



REAL ESTATE INVESTMENT IN AFRICA

Is the Honeymoon Over?

June 2017



CBRE

INTRODUCTION

The environment for real estate investment in Africa contains a perplexing mix of positive and negative factors. This is quite apart from the obvious fact that, in a continent of 54 countries and wide variations in levels of economic development, it's a very diverse landscape.

On the positive side, there is interest from a variety of investor types and origins. These include developers, conventional institutional funds, hedge funds, sovereign wealth funds, Ultra High Net Worth Individuals and others; and they span Asia, USA, the Middle East, South Africa and Europe. Product quality is improving across all sectors due to the growing influence of international occupiers and developers, transparency and ease of doing business are improving in some countries, and the high yields available – up to 15% in some places – appear to offer good value, even against a background of high vacancy levels and soft or falling rents.

On the other hand, the collapse in energy and commodity prices (See Figure 1) has dented growth in many countries, including large economies such as Nigeria and Angola, and exposed a lack of diversity and still-high levels of dependence on natural resources. The recent strengthening in the US Dollar against many currencies has raised the debt-servicing burden for countries with Dollar-denominated debts, and slower prospective growth in key export markets, notably China, is a concern. The combination of slower rates of economic growth and abundant development has left many markets looking oversupplied, such as Kenya, Ghana and Angola. So where does this leave the expectant investor? Are African property markets less attractive than they were three years ago? Is the honeymoon over?

COMMODITIES HAVE HIT EMERGING MARKETS

World Bank index of precious metals prices

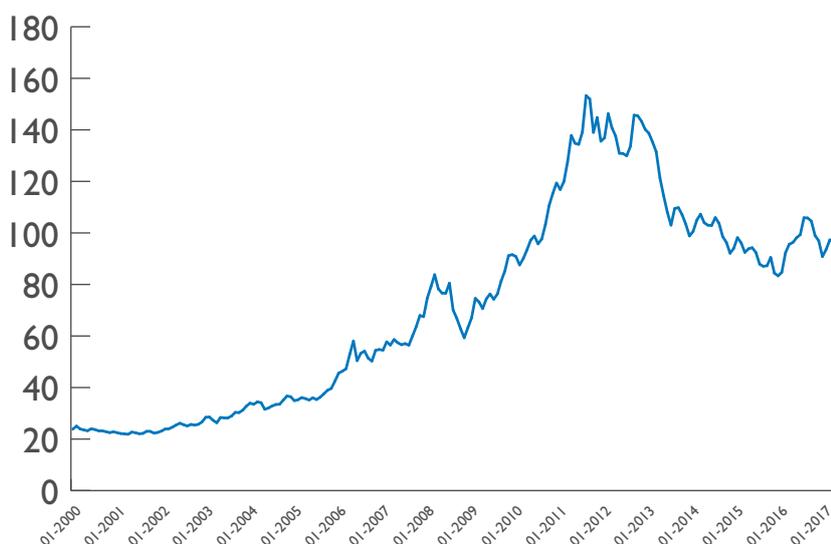


Figure 1: World Bank index of precious metals prices

Source: Macrobond

This paper follows a recent roundtable breakfast hosted by CBRE and DLA Piper, and attended by leading African investment professionals and academics. The paper will highlight the investment opportunities and challenges across Africa, illustrated with reference to specific markets. It also summarises the roundtable topic discussions held at the seminar.

I. Is the investment and development environment for real estate in Africa improving? What challenges remain and where ?

There has been some improvement in “ease of doing business” ratings in sub-Saharan Africa in recent years, notably in starting a business, securing construction permits and access to utilities¹. This should provide a better environment for investment and development. However a number of structural and operational challenges remain, which can be summarised as follows:

- **Investor approach and due diligence:** Some investors enter Africa with a “Western” mentality even though certain markets, particularly those growing very rapidly through development, do not lend themselves easily to rational price-value analyses for investment selection. Non-domestic investors need to understand local nuances and adapt accordingly. Since consultancy and partnership networks are often fragmented at present, one recommendation is greater local engagement and stronger “on the ground” presence to build partnership relationships in the country. Kenya is cited as a market where, despite rapid growth, issues surrounding title are still a barrier to real estate investment. Thorough due diligence is therefore essential but can be challenging.
- **Land and planning systems:** While office markets are improving in terms of asset quality, many markets remain largely unregulated from a land and planning perspective. As a result, market conditions are unbalanced, with high levels of vacancy and development which clearly exerts downward pressure on rental levels. Acquiring land in the first place can also be difficult, partly of price volatility resulting from loose planning arrangements, but also because of the need for extended due diligence.
- **Legal and regulatory:** A wider concern with all inbound investment is getting money in and out of the country of choice with minimal friction or penalty. Opaque pricing and currency issues are viewed as challenges or possible barriers. While it may be desirable for transactions to be conducted in USD, many markets require that local currency has to be used. Concerns over the ease and/or exchange rate of repatriating capital is a persistent issue that may deter some investors.
- **Don’t start with real estate:** Partly because of the challenges described above, it may be advisable to establish a presence in other sectors before diversifying into real estate. Minerals or other natural resources may be a better starting point than investment in real estate, not least because this allows new entrants to generate positive impacts on local economies and employment. Of course this requires access to sufficient expertise in these sectors and in some cases there may specific regulatory hurdles as well: in Angola for instance prospective foreign investors investing in certain sectors must enter into partnership with local companies whereby at least 35% of the share capital or effective participation in the management must lie with the local partners.

In summary, the long-term view regarding ease of doing business is still a positive one. The jurisdictions that are most likely to ‘rise up the ranks’ are those that focus on removal of the common barriers relating to: currency and foreign exchange; transparency of title; ease of establishing local partnerships; and adaptability and accessibility of local market practices. In Kenya for instance, government-backed preregistration services have significantly cut the time needed to start a new business.

¹ Source: World Bank

2. What does President Trump mean for African markets?

- The election of Donald Trump as US President in November 2016 will likely represent a significant change in policy direction in at least two areas – a move towards fiscal expansion and towards a more protectionist trade position.
- The Trump administration inherited a growing economy, and fiscal expansion will provide further support to domestic growth, at least in the short term, although more recently question marks have been raised about the true impact of these expectations. This is one reason why markets have mostly reacted positively, and also represents an upside to countries that export heavily to the US. Strong commitment to domestic US infrastructural investment may also have a positive impact on commodities producers. Beyond that, the fact that some areas of policy have yet to be articulated in detail, the suggestion that international development is a low priority, and concerns over isolationism on trade and the overall style of government all add up to a high level of uncertainty.
- One component of this relates to currency exchange rates and interest rate differentials. Expectations of higher US growth, and hence higher inflation and interest rates, have pushed USD higher over recent months. There are various implications from this. Some African countries, such as Angola, favour transacting in local currency. The exchange rate problem for those African countries that prohibit or discourage deals conducted in USD or other low-volatility currency, may be aggravated by the increased strength of USD.
- Secondly, a period of stronger US growth and higher domestic returns available for lenders and investors, may crowd out some overseas capital investment, including in Africa. One participant noted that it is already growing more difficult to secure financing from the US for projects in Africa, citing his experience in Nigeria. Many emerging markets have also built-up significant dollar-denominated debt, which becomes more expensive to service in a higher US-interest rate environment.
- A significant area of concern highlighted was the stated antipathy of the new President towards international trade agreements, the likelihood of modification or repeal of trade agreements and the associated possibility of the imposition of pre-emptive trade tariffs. While the realities of reshaping established and globally-integrated trade patterns should not be downplayed, this is an area of policy where the President has a high degree of autonomy. Whether all this has a harmful effect on African markets is hard to tell, but it looks likely to disrupt international supply chains and may have a self-fulfilling element. One specific example where trade may suffer is the US protection of certain imported textiles under the African Growth and Infrastructure Act, which currently attract reduced or no tariffs. This arrangement may lapse if Trump seeks to encourage US growth in the textiles industry, negatively impacting investment in African textiles. A related area

² Source: OECD Aid Statistics 2016



concerns possible cuts to overseas aid budgets: Africa receives around a third of OECD overseas development aid, and the US is the single largest donor².

- Changes in location decisions resulting from a more isolationist trade stance are also possible. Expected policy changes include higher taxes and/or tariffs, at least temporarily, on repatriated profits, designed to encourage location and production in the US. There may also be opportunities for Americans to set up international companies and trade back into the US – this supports US growth, but also contributes towards economic development in Africa, although the introduction of tariff barriers may discourage this. Many foreign investment-based projects are using Mauritius as a conduit for investment in Africa and the number of foreign companies using Mauritius as a trade platform is increasing. This increase is recent and, while it is uncertain what proportion is American, it is not expected that the Trump administration would affect this substantially.
- A further area of discussion focussed on measures that African countries could take, either individually or more likely collectively, to militate against possible negative impacts from a more restrictive or isolationist trade stance.

At a general level it was suggested that African countries should use the change in regime as an opportunity to consider what they could do to make themselves more attractive to American, and other, businesses. Part of the issue is the sheer diversity, and in many cases relatively small size, of African economies, which perhaps discourages them from being seen as viable investment destinations. Measures to present a more unified face to the outside world – such as harmonisation of laws and policies to facilitate trade and foreign investment – should be reconsidered in order to progress towards being seen as a coherent economic bloc.

- It is worth noting that a high level of US policy uncertainty still persists. Although domestic economic optimism in the US has broadly improved since Trump's election, elements of the policy agenda remain unclear and the administration has faced pushback on some key areas, notably tax reform. The continuing appreciation of the USD also works to the disadvantage of domestic (US) manufacturers and, if it persists, would favour the relative pull of non-US locations.



3. Lower oil and commodity prices have had a detrimental effect on demand and property prices in many African countries. What can be done to diversify and stimulate recovery?

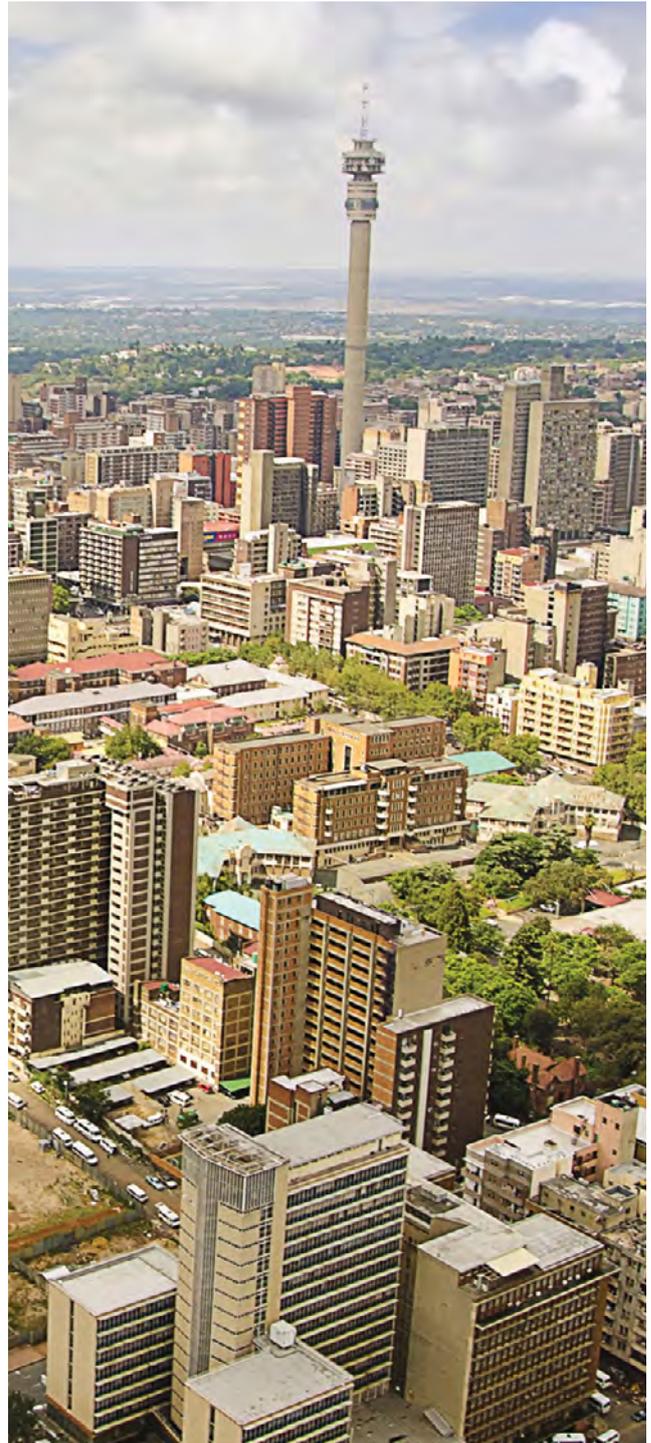


Figure 2: IMF Oil Price Index

Source: Macrobond

- Debate on this issue highlighted the point that the extent of this problem clearly depends on the level of economic dependence on oil or other commodities. Despite substantial differences between countries on this point, there was a degree of commonality in the suggested areas of focus that might generate improvements or solutions. Benefits for the consumer sector of economies, via lower petrol prices were also highlighted as a counterweight.
- A distinction was drawn between countries or groupings with low oil/commodity dependency – such as Tunisia and other North African markets, Zimbabwe and to a lesser extent Kenya – and oil-based economies such as Angola, Mozambique or Rwanda. While the first group has naturally been less severely affected it has not been entirely immune, partly because of the prominence of other commodities in national economies and particularly their role in driving foreign currency earnings. An example is Zimbabwe where gold and tobacco are major currency earners.
- In countries with higher levels of oil-dependency, more substantial impacts are evident. Rwanda, for instance, saw an almost complete cessation of development activity, while Angola suffered a significant reduction in inward investment from overseas. However, Angola is also cited as an example of a country where this is producing long-term beneficial effects, through “forced” diversification into other sectors. In some instances this is encompassing sustainable investment with social or environmental benefits, and is certainly encouraging a more long-term approach than the previous focus on rapid repatriation of dividends.

- The focus on diversification is relevant even in countries with lower levels of oil dependency. Some economies are already relatively well-diversified such as Zimbabwe (technology and tourism) and Kenya (agriculture) and arguably the need is less pressing here. Nevertheless certain general themes were raised. These included investment in alternative forms of energy such as solar and renewables, to lower the level of oil dependence in the first place.
- There was considerable discussion of the possible role of governments in supporting attempts at diversification, and two broad strands of thought: One focussed on identifying and supporting key growth sectors – in effect “picking winners” – among which technology, automotive, aviation, services and industrial were suggested. Framing such an approach so as to pick the correct sectors, and a policy platform that is supportive but not over-interventionist, requires thought in different national contexts. The second focussed more on providing the pre-conditions in areas such as healthcare, education, living standards and infrastructure in which diversification could thrive organically.
- In either case, there was an identified need to refocus on two areas: (a) the practicalities of doing business efficiently and (b) the scope for inter-country co-operation. On the first issue, streamlining bureaucracy and the information requirements associated with securing funding were highlighted as ways of removing barriers to investment – exemplified by the experience of funding affordable housing schemes in Zimbabwe.
- As regards inter-country co-operation, investors will respond positively to greater consistency of systems and policies across markets. It was felt that there was ground to make up in West Africa on this front particularly on education and infrastructure, which would require joined-up political commitment. It is important to identify coherent “blobs” of countries where such co-operation might be feasible: for instance, scope for co-operation across the North African belt was cited as an area with potential, but has so far seen limited success.



4. Massive urbanisation is a trend producing opportunities in many African markets. But lack of infrastructure makes some of the most interesting investment locations vulnerable. How important is infrastructure investment for supporting growth, and where and how is this being achieved?

- At a general level there was a high degree of consensus about the importance of adequate infrastructure, and its role as a limiting factor in bringing developments forward. By extension this is also an issue that could limit the expansion of cities, and hence economies, by restricting the development of otherwise-viable new areas or at the very least adding to their cost, and hence limiting the movement of activity away from high-cost city centres. It is accepted that substantial increase is needed in the scale of infrastructure investment across the continent and that, in tandem, the degree of inter-country collaboration in this area needs to increase.
- Contexts clearly differ, but the components of infrastructure deemed most critical for both commercial and residential developments are water; sanitation; power and telecoms. In some instances the issue is not so much the availability of nearby infrastructure supply as the difficulty of delivering it successfully into a development.
- Various examples exist of inadequate infrastructure hindering projects. In Nigeria, for instance, the infrastructure is not in place to support projects catering for middle to lower-class housing. Erratic water or electricity supplies increase project costs; in particular, the installation of generators increases energy costs by between 3-5 times compared to electricity taken from a reliable grid infrastructure. Studio apartments in Tanzania would cost the same in Dar es Salaam as the more prosperous Cape Town in South Africa, because of the lack of reliable infrastructure, while in Kampala, Uganda, new retail malls are slow to let up partly due to inadequacies in the infrastructure. Part of the reason is that governments often do not have sufficient capital to fund these projects on their own.
- By the same token there are examples of success, some of which illustrate the potential of new or innovative forms of financial partnership, as distinct from the conventional state funding route. In Mozambique for example, redevelopment of agricultural land and a north-south coastal link road have moved development away from high-price urban centres. In Angola, the government's focus on power left it unable to fund telecoms so optical fibre technology was provided by Unitel with international partners and is available in offices and government-built houses in Luanda. Uganda is also prioritising infrastructure development at central government level, based on expected benefits for aggregate economic growth. China has also had substantial involvement in infrastructure projects across Africa, such as ports in Tanzania, but has recently begun to scale this back to focus on domestic investment.

- Several of these examples illustrate the significant returns available to developers who are willing to improve the infrastructure around their projects, including access roads which may not be part of their land plot. Of course this requires upfront capital and so restricts market entry without some form of government assistance. The form that this should take is a key area of policy decision-making: should infrastructure investment be prioritised for general economic benefit; or targeted to support specific developments?
- In the second category there are further issues relating to the form, structure and risk-revenue sharing arrangements between governments and private investors. The private sector will typically require certain assurances from the government before they become involved and the ability of the government to meet certain thresholds and deliver on projects post-investor involvement is not always guaranteed. Several African countries have begun looking to some form of PPP structure although in many instances the poor quality of legal infrastructure is a restriction.
- The willingness or ability of governments to take on underwriting risk is also a factor. Some private entities have sought to build/develop and then take a guaranteed profit from the government, leaving the government to generate operating profit from the project to recoup its costs. This clearly reduces risk for the investor but potentially raises it for the government. Such a model was used to fund a toll road in Nigeria, but the government struggled to recover its outlay in toll revenue and ultimately the project failed.
- Structures vary but investors will generally only participate if one or more conditions are met:
 - their government partner will provide a project underwriting guarantee;
 - the venture is insured pre-closing; since insurers want government guarantees but are wary of various governments' track records, previous defaults can become an issue here;
 - the private investor is reimbursed for project costs by local or central government, with the government then generating a return from operating revenues over time.
- The stability and credit position of governments may be an issue in providing sufficient reassurances to secure private funding. Clearly the challenge is to make a public-private endeavour an attractive proposition for both parties.



5. Africa's real estate markets are still “emerging” and international developers are mostly active only in the more institutional markets. Is there a product mismatch, and what type of product best matches with current demand?

- The adequacy of commercial and residential stock in terms of scale, quality and location is partly determined by some of the factors highlighted above: financial and funding structures, infrastructure and the role of government as funder or enabler.
- Generally across Africa, there is strong demand for, and undersupply of, housing for low-middle income groups. Cote D'Ivoire for instance is estimated to have a housing shortage of 400,000 units. At the same time some markets such as Ghana are characterised by an oversupply of luxury/high-end residential property with high vacancy levels.
- In part this is a function of traditional construction models. The cost of building in Africa is high because most materials are imported which tends to push developments up the quality curve in order to be financially viable. Alternative models are worth considering; for example, prefabricating buildings overseas before importing them could reduce construction costs; sourcing more, or alternative, materials and labour locally rather than importing would reduce the cost of construction. However, lack of skills remains a serious issue.
- The deficiency of low to middle income housing does not necessarily have to be addressed through government-funded affordable housing schemes. It could be a significant opportunity for developers. Two factors are important in developing this opportunity: the nature of the mortgage market; and the use of public-private partnerships.
- Some countries have well-developed mortgage markets that provide low-to-middle income groups with the capital to buy, but overall access to mortgage finance is low. Moreover as a consequence of the very high rates of domestic inflation in many parts of Africa, and the high cost of housing, developers and lenders often insist on hard currency funding. This presents a significant problem to potential mortgagees since, as they are mostly paid in local currency, their mortgage repayments are susceptible to fluctuations in local inflation levels and exchange rates. There have been attempts in some countries to promote local currency funding through deregulation, but with limited success. This is something which should be developed further.
- Public-private partnerships (PPPs) clearly offer the potential product to resolve the mismatch in product quality and boost the production of mid-market properties. However, the success of PPPs across Africa has been mixed. Many PPPs in Africa have involved Chinese investors which, while delivering cost savings, has sometimes produced mixed-quality products. As a result some governments, such as Botswana's, are suspicious of PPPs. The success of PPPs in Africa is also conditional on a more holistic approach being adopted regarding investment, for example, the provision of adequate infrastructure before project commencement and, more widely, better economic governance to boost the flow of such projects.
- Overall the potential exists to reconcile the delivery of quality-appropriate buildings and boost the flow of institutional and other funds into Africa markets. The mechanisms to do so need to be reactivated and focused on:
 - local currency mortgage markets, with banks bearing the costs of any associated hedging, so as not to penalise local borrowers;
 - overcoming the reluctance of some governments to embrace PPPs;
 - upfront development of adequate infrastructure to promote confidence in project delivery and encourage the flow of project funding;
 - developing a policy and funding framework conducive to meeting the growing demand for affordable housing.

SUMMARY AND CONCLUSION

Several short to medium-term challenges remain, including currency fluctuations, global political uncertainty and immature financial and planning structures. Nevertheless, opportunities exist and a period of limited short-term growth may offer investors the opportunity to formulate strategy for the period beyond.

In terms of policy direction, the attractiveness of markets to investors would be improved by:

- increasing transparency and minimising sources of friction associated with entering markets and repatriating capital;
- identifying and testing policy goals for central governments, including their participation in financial structures and risk underwriting;
- developing scope for inter-country co-operation in critical areas, notably infrastructure investment;
- mechanisms for sharing learnings and best practice from different forms of policy intervention and market reforms.

OUR VIEW ON SUB-SAHARAN AFRICAN REAL ESTATE MARKETS GET PREPARED...!



Figure 3: Strategy toward Sub-Saharan African Real Estate Markets

Source: CBRE

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