MCO REAL ESTATE
International perspective, local expertise

Lagos, Nigeria Real Estate Investment Report

Q1:2016

Is the worst now over…..?
Since coming into office in May 2015, the Federal Government has been able to sustain the naira at the official rate of N197:US$1 at a cost of the depletion of the country's external reserves which currently stand at c.US$27Bn. International investors previously betting on an unavoidable devaluation of the Naira and subsequently sitting on the fence in expectation are now re-evaluating their plans with early movers beginning to ink agreements on transactions.

Large ticket transactions in the retail, office and mixed use space where rental receipts are denominated in dollars continue to offer the best risk adjusted returns with the added benefit of a built-in hedge against potential future devaluation.

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Q1:2016 Market Summary:

- ***Land*** — *Weakening prices on the back of a growing supply overhang due to the slow-down in the economy and the lack of liquidity in the system means that buyers are able to negotiate reduced prices from motivated sellers*
- ***Residential*** — *Strong demand in the lower to mid-tier sector continues to sustain the residential market with local demand relatively less impacted by the on-going economic volatility and wider market slow-down.*
- ***Retail*** — *Consumer demand and market awareness is leading to expansion of a variety of modern retail formats beyond the primary cities of Lagos and Abuja and into secondary cities*
- ***Office*** — *A weak economy coupled with a strong supply pipeline means lower rents and longer lead times to lease up buildings particularly for new Class A developments on the Lagos Island*
- ***Logistics*** — *A dearth of modern logistics hubs suggests increased opportunities to build supply within this sector to meet growing demand from organised retail and online services growth*
- ***Hospitality*** — *Existing brands are building their pipelines while new brands are entering the market. Market fundamentals remain attractive with the expectation of a pickup in the medium term following the current slow-down*
- ***Finance*** — *The recent increase in the CBN Benchmark rate offers no respite for developers seeking to raise debt in local markets. Offshore funds continue to grow their portfolios and are the preferred choice along with joint venture arrangements for local developers seeking to build out their schemes.*

1. INTRODUCTION

We introduce our Q1 2016 Lagos Real Estate Investment Report analysing the Lagos real estate market up to the first quarter of 2016. Our report focuses on investment and development activity in the Lagos and Nigerian markets. We trust it will bring clarity to your investment decision making process as you seek to create value in the Nigerian real estate markets.

MCO Real Estate is a real estate investment and advisory firm founded in 2010. We originate and package opportunities for investors and we structure and arrange finance for developers. We provide research, feasibility studies and transaction advisory services across all property types to enable our clients make the right investment decisions.

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 or visit our website for further information on how we can assist you.

2. NIGERIA ECONOMIC OVERVIEW

According to the National Bureau of Statistics Nigeria's GDP growth collapsed to 2.11 per cent in the fourth quarter of 2015 compared to 2.84 per cent recorded in the third quarter and 5.94 per cent recorded in the fourth quarter of 2014. This is the lowest quarterly growth rate recorded over the last 10 years and is in sharp contrast to the heady growth rates of between 4 and 8 per cent recorded over the same period.

The World Bank estimates 2015 overall GDP growth at 3.3 per cent and a recovery over 2016 -2018 with growth rates estimated at 4.6, 5.3 and 5.3 per cent respectively.

As part of its economic policy, the Federal Government has chosen to take a stand on supporting the naira which has come under pressure based on a steep fall in the oil price from which Nigeria derives 95% of export earnings and 70% of government revenue.

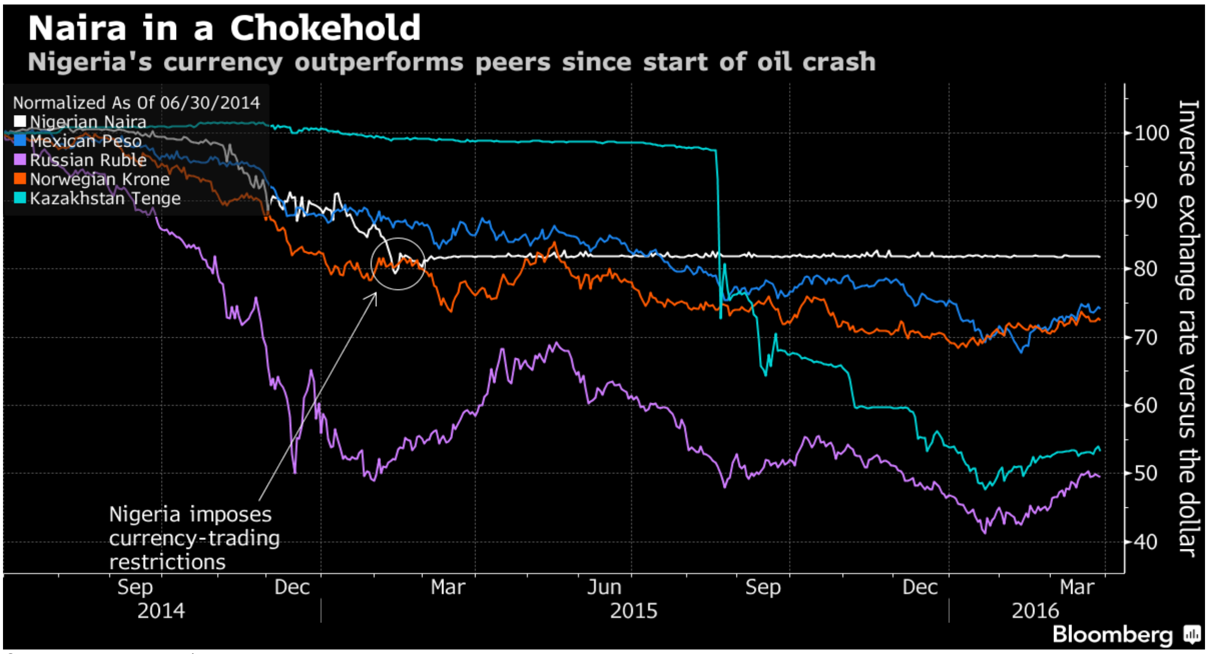
Nigerian Economic Metrices (March 2016)

1	**MPR**	12.00%
2	**USD/NGN**	197.00
3	**External Reserves**	US$27.87Bn
4	**Bony Light**	US$36
5	**Inflation (March)**	12.40%
6	**GDP Growth (Q4 2015)**	2.11%

Source: Central Bank of Nigeria, NBS

As much as the official rate stands at N197:$1 the parallel market rate has fallen to c.N320:$1, suggesting an implied 60 per cent devaluation in the currency. The cost of supporting the naira is evident in the fall in the country's reserves from a height of c.US$39Bn as at mid 2014 to c.US$27Bn in recent times mirroring a fall in the price of oil over the same period from a high of US$114 per barrel in June 2014 to US$36 per barrel in March this year.The policy decision to support the naira appears to have been successful over the short term as both external reserves and the parallel market rate have stabilized in recent times.

The Naira however remains on a watch-list of emerging market currencies expected to be devalued within a short time frame. Markets are betting Nigeria will be forced to follow oil exporters from Russia to Kazakhstan and Mexico and other emerging market economies such as Egypt, Venezuela and let the currency weaken. The graph below shows the Naira compared to a sampling of other oil dependent national currencies that have weakened since the fall in the oil price.



Courtesy Bloomberg / FT

The symptoms of a weakening macroeconomic environment are reflected in the on-going foreign exchange shortages, a slowing GDP growth rate and rising inflation. Over the short term, it is expected that there will continue to be pressure on the Naira which the Federal Government seeks to manage via a variety of fiscal policies. The falling parallel market rate at which majority of the population has to transact is likely to continue to lead to inflation of most imported consumer items and gradually bleeding into locally manufactured good that have even a small component of imported materials. The rise in inflation has already led to an increase in the Monetary Policy Rate from 11 to 12 per cent which will continue to negatively impact credit to the real sector, dampening growth and subsequently putting a damper on jobs creation over a medium term horizon.

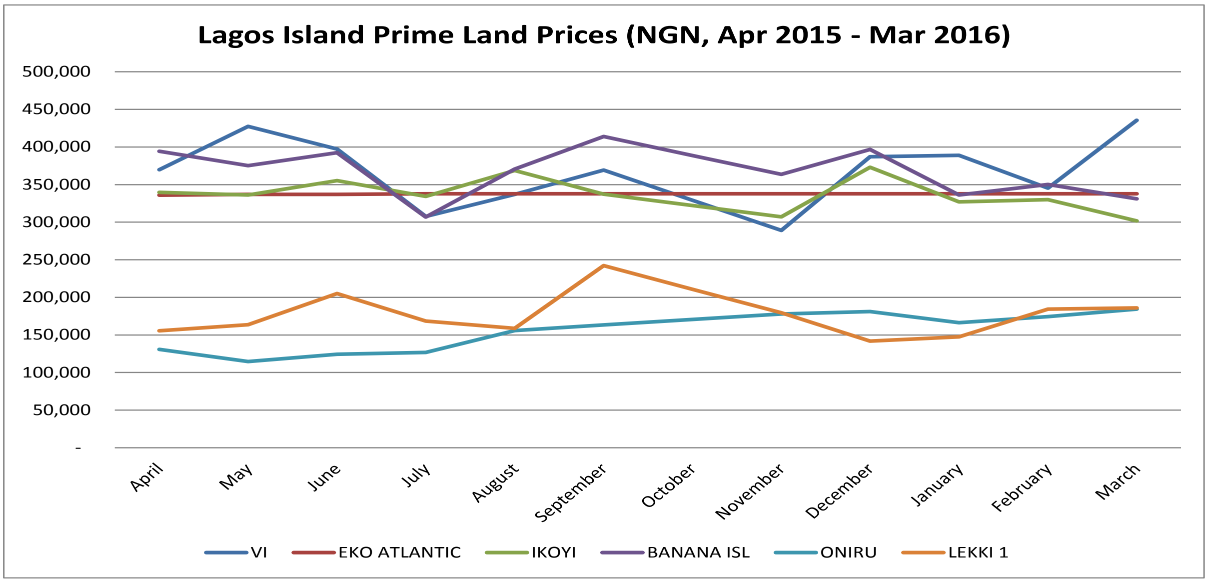
3. REAL ESTATE OVERVIEW

REAL ESTATE MARKET SUMMARY

Across Nigeria and particularly in the larger Lagos and Abuja markets, the Federal Government's fight against corruption and general fiscal tightening has plugged leakages but has also led to considerably reduced liquidity in the system. In addition to the stock market, real estate is seen as a major store of value. Funds that had traditionally poured into the real estate market before the change of government have in recent time remained hidden from view for fear of attracting unwelcome attention. Additional delays to passing the budget have led to a lack of liquidity and a considerable supply overhang of land and property at all levels of the real estate market. Prices have weakened with the falling naira leading to greater falls for dollar benchmarked assets.

International investors fearing a depreciation of the naira have been loath to invest in assets with the risk of devaluation hanging over their heads and this has led to a slow-down of big ticket transactions. However there are a few bright spots. The attraction of a large and ever expanding middle class consumer base continues to draw attention to the Nigerian real estate markets. Emerging market funds particularly from South Africa, familiar with African markets are deploying funds to acquire interests in large prime development projects that are expected to yield high returns in a market that is still very much undersupplied compared to the opportunities available.

PRIME LAND PRICE MOVEMENTS



Notes
1. Land value data is derived from advertised sales prices
2. Eko Atlantic prices are blended waterfront and non-waterfront prices denominated in US$
3. Exchange rate of 197:1 is used to convert Naira to dollar values

Overall prime Lagos Island land prices have maintained their values in Naira terms through the economic slowdown since 2015. As is the case with assets which are equally valued in dollars, the falling naira value on the parallel market suggests an implicit fall in asset values in dollar terms. This also translates to the fact that Dollar denominated assets appear increasing expensive when benchmarked against competing naira denominated assets. Banana Island land values currently stand at c.N331,000 (US$1680) psqm. Changes in Ikoyi zoning laws towards higher densities means that the character of Banana Island is gradually changing from large plots under owner occupation to multi-family apartment developments, maximising available space in order to ensure a commercial return on the expensive land. The gradual change from a quiet owner-occupier neighbourhood to a transient leasing neighbourhood will over time increase traffic, footfall and reduce the sense of peace traditionally characterised by the neighbourhood. Lekki Phase 1 land values currently stand at c.N186,000 (US$944) psqm. There is current a high volume of supply on the market suggesting low demand with the expectation that sale prices will either stagnate or fall over the mid-term. The buyer is currently at an advantage with the expectation that there are good opportunities to be had at a discount in the current market. Even though Lekki Phase 1 is a very popular residential destination and benefits from its location close to Ikoyi via the Ikoyi-Lekki Link Bridge, it is still ranked equal in value to Oniru at c.N184,000 (US$936) psqm which benefits from its immediate proximity to Victoria Island. Victoria Island remains the most expensive of Lagos Island prime land at prices of c.N435,500 (US$2,2000) psqm, while Ikoyi land values currently stand at c.N302,000 (US$1,500) psqm. Eko Atlantic which is Dollar denominated remains stable at a blended price of c.US$1,700 psqm.

THE RESIDENTIAL MARKET

According to the UN, Nigeria's population of c.183m is estimated to more than double over the coming 35 years while the migration from the rural area to cities is expected to more than triple over the same period. This huge population increase will continue to sustain housing demand over the middle to long term and is already evident in the strength of demand for housing stock in the lower to middle income segment of the market. However, over the short term, as much as demand remains very strong, affordability has been eroded on the back of an economic slowdown, rising unemployment, lower salaries and rising local costs of imported materials that make up a considerable portion of the final sales price of residential units.

Taking into account actual demand, the sweet spot for residential housing developers has long since moved from the high end segment of the market where properties are valued above N60m (US$300,000) to the lower to middle market segment where properties are valued from N12m – N50m (US$50,000 – US$250,000). The issue of affordability means that flats and terraced houses are in greatest demand however the canny developer is always seeking to get the right balance between cost of land, localised demand for different housing types, quality of finish, profit and speed of sale and it is the successful developer that is able to strike the right balance between these to deliver an optimum return.

THE COMMERCIAL OFFICE MARKET

Ikoyi and Victoria Island are the most active markets for Institutional Class A supply in Lagos. New developments currently leasing or due to be delivered through 2016 and into 2017 include The Wings Towers (27,500 sqm), Nestoil Tower (7,500 sqm), Madina Tower (8,300 sqm) and Civic Centre Towers (8,096 sqm) in Victoria Island and Heritage Place (15,631 sqm), Alliance Place (6,670 sqm), Kingsway Tower (12,000 sqm), Temple Tower (14,000 sqm), BAT's Rising Sun (10,000 sqm) and Lake Point Towers (13,400 sqm) in Ikoyi. Within the currently challenged economic environment, the current strong supply pipeline is not mirrored by equivalent demand and this is reflected in a fall in leasing rates over the past year and a half from prime rents of US$1,000-US$1,200 to prime rents of US$800-US$1,000 suggesting a rental fall of c.20%.

The over-supply mirrored in falling rents is likely to put a damper on further commercial development over the short term. This is not least because of the challenges of raising finance in a market where pre-leases are hard to come by. It is notoriously difficult to predict real estate cycles for projects as by their very nature they take 3 – 5 years to develop. Our feasibility studies seek to analyse demand and supply for development projects based on the amount of time required to build-out a new development and current and future development pipelines and this helps us to mitigate risks on behalf of our clients seeking to develop new projects. However, in order to reduce risks in the current market, it is essential that sponsors move away from building speculatively to developing based on pre-leases wherever possible.

THE RETAIL MARKET

Based on the back of sustained economic growth and growing consumer demand, modern retail formats are changing and expanding from large Lagos based developments such as The Palms (19,520 sqm), Festival Mall (10,900 sqm) and Ikeja City Mall (22,000 sqm) to Abuja (Jabi Lake Mall 26,478 sqm, World Trade Center Capital Mall 21,500 and Maitama Mall 23,855 sqm) and further afield to other secondary cities such as Onitsha Mall (12,100 sqm) and Owerri Mall (12,500 sqm).

Formats are also changing to better adapt to the challenges prevalent in the Nigerian markets. A number of Malls in the pipeline are now part of larger mixed use schemes (Festival Mall, Capital Mall and Maitama Mall) while secondary city malls and some of the new Lagos based malls such as Maryland Mall.(7,000 sqm) are smaller in order to meet the reduced demand of a smaller catchment area. Ikeja City Mall has recently been sold by Actis, RMB Westport and Paragon to Hyprop and Attacq, two South African funds, in a deal reportedly worth c.US$91 million. The successful sale of the asset will also attract additional investors to the Nigerian retail segment of the market having seen the potential for a successful exit from their investment.

LOGISTICS / WAREHOUSING

The burgeoning growth in modern retail outlets and online retail has led to increased demand for modern warehousing and logistics hubs. This has been born out in the recent announcement by Geoffrey White, CEO for Africa at Kuwait-based Agility Public Warehousing Co K.S.C., the largest logistics company in the Middle East of their intention to build warehouse and logistics parks in Lagos and Abuja. Nigerian has achieved the highest increase on Agility's Logistics Index of 45 emerging markets countries by rising 10 points to No.17 based on attractiveness of market size and growth and improvements in compatibility and connectedness.

REAL ESTATE FINANCING

The year-on-year change in inflation for the 12 month period to March 2016 stood at 12.4 per cent with inflation accelerating from 11.4% recorded in February and 9.62 per cent recorded in January. The inflationary figure is now well out of the 6-9% target range set by the government. The rise in inflation has led to an increase in the Monetary Policy Rate (MPR), the rate at which the Central Bank lends to commercial banks and other clients from 11 to 12%. This is a signal to lending banks to increase lending rates and it means that debt capital will become even more expensive for real estate developers with lending rates currently standing at 25 to 30 per cent.

Conversely, international investors continue to seek institutional real estate assets to develop or purchase with a current focus on commercial office, retail and logistics space. South African funds remain the most ambitious with a preference for retail and office developments. Development is undertaken with a local Joint Venture partner in order to reduce risk while acquisitions are preferred on fully let income producing properties occupied by blue chip clients. Local pools of institutional capital continue to remain absent from investment in the real estate market preferring to invest in either the stock market or sovereign bonds.

4. ABOUT US

MCO Real Estate ('MCORE') is a real estate investment and advisory firm founded in 2010 with a focus on investment and structured finance towards the delivery of large scale real estate investment opportunities. We structure and arrange finance for developers and investors, we originate and package investment opportunities on behalf of local and international clients and we provide research and transaction advisory services across all property types to enable our clients make the right investment decisions.

Our clients include development companies, local and international investment companies, oil and gas companies, engineering and consulting firms, high net worth individuals, family offices and private corporations. We are members of the Association of Investment Advisors and Portfolio Managers (Nig) and also members of the UK Society of Investment Professionals. We believe that by partnering with MCORE, we will afford you a level of expertise and experience that will avail you a much greater probability of achieving success. Call us now to discuss how we can enhance value in your world.

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