016 report.



Q3:2016 Market Summary:

- ❖ **Land** Prime land prices have generally retained their value in Naira terms through the challenging 2015-2016 economic cycle albeit with a considerable fall in pricing in Dollar terms and an increase in the supply of prime locations up for sale suitable for commercial development particularly in Victoria Island and Ikoyi.
- ❖ **Residential** Demand is such that even in the downturn, buyers are prepared to purchase property where they feel that they are getting value for money. Developers that are able to offer good quality residential units in attractively located estates that tick the boxes for buyers will still sell out.
- ❖ **Retail** The retail sector has been hit by a triple whammy of reduced consumer spending, a falling Naira leading to inflationary pressures on imported consumer goods and supply constraints in sourcing foreign exchange to buy the goods to stock shelves. This has negatively impacted retailer's turnover with a knock-on effect on their ability to pay rents.
- ❖ **Office** The commercial office market continues to suffer from a supply overhang initially due to a strong development pipeline but now aggravated by a fall away of corporate demand due the constrained economic environment. The upshot of this is the weakening of rents and the increasing prevalence of sweeteners to attract new tenants to fill space
- ❖ **Hospitality** A challenged hospitality sector will continue to track the performance of the wider economy. It will however be a major beneficiary of any pick-up in economic activity particularly on the back of stable or rising oil prices.
- ❖ **Finance** International investors remain reluctant to invest in Nigeria as a lack of convergence between the official and parallel market rates, continues to draw attention to the lack of liquidity and currency risk inherent in the foreign exchange market.

1. INTRODUCTION

We introduce our Q3 2016 Lagos Real Estate Investment Report analysing the Lagos real estate market up to the third quarter of 2016. Our report focuses on investment and development activity in the Lagos and Nigerian real estate markets. We trust it will bring clarity to your investment decision making process as you seek to create value in the African real estate markets.

We believe you will enjoy our latest report and hope that it assists your decision making process in relation to investment in Lagos within a wider Nigerian context. If you find this report of value, we ask that you kindly forward it to your in-house

investment team or to any colleagues involved in African Real Estate with a focus on Nigeria. Please also feel free to contact us via the details below or visit our website for further information on how we can assist you.

2. NIGERIA ECONOMIC OVERVIEW

The Nigerian economy continues to break records on the downside. The August year on year inflation figure of 17.6 per cent was the highest in 11 years. Foreign reserves currently at N24.5Bn are their lowest in 11 years at which time the country's GDP stood at US\$112Bn, less than a quarter of where it stands today. The naira continues to hit new lows against international currencies, the National Bureau of Statistics has stated that Q2 capital importation of \$647.1 million fell by 76 per cent relative to the second quarter of 2015 and is the lowest level on record and finally it is predicted that Nigeria's economy may shrink by 1.3 per cent in 2016 which would mark a full year in recession last seen 25 years ago.

The government continues to grapple with rising inflation coupled with slow to negative growth and is in a quandary as to whether to tighten monetary supply to reduce inflation or to increase liquidity to induce growth and create jobs. Against the wishes of the Finance Ministry, the Central Bank during its last policy meeting voted against further easing and maintained interest rates at 14 per cent choosing to focus on tackling inflation and retaining interest rates at the current level in order to attract foreign investment into the country via the higher yields on offer.

The Naira was finally allowed to move from a managed to a free float in June 2016 at which point it fell from N180 to N282 to the Dollar. The Naira has since drifted downwards to its current rate of N305 to the Dollar compared to the parallel market rate of N460. It has since become clear that the continued divergence between the official and parallel market rates does suggest that the free floating Naira is yet to be fully subjected to the laws of supply and demand and rather than being allowed to float freely is still being stage managed for the benefit of the few that are still able to access foreign exchange at the official rate.

The wide margin between the official and the parallel market rate remains a signal to foreign investors that the Naira yet has a way to fall and the current paucity of foreign currency in the market is a reflection of this view which may only be ameliorated as at when the spread between the official and parallel rates starts to reduce and investors are reassured that Naira investments made today will not half in value by tomorrow.

All is not quite gloom and doom however. The cloud always has a silver lining. There is hope that the economy has seen the bottom of the cycle. Inflationary pressures appear to be subsiding with the month on month change from July to August falling to 1.01 per cent.

The Federal Government is borrowing to stimulate economic growth and jobs creation with a focus on infrastructure development and agriculture and the parallel market has in very recent times reversed course with a gradual move towards the official rate.

Nigerian Economic Metrics (Sept 2016)

1	GDP Growth (Q2 2016)	-2.06%
2	Inflation (Aug)	17.61%
3	MPR	14.00%
5	USD/NGN	305
6	External Reserves	US\$24.5Bn
5	Bony Light	US\$49.9
Source: NBS, Central Bank of Nigeria		

3. REAL ESTATE OVERVIEW

REAL ESTATE MARKET SUMMARY

The mid to high end market continues to stagnate based on a dearth of corporate clients in the commercial office market, retail tenants under pressure from falling retail revenues on the back of faltering consumer demand, a weakening Naira and the higher cost of imports, the pull back of IOC's from on-shore to offshore operations coupled with a falling oil price leading to reduced profits, staff lay-offs and a fall-off in demand for luxury residential rentals traditionally occupied by oil company staff and a general fall in liquidity negatively impacting transaction volumes.

However the middle market continues to show greater resilience with borrowings in Naira and less exposure to the falling naira against the dollar. The middle market is also supported by the sheer demand of consumers for housing and an improved retail experience, with consumers with Naira to spend migrating to the value-for-money perception of the middle market offerings.

REAL ESTATE INVESTMENT & FINANCING

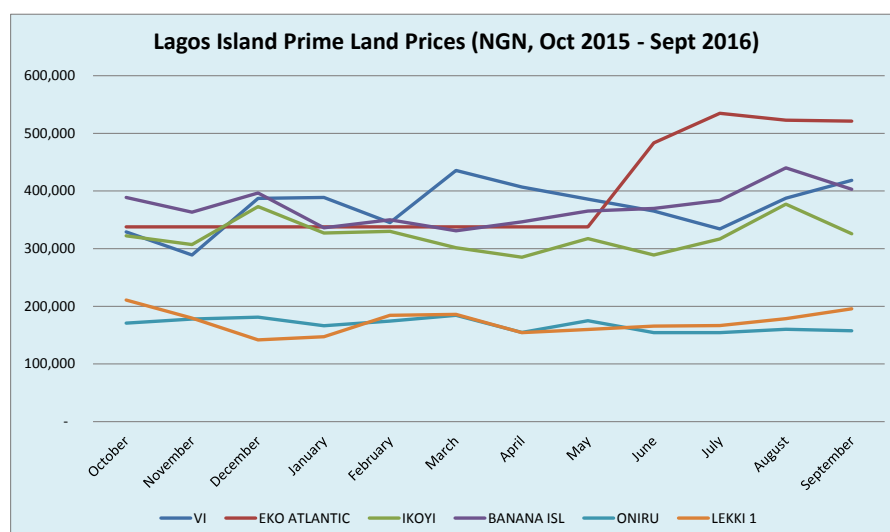
A lack of foreign exchange coupled with high levels of volatility have been seen as major challenges for investors looking at Nigeria as an investment destination over the last two years. Issues around the lack of foreign exchange liquidity have led to concerns about the ability to source Dollars to repatriate Naira denominated returns and the volatility of the rate at which any conversion may take place. In addition, the rate of growth has also slowed leading to additional concerns as to the resilience of projected investment returns.

New Investment Transactions

Portfolio Company		Deal Date	Deal Size (US\$m)	Investor	Structure
Landmark Africa	Landmark Village, a mixed-use development in Victoria Island including an events center, restaurant, Café, office space, residences and a hotel	April 2016	20	Vantage Capital	Mezzanine
Imani & Sons	Maitama Mall Mixed Use Development. Retail, Commercial Offices & Hotel	TBC	220	Momentum Africa Real Estate Fund and Eris Property Group	TBC

PRIME LAND PRICE MOVEMENTS

Prime land prices have generally retained their value in Naira terms through the challenging 2015-2016 economic cycle albeit with a considerable fall in pricing in Dollar terms and an increase in the supply of prime locations up for sale suitable for commercial development particularly in Victoria Island and Ikoyi.



Notes

1. Land value data is derived from advertised sales prices
2. Eko Atlantic prices originally quoted in US\$ are blended waterfront and non-waterfront prices
3. Official USD/NGN rates are used to convert Naira to dollar values

Eko Atlantic City at an average price of US\$1,700 (N520,000) psqm has taken the position as the most expensive land in Lagos. The rise in Eko Atlantic City land prices is due to the fact that prices are quoted in Dollars and hence continue to rise in Naira terms as the Naira continues to lose value against the Dollar. Eko Atlantic City prices are now far removed from the reach of local consumers and are now affordable in the local market primarily to corporates that generate revenues from Dollar denominated sales, ie oil companies and commodity exporters.

Banana Island at N400,000 (\$1,326) and Victoria Island at N418,000 (\$1,377) psqm continue to vie for the second most expensive prime Lagos location after Eko Atlantic City with Banana Island now well entrenched as the prime Lagos Island residential address while Victoria Island retains its title as the Lagos Commercial Business District albeit with the growing threat of Eko Atlantic City as an alternative commercial destination.

Lekki and Oniru prices at N196,000 (\$644) and N158,000 (\$518) psqm continue to track one another with Lekki benefiting from the growth of Admiralty Way as a growing commercial thoroughfare while Oniru continues to benefit from its proximity to Victoria Island and its subsequent growth as a secondary commercial office destination.

THE RESIDENTIAL MARKET

Demand is such that even in the downturn, buyers are prepared to purchase property where they feel that they are getting value for money. Developers that are able to offer good quality residential units in attractively located estates that tick the boxes for buyers will still sell out. The high end rental market, priced in dollars and targeting a diminished oil and gas expatriate population, continues to remain in the doldrums. The attraction of the high end market has always been that buyers can afford to pay to own, however in a market where high end buyers are in short supply, in order to stay afloat, high end developers have started to target a younger local affluent demographic with luxury apartments starting at circa N70m. The relatively youthful Nigerian demographic is still under-served by the market with considerable demand for one and two bedroom apartments in prime locations on the Lagos Island and mainland.

THE COMMERCIAL OFFICE MARKET

The commercial office market continues to suffer from a supply overhang initially due to a strong development pipeline but now aggravated by a fall away of corporate demand due the constrained economic environment. Up until 2015-6, total commercial office space in Victoria Island and Ikoyi has amounted to circa 500,000 square metres with Victoria Island space about three times that of Ikoyi. However, over the coming two years from 2016 to 2017, a further 100,000 sqm or 20 per cent of existing supply is due to come onto the market with Ikoyi adding twice as much space as Victoria Island over this time period .

The upshot of this increase in demand paired with the falling supply is reflected in falling rents which touched US\$1,200 square metres as recently as early 2015 but which have now fallen to circa US\$800 per square metre for Class A properties and down to as low as US\$500 per square metre for landlords under pressure to let space. US\$ denominated rents have come under increasing pressure based on comparisons to office space charged in Naira. There is also an additional argument as to the conversion rate to use considering the official rate of one Dollar to N305 compared to the parallel market rate of one Dollar to N460 and the obvious preference to use the official rate. Additional sweeteners such as fit-outs and rent-free periods of up to a year are now also available to tenants.

THE RETAIL MARKET

One of the favourites of Nigerian real estate investors in recent times, the retail sector, has not escaped the current challenges of the slowing economy. A triple whammy has befallen retailers - reduced consumer spending, a falling Naira leading to inflationary pressures on imported consumer goods and supply constraints in sourcing foreign exchange to buy the goods to stock shelves. This has negatively impacted retailer's turnover with a knock-on effect on their ability to pay rents. In addition, rents are often Dollar denominated and as such are also rising in Naira terms. This has led to creeping vacancy rates and the slow up-take of space in new developments.

On the supply side, we have recently seen the opening of Novare's 22,000 square metre Lekki Mall, Maryland Mall on the Lagos Mainland with 7,000 sqm of GLA and Onitsha Mall located in Onitsha, a secondary city in the South East of Nigeria with 12,100 sqm of GLA. The smaller malls cater to the reduced demand of a smaller catchment area or the constraints of a smaller site. Shopping mall asking rents range from \$800 psqm for prime Lagos locations to circa \$450 psqm for locations in secondary markets.

HOTEL MARKET

The Nigerian hotel sector in general and the Lagos market in particular have been operating in a very challenging market over the past few years. Before the current economic meltdown, the hotel market had already been struggling to recover from the Ebola scare and was additionally negatively impacted by the slowdown in economic activity brought about by the 2015 elections.

The sector has been badly hit by the current slowdown in the economy brought about by the fall in the oil price, the slowdown in public sector spending and the fall in international business travellers. Investors have fallen out of love with the sector and this is reflected in the fact that there was no foreign investment into the sector over the second quarter of 2016. It

is expected that the hotel sector will continue to track the performance of the wider economy with a pick-up in activity once the wider economy begins to perform better and with an added fillip that may come from any rise in oil prices.

4. ABOUT US

MCO Real Estate is a Lagos, Nigeria based real estate investment and advisory firm with a focus on providing investment & transaction advisory services to local and international clients seeking to invest in or develop large scale real estate opportunities across Nigeria. We prepare project feasibility studies, we arrange funding for developers, we present investment opportunities to investors, we undertake pre-sales engagements as a key part of the funding process, we acquire real estate assets on behalf of clients and we support these activities with in-depth research to validate ours and our client's investment decisions.

Our clients include development companies, local and international investment companies, oil and gas companies, engineering and real estate consulting firms, high net worth individuals, family offices and private corporations. We are members of the Association of Investment Advisors and Portfolio Managers. We are your real estate partners. Call us now to discuss how we can be of service to you.

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