IREP
International Real Estate Partners

LAGOS, 2018 Q2 REPORT

COMMERCIAL MARKET OUTLOOK

ECONOMIC BACKDROP

Recap on Q1 2018

2018 began with a set of optimistic projections for economic growth however, slightly contradictory to this, there was actually a delay in the rebound of the economy in Q1 2018.

According to the National Bureau of Statistics (NBS), having readjusted oil production estimates for Q3 and Q4 2017, and with it the oil gross domestic product (GDP), Nigeria's GDP growth dropped to 1.95% y-o-y in real terms in Q1 2018, from the revised 2.11% growth in Q4 2017. This slowdown has been attributed to the weak performance of the non-oil sector (driven mainly by agriculture) in Q1 2018, perhaps as a result of the fuel shortages and castle rustling, as well as the herdsmen/farmers crisis that has plagued the Middle-Belt part of the country.

According to the NBS, the oil sector witnessed a boost as real GDP growth was at 14.77% y-o-y and 13.24% q-o-q in Q1 2018. The sector contributed 9.61% to total real GDP Q1 2018, up from 8.53% and 7.35% recorded in Q1 2017 and Q4 2017 respectively.

Real GDP growth in the real estate sector, on the other hand, contracted by 3.48% to -9.40% in Q1 2018, making it the highest dip in 2 years and its fourth consecutive decline. Its contribution to total real GDP also dropped to 5.63% in Q1 2018, lower than the 6.43% and 7.03% contributions recorded in Q1 2017 and Q4 2017 respectively.

Q2 2018

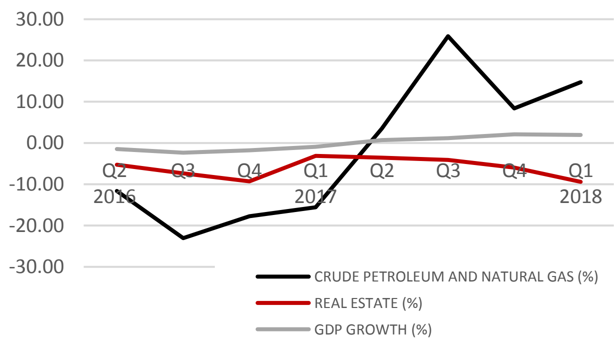
As hoped for in Q1 2018, the Nigerian economy seemed to regain some lost momentum in Q2 2018. The purchasing manager's index (PMI) hit a new record high in May, oil prices remained firm in April and May, and inflation dropped steadily to its lowest rate since Q1 2016, 11.23% in June. It is interesting to note that whilst some economists, including the IMF predict a double digit inflation rate till year end, (possibly due to pre-election spending), the Central Bank of Nigeria (CBN) is expecting inflation to dip to a single digit as historic evidence has shown that inflation usually declines in the year preceding an election. In addition to this, the CBN has maintained the exchange rate peg of NGN 305 / USD at the CBN window, the business environment has been fairly stable and the economy appears to be gaining steam. Nigeria moved up 24 places in the Ease of Doing Business Index to 145, (from a previous ranking of 169 out of 190), and has been predicted amongst the 10 most improved countries for 2018.

2.11%
Q4 2017 GDP Growth *(revised)*

1.95%
Q1 2018 GDP Growth

Source: Nigerian Bureau of Statistics

However, whilst investments seem set to benefit from this improving business climate, the delayed implementation of the 2018 budget, has stalled major investments and projects for the year. To add to these woes, in the real estate sector, the World Bank has ranked Lagos, the commercial capital of Nigeria, 36th and 31st out of 36, (when compared to the other cities in Nigeria including Abuja), for dealing with construction permits and registering a property respectively. It is clear that something urgently needs to change if the real estate sector is to see a rise in real estate growth rates and / or reach the contribution to GDP levels seen in other emerging economies.



Despite diversification attempts across various market segments, the oil and gas industry remained the major driver of the Nigerian economy, and the international crude oil price, plus Nigeria's production capacity, currently $77 per barrel and 2 million barrels in Q1 2018 respectively, (NBS), will continue to dictate the economy and will therefore remain key economic indicators to watch out for. It is worth noting that the banking industry has begun to intensify its lending across other sectors of the economy and it is hoped that this strategy will eventually help act as a cushion against any future shocks by one volatile commodity.

Global moves and the rest of 2018

We consider that in addition to previously mentioned drivers like power and security, the three key economic drivers to watch out for in Q3 and Q4 2018 will be global oil prices, Nigeria's forthcoming elections and its economic policies.

In April 2018, Presidents Buhari and Trump met to discuss the level of trade between Nigeria and the US. Whilst this appeared to have improved investor's confidence at the time, current fallout from the US / Russia Helsinki summit, coupled with recent government upheaval may serve to curb this confidence. We consider that ahead of the 2019 elections, pre-election uncertainties will threaten fragile foreign investor confidence as this may drive uncertainty around government policies. We also consider that the disarray within the agricultural sector due to the aforementioned herdsmen / farmers' crisis may lead to food shortages and sector inflation.

That said, we are hopeful that the efforts of the government directed toward the sector via cheap credit financing, will pay off and set the sector back on track. In addition, in the recently released World Economic Outlook, the International Monetary Fund (IMF) stated that the economy of Sub-Saharan Africa would expand by about 3.8% in 2019, (as compared to its April 2018 forecast of 3.7%). They also reflected *"improved prospects for Nigeria's economy,"* forecasting a growth rate of between 2.0 % and 2.5% in 2018.

REAL ESTATE MARKETS

OFFICE

Rate consolidation

2018 continues to be difficult as the real estate industry, unlike other sectors, remains in recession due primarily to its reliance on capital expenditure and the current non-liquidity in the market. Whilst there has been a marginal increase in transaction rates in the Lagos office market as the demand for prime office space slowly picks up and a lot of enquiries are being received for vacant spaces, (thus providing some welcome relief to a sector that has struggled with high vacancy rates and an oversupply of office spaces in the last four years), many transactions still fail to conclude, primarily due to high initial costs.

That said, Q2 2018 recorded a couple of new entrants into the market and there were some notable business relocations by some multi-nationals to prime office spaces in Ikoyi and Victoria Island, (some top indigenous companies also moved to their newly constructed office buildings). These, plus noted reduction in energy costs experienced by tenants in the LEED certified Heritage Place and increased interest in co-working space will no doubt be welcome news to a beleaguered sector.

Asking rents for annual prime office spaces in Ikoyi and Victoria Island have largely remained stable at $700 and $600 respectively. However, as we continue to hear of rental concessions still being given, note various building projects such as Desiderata, Kingsway Towers, Madina, Cornerstone and Grey Stone Towers, nearing completion, and have noted the refurbishment of a couple of Grade B buildings, (the iconic IMB Plaza to name just one), it is expected that the office sector will receive over 50,000m^2 of new office space in 2018 alone, further adding downward pressure to asking rental prices in the prime sub-markets of Ikoyi and Victoria Island.

RETAIL

Stability in the larger malls

The wider retail industry is seen to be on the rebound and vacancy rates in many malls improving from lows of 30-60% to 60-80%. Asking rentals for the big malls, (still largely US$ denominated), have remained stable through Q2 2018 as many tenants have adjusted to the current state of the economy and are keeping up better with payments, probably due to rental discounts and concessions granted by landlords such as fixed exchange rates for US$ denominated rents.

The push for smaller centres

The increase in smaller new entrants in Q2 2018 especially along the Lekki corridor has helped to boost the retail industry, with a lot of retailers expanding to take up spaces in newly built and well located, smaller neighbourhood retail centres. Another (somewhat disturbing), trend we noted is the conversion of residential buildings on major streets to small shopping centres catering largely to small retailers serving to completely change the look and feel of hitherto residential neighbourhoods; places like Surulere and Ikeja come to mind.

In the short to medium term, we expect that the larger malls will continue to strive to differentiate themselves from their smaller neighbours by seeking to create a more memorable shopping/entertainment experience for customers.

SHORT-LET APARTMENTS

Optimism within the short-let apartment segment

A recently conducted piece of research into an emerging player in the commercial real estate space indicates that the need for short-let apartments has maintained an upward trend in spite of the challenging economic environment. This increased demand has spurred savvy business operators to accelerate their expansion plans in 2018 by seeking out strategically located residential buildings or vacant apartments in prime areas to be converted into short-let apartments to meet the flexible needs of people who require such accommodation. One factor that has led to the increases in this sector is the upsurge in demand by corporates who would rather pay for short-let apartments for their expatriate staff as opposed to paying annual apartment rentals.

The rental range for short-let apartments is wide and depends on the quality, branding, unit size and location of the offer. Rents can go as low as NGN 25,000.00 for a studio apartment to as high as NGN 140,000.00 per day for a 3-Bed apartment.

The commercial outlook for short-let apartments remains attractive in light of positive market fundamentals, expansion possibilities and strong levels of profitability. We believe this market presents unlimited opportunities and is a sector likely to spur increased investor interest.

INDUSTRIAL

Market continues unchanged

Our view on this market has largely not changed from our Q1 2018 report and we continue to anticipate general stagnation with some emerging growth in this market in the short term.

As rentals have remained largely stable and as the retail market continues to see upward growth, (and as the demographics in Nigeria continues to also see upward growth), we anticipate that the industrial real estate market will continue to afford opportunities for growth for investors.

For further information, please contact

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