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SPECIAL REPORT: MIDDLE EAST & EAST AFRICA

Harness the potential

AFRICA Steady economic growth is generating bright investment prospects in the south of Africa, but a key challenge is developing functioning capital markets, say **Karl-Werner Schulte** and **Steen Rothenberger**

For many, the mere mention of Africa will bring to mind negative headlines of civil strife, hunger and autocratic governments. Arguably, investors are given to a certain Afro-pessimism. As with other investment classes, Africa's real estate sector remains a blank spot on the investment map of international players but this is less than plausible, for while investments in Africa admittedly harbour great risks, they offer opportunities just as big.

Africa is obviously not a homogenous market and investors should not mistake one part of the picture as representing the whole. There is a wide gap between the situations across Africa. At one end of the scale you will find the economically advanced Republic of South Africa, and at the other end countries such as Sierra Leone or Somalia, the continent's poorhouses. Similarly, the differences in political stability between the African countries are vast. In a World Bank ranking, Mozambique, Zambia, Ghana, and South Africa scored place one through four, making them as politically safe as, say, mainland China. Bringing up the rear were Nigeria, Ivory Coast, the Democratic Republic of Congo and Sudan.

The reticence of investors is to some extent explained by the extremely low level of transparency characterising the African real estate markets. On the global transparency index of Jones Lang LaSalle, only South Africa ranked in the upper segment, placing 23rd. Next in line are Morocco and Egypt in places 60 and 62, thus outranked by countries such as China, Argentina, India, and Indonesia. Syria, Sudan and Algeria are at the bottom of the list, in places 79 to 81. More often than not, there is a scarcity of continuously updated and verifiable real estate market data. If nothing else, the Investment Property Database (IPD) has been active in South Africa since 1996. It analyses real estate returns, compiles market indices, and conducts real estate market research. IPD has signalled that it will expand its activities to encompass countries such as Kenya, Tanzania, Uganda, and Nigeria. It would certainly take market transparency in these countries a big step forward.

A well-established South Africa

Unsurprisingly, investors will find by far the most advanced real estate market on the continent in South Africa. Demand on the office markets tends to focus on decentralised locations, away from the crowded inner cities. As a case in point, rent rates in the South African financial hub of Sandton north of Johannesburg are substantially higher than those in the traditional business district. According to a market report by Knight Frank, top rents in Johannesburg equal US\$20 (€15)/m² per month, compared with US\$17.50/m² in Cape Town.

The market for retail real estate extends from small-scale retail formats to sprawling shopping centres. Retail sales were rather slow to grow last year; rents are expected to soften and vacancies to rise. While top rents in retail in Johannesburg average US$35/m² per month, they run as high as US$45/m² in Cape Town.

The South African market for industrial real estate has experienced a massive boom in recent years. Rent rates have surged in tandem with a skyrocketing demand largely fuelled by the limited supply in adequate available floor space. IPD data suggest that industrial real estate realised the highest returns in the past few years. In 2008, for instance, total returns equalled 18.1% (not adjusted for the 2008 inflation rate of 11.3%). Current rent rates in Johannesburg are US$5.50/m² per month and US$5/m² in Cape Town, according to Knight Frank.

Aside from South Africa, real estate markets in North Africa are quite advanced – Egypt, Morocco and Algeria, for example. In terms of transparency, they outrank most sub-Saharan countries, or so the Jones Lang LaSalle transparency index suggests.

Potential in the South

That said, the African real estate market is not limited to the Maghreb states and the continent's southern tip. Markets in sub-Saharan countries (ex South Africa) are less familiar than the countries mentioned above, yet they harbour an enormous potential. The steady economic growth of the region is creating demand for prime floor space by domestic and international companies, for office, retail, industrial, residential and recreational use. The trend has fostered the growth of business districts outside the traditional CBD over the past years.

The increase in purchasing power has vitalised the market for shopping centres. Demand is increasingly draining from traditional retailers and street vendors. A fast-growing African middle class and foreign businessmen are driving up condominium prices and rent rates. Recreational real estate, too, continues to be a worthwhile investment. This segment is driven above all by the burgeoning tourist industry that benefits more than others from the improved political stability in sub-Saharan Africa. Popular tourist destinations include national parks, coastal regions, cities such as Mombasa or Africa's highest mountain, Kilimanjaro.

Despite the sometimes high rent levels, international investors have been extremely cautious with their commitments in equatorial Africa. While the real estate markets of other emerging countries in Asia, Latin America and Eastern Europe have increasingly benefited from the globalisation of capital markets, the trend has virtually bypassed Africa.

Nascent investor interest

Yet the first signs are emerging that foreign investors are increasingly prepared to play a bigger role in the African market. Rutley Capital Partners, a private equity member company of Knight Frank, has launched – together with the Insurance Company of East Africa (ICEA) – the Rutley Capital East African Property Fund with a volume of US$350m. The new fund will be listed on the London Stock Exchange and a few selected stock exchanges in Africa. Capitalworks Investment Partners is also launching a fund to invest in Mozambique, Zambia, Ghana, Nigeria, and Mauritius. This fund has an equity share of US$500m, and a borrowed capital share of equal size. Middle Eastern investors invest mostly in recreational real estate.

Investors in Africa frequently benefit from the conspicuous discrepancy between supply and demand on the real estate markets. In most investment and letting markets, soaring demand tends to be matched by a dramatic bottleneck in available floor space. According to a survey by Cushman & Wakefield, the supply in prime space is insufficient in all seven of the analysed markets, these being Nigeria, Tanzania, Uganda, Zambia, Ghana, Angola, and Kenya. Indeed, Tanzania, Ghana, and Angola reportedly offer no prime space at all. The booming demand generated by international companies has, however, led to drastic price hikes.

High rents in Angola

An obvious case in point is Angola's capital Luanda. As figures released by Knight Frank show, tenants pay top rents of US$140/m² per month for office space. The going rate for retail is US$100/m². This puts top rents on a level with or above most European real estate markets. Rental growth in Luanda is driven by international firms relocating to the city because of the booming petroleum industry. While Angola may be an extreme case, rent levels are very high in the other sub-Saharan countries, too. For instance, monthly top rents for offices in Kinshasa in the Democratic Republic of Congo average US$75/m². In the Nigerian city of Lagos they run as high as US$65/m². At the bottom of the list is Lusaka in Zambia with just US$18/m².

The high rent rates reflect the lack of maturity of African real estate markets south of the Sahara. In fact, a lack of transparency is a grave issue specifically in these African countries, and it will have to be solved to entice international institutional investors to take an interest in these markets. For this reason, IRE|BS has set up both the IRE|BS Foundation for African Real Estate and the African Real Estate Center in order to contribute to more transparency through pinpoint research. Another set goal is to raise positive awareness of Africa as an investment location among investors, and to free the image of the African continent from negative stereotypes such as civil wars and famines by highlighting its bright prospects.

Once these clichés have been overcome, one of the chief tasks of decision-makers on the ground will be to establish functioning capital markets that encourage the placement of indirect real estate investments along with the development of viable exit strategies.

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