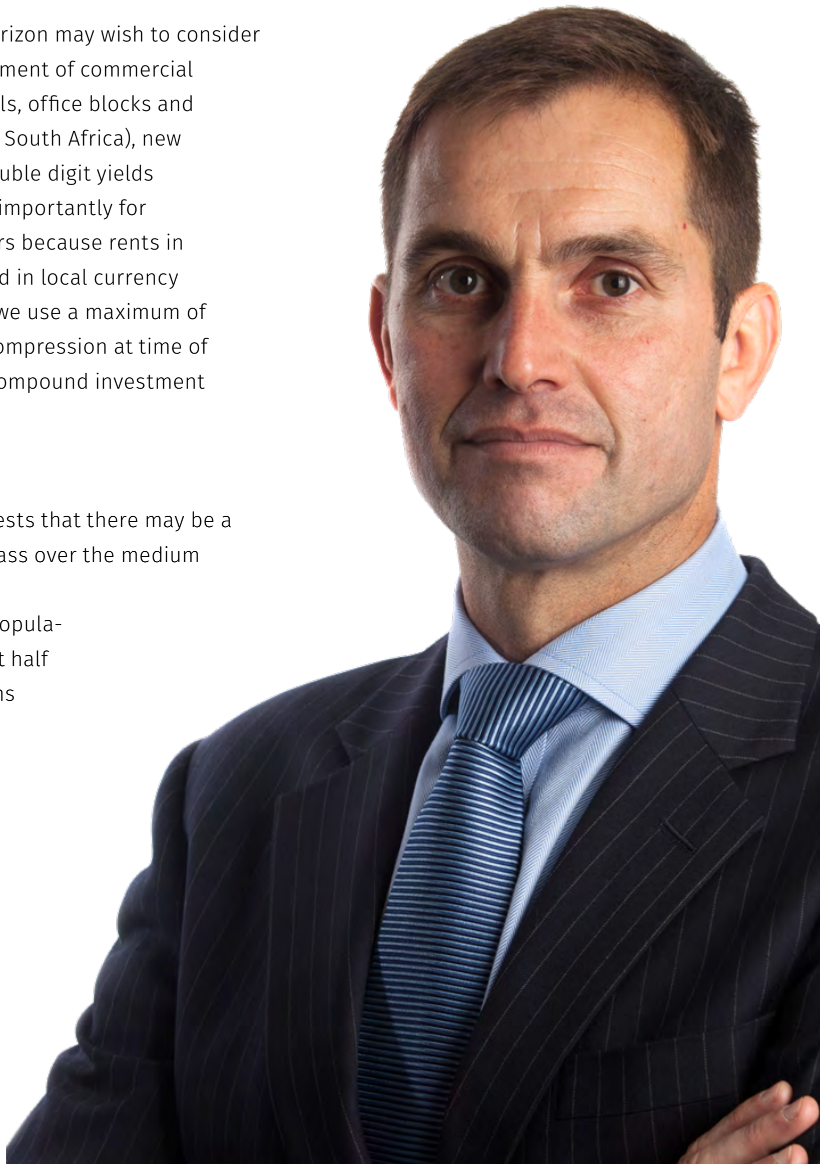
Investment adventures in commercial real estate development

By David Lashbrook,
Head of Africa Real Estate,
Momentum Global Investment Management



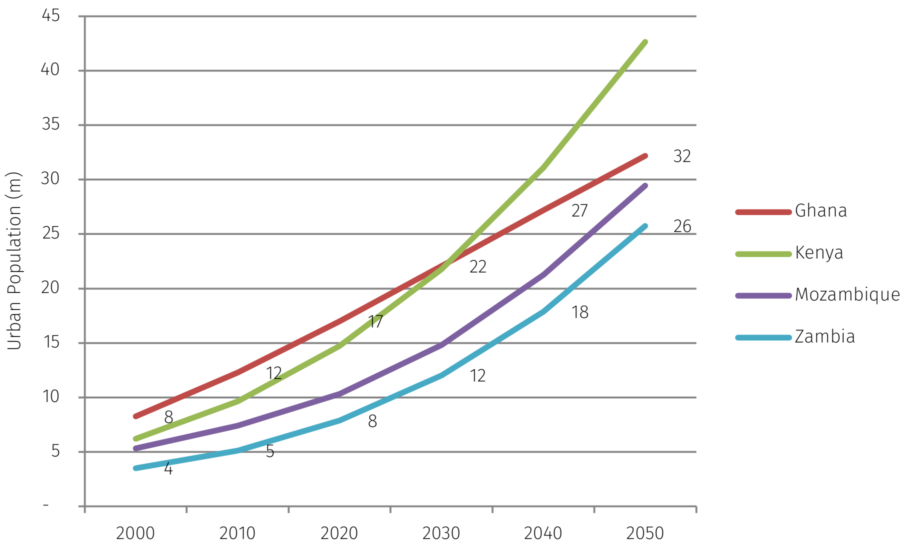
Investors with a long term investment horizon may wish to consider investment opportunities in the development of commercial African real estate such as shopping malls, office blocks and warehouses. In frontier Africa (i.e. Africa outside of South Africa), new projects are typically delivered by developers at double digit yields (calculated as rent/total cost including land). And, importantly for international investors, these yields are in US dollars because rents in frontier Africa are normally paid in dollars or settled in local currency but referenced back to dollars. Applying leverage (we use a maximum of 60%), annual rental escalations of 3-4% and yield compression at time of exit, one can see that it is possible to achieve net compound investment returns in the high teens or more.

DEMAND/SUPPLY IMBALANCE

An analysis of the demand and supply factors suggests that there may be a sustainable investment opportunity in this asset class over the medium term.

On the demand side, sub-Saharan Africa's urban population is expected to increase fourfold during the first half of this century. In this period, the urban populations of Ghana, Zambia and Nigeria are expected to increase sevenfold and Nigeria's urban population is forecast to grow to a mammoth 295 million! Africa's favourable and growing demographics only explain half of this story. Another significant factor is the substantial increase in urbanisation rates as people migrate to the cities in search of jobs. I firmly believe that the mobile telephone has contributed to this migration. I grew up in Zimbabwe before the age of mobile phones, the internet and

CURRENT AND FORECAST URBAN POPULATIONS OF GHANA, KENYA, MOZAMBIQUE AND ZAMBIA



Source: United Nations, Department of Economic and Social Affairs, Population Division (2014). World Urbanization Prospects: The 2014 Revision, CD-ROM Edition.

social media. The press was highly censored and we were perhaps a little sheltered from the wider world. I don't think we were the only country either. Today, mobile phones (and particularly smart phones) allow people to have the world at their fingertips. I acknowledge that only the wealthier Africans own smartphones, but most at least own a mobile phone and information sharing by text is extensive. Young Africans can read about western news, values and celebrities and I believe this is creating a cultural change as they aspire to become part of this more materialistic world. This is driving people into the cities as they seek to improve their lifestyle.

On the supply side, consider the corresponding chart, which shows the average urban population that is supported by one regional-sized shopping mall. It is above 1 million people per mall (and 5 million in the case of Nigeria!) in frontier Africa. The comparative ratio for Johannesburg in South Africa is only 100,000 people per regional sized mall. Yes, I acknowledge that Johannesburg (along with London and Dubai) is one of Africa's shopping capitals and yes, I acknowledge that the general Johannesburg population is far wealthier than in other sub-Saharan African countries, but these statistics do suggest that sub-Saharan African cities outside of South Africa can potentially absorb significantly more retail space. Trading data from the first malls to be set up in these countries shows that they are performing well: Accra Mall in Ghana and Ikeja Mall in Lagos, Nigeria are classic examples.The above demand and supply examples suggest that there will be a sustained imbalance of these factors over the medium term which should create exciting opportunities for developers and investors.

EMERGENCE OF BUYERS: A GOOD REASON TO DEVELOP NOW?

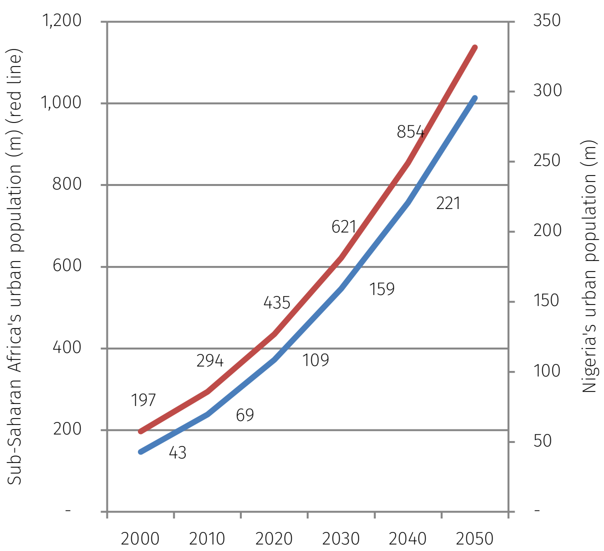
When compared with South Africa and the rest of the world, we believe that frontier Africa's commercial real estate markets are still in their relative infancy. Information is difficult to find (if it exists at all), transactions are few and far between and listed buyers such as REITs are virtually non-existent. The recent sale of the Ikeja Mall in Lagos by Actis and RMB Westport to Attacq/Hyprop is a significant transaction for this fledgling market as is the purchase by Delta of the Barclays Bank building in Mauritius. I believe the frontier African real estate market is in a similar situation today as the South African real estate market was at the turn of the century. Back then, the South African listed property market had a market capitalisation of $1bn. Today, the market cap is $25bn. Back in 2000, developers could develop for double digit yields. Over the last 15 years, yields have compressed to single digits as liquidity in the market has deepened (see the corresponding chart). I expect the same trend to occur in frontier Africa, which suggests that now may be a good entry point.

CHALLENGES

However, there is a good reason why there are only a handful of developers in frontier Africa: doing business there is not easy or cheap. Five of the bigger challenges are listed below.

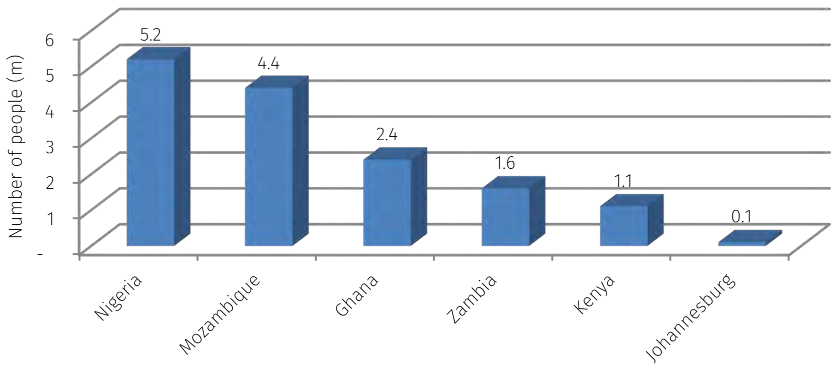
• Certainty over land title is not always crystal clear. Land title regimes vary from country to country (and even within country), having been originally set up by former colonial powers and then amended by the independent African governments. Deeds offices are not as efficient as in the developed world and sometimes there

CURRENT AND FORECAST URBAN POPULATIONS OF NIGERIA AND SUB-SAHARA AFRICA



Source: United Nations, Department of Economic and Social Affairs, Population Division (2014). World Urbanization Prospects: The 2014 Revision, CD-ROM Edition.

URBAN POPULATION PER REGIONAL-SIZED SHOPPING MALL



Source: United Nations, Department of Economic and Social Affairs, Population Division (2014). World Urbanization Prospects: The 2014 Revision, CD-ROM Edition, Eris Property Group.

appears to be more than one claim to title. We mitigate this risk by focusing on city central developments where history of title is often cleaner and by employing reputable local counsel to perform legal due diligence on ownership and transferability of title.

• Procurement. A significant portion of all construction materials has to be imported. This has major implications for the costing of projects and the timing of completions. Port clearing can be slow and duties expensive. In addition, other factors can cause hardship. For example, as a result of the oil price collapse, Nigeria (as Africa's largest exporter of oil) is currently suffering from a huge shortage of dollars. This means that despite having a mountain of local currency, developers may not be able to obtain the dollars they need to pay for imported materials and retailers may be unable to pay for imported stock. This is a very real challenge in Nigeria at the moment: developers and retailers are devising mitigation strategies such as sourcing locally but there is a limit as to how far this can go. Pressure is growing on the Nigerian government to devalue the naira and to let it float.

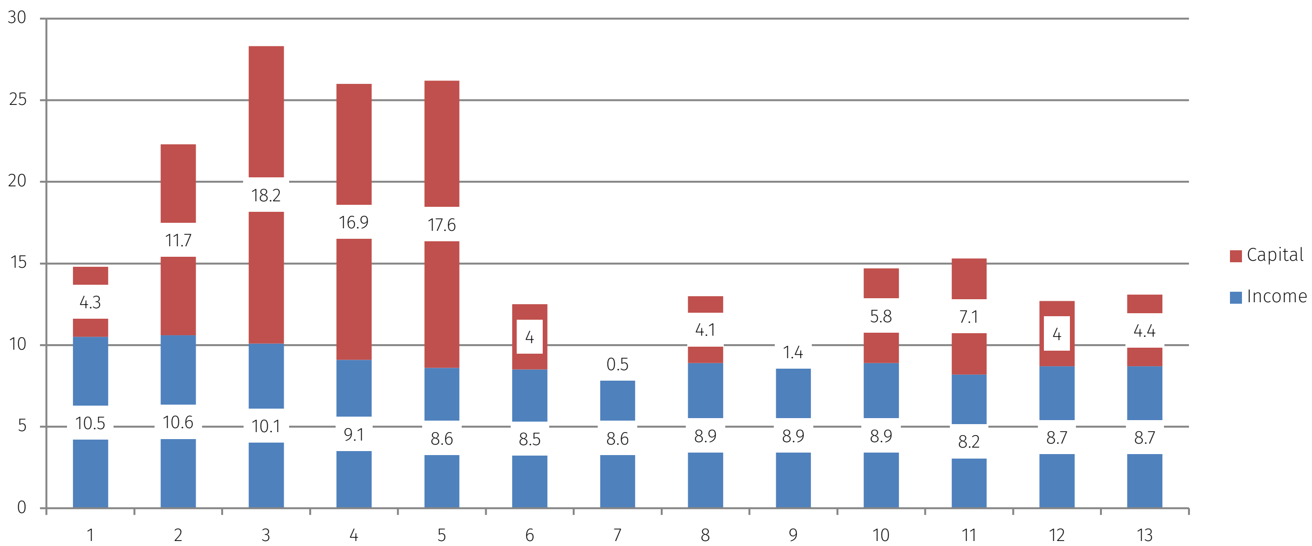
• Sudden regulatory change. African countries are prone to sweeping regulatory changes which often have severe unintended consequences for business. We mitigate this risk by (1) partnering with reputable outfits that have operated there for generations and (2) by remaining in constant contact with our teams on the ground. This allows us to anticipate changes and to be nimble in our response.

• Corruption. This is unfortunately one of the first questions all investors ask. Yes, there is corruption in Africa, but there is corruption all over the world: it is just the extent that varies. We avoid corruption by partnering with local private entities that have operated honestly and successfully through several political cycles. It is possible to do business without corruption.

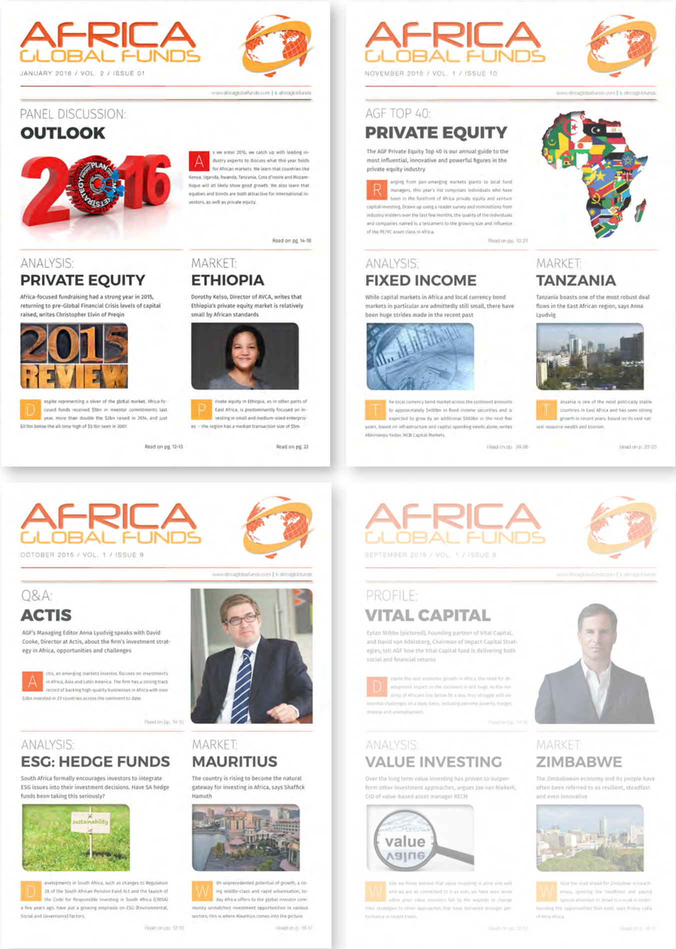
• Reliance on commodities? Most African countries are net oil importers, so the weak oil price in particular has benefitted them by improving their balance of payments and putting more cash in the pockets of consumers. I do however acknowledge that the oil price collapse has been tough for the major oil exporters such as Nigeria and Angola.

The challenges highlighted above demonstrate why investors in the African real estate asset class should consider partnering with a team that has a strong track record and a physical presence on the continent. With the implementation carefully undertaken by experienced hands-on professionals, investors should be able to benefit from the demand/supply imbalance that has the potential to provide a sustainable source of meaningful real return over the medium term.

IPD SOUTH AFRICA PROPERTY INDEX RETURNS



Source: IPD Database, past performance is not a guarantee of future returns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