



# REAL ESTATE INVESTMENT IN AFRICA

The Struggle Between Perception and Reality



# OVERVIEW

In May 2000 the Economist magazine referred to Africa as “the hopeless continent”, beset as it was in many countries by inadequate physical and business infrastructure, economic over-dependence on energy and natural resources, low educational attainment and poor governance.

For at least some of the period since then, real estate markets have seen marked improvements, with growing interest from a range of investor types, including Sovereign Wealth Funds, hedge funds, developers and HNWIs. These investors have been active across all sectors, motivated by improvements in product quality, high yields, improving transparency, rising incomes, better investor protection legislation and greater ease of doing business.

Concerns remain though: economic growth in a number of African countries has slowed from the levels seen over the past ten years; falling oil and commodity prices in recent months have had adverse impacts; and high levels of direct development, coupled with weaker occupational demand, have created conditions of over-supply in some markets. Despite this, even the larger markets are smaller than emerging eastern European markets were when they began attracting meaningful amounts of real estate capital. A more general emerging market slowdown and the rising debt burden from externally-funded infrastructure programmes add to the uncertainty.

From a property investment perspective, therefore, there are both positives and negatives. 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, including the repatriation of funds, title and valuation issues, infrastructure, investment vehicles and emerging opportunities, illustrated with detailed reference to specific markets. It also summarises the topic discussions held at the seminar.

# FOCUS TOPIC I

## INVESTMENT PROSPECTS IN AFRICA

African real estate has become an increasing part of investment portfolios over the past 20 years, which prompts the question as to prospects for the next 5-10 years. Is it a good time to invest? Will viable investment structures such as REITs be introduced more widely? And what other factors will act as catalysts or barriers?

While acknowledging market volatility, there was some consensus that there are attractive opportunities for acquisition in African real estate. Favourable economic and demographic characteristics in certain countries and the trend towards urbanisation, underpin good long-term fundamentals, but there is a clear need for selectivity and rigorous due diligence.

Examples include Nigeria, where there is a high level of income-producing stock particularly in the retail sector and more set to come to the market in 2016 and beyond. At present most investors are domestic, but there is growing interest from the rest of the world.

In South Africa there are good-quality assets in a highly liquid market. Again, domestic investors are prepared to invest, international investors less so because of the currency risk.

In parts of East Africa, similar challenges exist alongside a relatively immature commodity market. Ethiopia may offer opportunity, although high construction levels mean that there is possible supply risk at present.

### The investor base

Much of the current investment is undertaken by private equity funds. Due to legislative restrictions, risks around money laundering and the inward looking nature of African markets, several other investor types are deterred and largely absent. Overseas pension funds, for instance, initially held back because of legislative restrictions and only sought exposure to certain African markets once these were lifted.

### Politics and infrastructure

Political stability and quality of governance is key to investment and if the politics and regulatory frameworks are stable, investment will rise. Some countries lack stability, but are simply too big to ignore and so see high levels of investment anyway, Nigeria, Kenya and Ghana among them. Even then, investors recognise the political risk and expect to be rewarded for it.

Chinese investment in infrastructure projects appears to be diminishing across Africa, or at least growing less rapidly. Moreover some infrastructure plans, however funded, frequently fail to materialise. For example, building corridors cross-continent would open up multiple countries for investment, but the level of cross-national co-ordination involved is a frequent stumbling block.



### Why are others not investing?

One challenge is the difficulty in attaining target returns, partly because of the fact that there is excess supply in many places, such as Lagos and Nairobi. Conversely, in some other countries there is a lack of investment stock and limited commitment to build more. Sales are therefore dominated by the same, established, domestic players. Other opportunities for mobile capital, such as India and Russia, also divert some capital elsewhere.

### Financial structures including REITS

Increasing investment also depends on changes to financial structures and specifically increased coverage of REITs. REITs have transparency advantages but the size of the potential market is questionable. Some US REITs are seeking exposure in the expectation of 14-20% returns, and the question is whether this is achievable in Africa. In Nigeria, for instance, REITs are not properly regulated and there is only one listed REIT. UPDC (UACN Property Development Company) – funded by UACN (United Africa Company of Nigeria PLC) – is the single largest property company and investor in REITs in Nigeria. There are numerous pension funds in Nigeria, but current legislation means they cannot invest in real estate directly. They can, however, access property via bonds and other debt structures. It is recognised that development of the REIT sector has the potential to address this barrier, although further legislative work is needed.

In summary, certain aspects need to be addressed in order to generate higher levels of investment:

- Political stability
- Investment in infrastructure
- Expansion in the coverage of available investment structures
- Banking and the availability of bank debt
- Judicial systems



## FOCUS TOPIC 2

# WHICH COUNTRIES IN AFRICA ARE ATTRACTIVE FOR INVESTORS?

Relative size and maturity of markets dictates that of the 54 African countries few are regarded as viable destinations for inward investment capital. Typically these comprise Nigeria, Ghana, Kenya and South Africa – but are there others that should be considered and, more broadly, are there steps that other countries could take to enhance their attractiveness to property investors?

Among the markets highlighted in the discussion were Ethiopia, Zimbabwe, Côte d'Ivoire, Senegal, Mauritius, Uganda, Zambia and Tanzania. The underlying reasons include large and growing populations, strongly positive GDP growth, shrinking dependence on commodities, an improving political and social context (in some cases), and greater stability in currency exchange and inflation rates. Côte d'Ivoire was cited as a market expected to see strong economic growth (7-8%) which, combined with restricted supply of office, retail and hotel space, could tempt investors.

There was a strong preference for Ethiopia: it has high-quality transport infrastructure and is committed to a process of democratisation, partly in the hope of attracting long-term investment. Limits on non-domestic retailers constrain the scope for retail developments, so the main growth opportunities may lie in the hotel and leisure sectors. There are also no regulatory restrictions on repatriating capital but the banking sector remains under-developed.

At a more general level, the steps necessary to raise the attractiveness of markets for investment include:

- Improved information availability and due diligence including legal frameworks and legal registration of property
- Transparency in valuation
- Easier capital repatriation
- Development of local mortgage markets
- Moves towards democratisation
- Improve tourism and access to visas

There are examples of some of these steps having been taken in some countries. For instance, in Kenya land rights were enshrined in the 2010 constitution and the unified land acts of 2012; investment vehicles such as REITs and limited liability companies have been established; limits on the repatriation of capital have been raised; and judicial and dispute resolution mechanisms set up. Nevertheless, progress is gradual and barriers remain.

We look further at two specific areas: valuation and capital repatriation.



# FOCUS TOPIC 3

## PROPERTY VALUATIONS IN AFRICA

Valuing property assets in fast-growing but immature markets, often with unusual assets and limited institutional infrastructure, presents particular challenges. Do, or can, valuations in such markets carry the same degree of precision as in more mature markets? Are the additional risks – such as unusual assets, unknown covenants, high levels of volatility – adequately reflected in values? Some examples of the characteristics of certain markets illustrate these points.

### Price acceleration

The combination of rapid economic growth, dependence on external events and variable stock quality can produce very rapid appreciation and price spikes in the value of the thin tier of very high-quality assets. In Luanda, Angola for instance prices have been consistently rising for a number of years and, only recently, have started to show signs of normalising. As a result they can seem unreasonably high to outsiders. In part this reflects differences in the origin of investment capital and development method: schemes built quickly by overseas investors meet the timescales demanded by investors but development quality often suffers. On the other hand, links with Portugal means that there are several developments commanding a higher price as they are built using European techniques. Local experience is recognised as the key to understanding the true value of property and the value segmentation of individual markets.

### Currency fluctuations

Leases in Africa are often denominated in US Dollars. Many emerging markets, especially commodity-driven markets, have weak currencies. Dollar and euro markets fluctuate over time whilst the Naira (Nigeria), for instance, has weekly spikes with no appreciation against the dollar and the black market rate is a fair reflection of real value. To encourage inward investment, and in particular avoid currency issues, a uniform currency benchmark is needed.

Currency fluctuations are also a challenge with property valuations in Zambia and Malawi. Since July 2015, development land has tripled in value, due solely to exchange rate fluctuations. Large portions of the stock of land are held by the State or by local rulers, which can cause irregular price movements. However, laws have been introduced which seek to address this problem and create powers to acquire and sell off development land.

### Comparables

One challenge is a shortage of genuine comparables. Some investors choose to develop their own assets directly in order to avoid some of the more arbitrary elements involved in the valuation process. Another option is to buy off plan, often at discounted rates, but this route comes with risks around building delivery, specification and timing.

### Development & supply risk

Uncertainties occur in the development process that are not normally encountered in more mature markets. For example, there may be issues in establishing necessary access roads and services for a property, and ensuring that all permits have been legitimately acquired for the development. One reason why the price of quality real estate in Luanda is comparable with premium destinations in western markets is a lack of high-quality developments.

Equally, supply patterns can surprise in the other direction. Until recently, it was widely expected that the number of new shopping centres in Zambia and Malawi would plateau but it has continued to rise.

Large-scale, sometimes publicly-sponsored, development schemes are not uncommon. The South African model of building brand new towns, including all the various elements of infrastructure, is spreading as a result of growth in the middle class.

## Occupier preferences and constraints

From an occupier's perspective, markets are not always fully transparent, and in particular due diligence on landlords can prove difficult. US companies, for example, have restrictions on who they can contract with, and the lack of transparency about the identity of their landlord can cause issues.

In a number of markets such as Rwanda and Kenya prices are not generally considered excessive. "Grade A" properties are scarce and so command high prices, but there is very little local demand for such high-quality property. In general local companies are looking for an "acceptable building" but are not interested in anything that comes at a premium price. As a result, non-domestic architects or developers who build flagship buildings risk being left with empty or partially-let property.

The market in many countries is landlord-friendly and it is not unusual for leases to sometimes require tenants to pay up to three years rent in advance e.g. Nigeria. Legal protection for tenants is gradually being introduced, which is going some way to address this.

## Summary

Property valuation in African countries is contingent on a wide range of variables. Difficulties in establishing clean title and the limited breadth and depth of the investor base, along with currency exchange challenges, are identified as the main factors.

While it might be argued that this uncertainty is reflected in higher yields, it also means that rigorous due diligence is required, with particularly stringent strategic planning needed for development projects.



# FOCUS TOPIC 4

## REPATRIATING CAPITAL

As noted above, liquidity and transparency are key issues for prospective investors. In addition, concerns about the availability and structure of investment vehicles; methods of getting capital into and out of markets; and related issues of currency volatility and cross-currency debt-raising are all considered to be significant challenges. What are the issues involved here and what examples exist of successful strategies for investors to get into and out of Africa ?

### Institutional arrangements

Repatriation of capital is possible from a number of African countries, subject to the understanding of and adherence to national and/or local regulations. In Nigeria, for instance, there is a regime for inward foreign investment which involves obtaining a certificate of capital importation when capital is brought into the country. This certificate guarantees that all capital, interest and dividends can be repatriated.

In Mozambique, capital must be registered with the central bank and authorised by the centre for investment promotion. Double taxation agreements (notably with Netherlands) facilitate the repatriation of capital, as they also do in Zambia. This can be achieved by a structure with a Mozambican holding vehicle and a foreign ultimate holding company, which provides the choice of transacting in the shares of the Mozambican holding vehicle or the holding company. This structure is also used in other African countries, such as Nigeria, where if a Dutch BV is used, withholding tax can be reduced from 10% to 7.5%.

Another tax loophole is available for long-term loans (loans for a term of 7 years or more with a 2 year moratorium). Interest on these loans is tax free and so a shareholder loan to the Mozambican holding vehicle can be used. However, the central bank is very restrictive about the interest rate that can be charged on these loans.





In general it is possible to repatriate funds subject to these types of stipulation, however a local presence in the country is required. In other words, the barrier may be as much perceptual as real. For example, Abraaj Advisers UK Limited has assisted investors in the last two decades: £2.8 billion has been invested and £3.2 billion has been repatriated, across all industries. Moreover for some jurisdictions it may be no easier to get money out of other markets such as China and India. The greater risk with regards to repatriation is the risk of currency devaluation.

### Exchange rate risk: local revenue vs non-local liabilities

Given the volatility of some local currencies – and the effect on profits of repatriating revenues at increasingly unfavourable exchange rates – this registers as a significant concern. Again, close attention to local arrangements and a degree of strategic flexibility are needed.

In Nigeria, for instance, the central bank has introduced restrictions on foreign exchange in an attempt to increase the use of local currency. There is an arbitrage between the central bank rates and other sources of foreign exchange, which can amount to a 20% difference. Prior to this, there were no restrictions on rents paid and provided there is a domiciliary account in USD, USD can be used. The law states that a landlord cannot reject payment in the local currency and so rent can be stated in USD but payable in any currency, including USD. Failure to understand this position has in some cases led to an insistence on quoting rents in USD, but payable in the local currency. Any significant exchange rate movements between the two can produce major short-term distortions in the rents payable.

There are regulatory and foreign exchange restrictions in place in some countries such as Ghana. The central bank had prohibited transacting in USD but this has now been lifted. The central bank does, however, make it very difficult to transact in USD through the imposition of transaction fees. Local practice is for dollar-based transactions but payable in the local currency. Prohibitions in dealing in USD do not apply to certain industries, including hospitality, hospitals, mining, oil and gas exporters – these industries can transact in USD.

### Summary

- Foreign exchange issues can be more challenging than the repatriation of funds. However, foreign exchange issues should be viewed in context and a longer-term scenario-based view deployed that protects against short-term currency fluctuations.
- Some asset classes provide a better hedge against foreign exchange volatility. For example, in **Zambia**, the hotel/hospitality asset class provides a good hedge because charges are in USD but the costs are in the local currency.
- Abstracting across local circumstances, general advice would be:
  - Plan ahead
  - Follow regulations when importing capital
  - Be creative and develop flexible options for repatriation
  - Take a longer term view in assessing the impact of foreign exchange issues

# CONCLUSIONS

- Real estate markets in parts of Africa have undergone considerable improvement in recent years, with growing economies, favourable demographics and increasing political stability attracting a range of investor types.
- The quality of stock is improving, driven principally by international occupiers whose requirements and corporate governance are dictating that building design, materials and environmental considerations all comply with their global standards.
- Variability in market conditions, including supply, and in the prevalence of well-established financial and legal systems mean that rigorous due diligence is essential. The availability of viable and robust investment structures is a further consideration for prospective investors. Local experience and representation are vital in most markets.
- Overreliance on natural resources, reluctance to diversify and the consequent volatility of local markets and currencies is having a detrimental short-term effect on the credibility and attractiveness of several oil dependent markets.
- Size and maturity dictate the markets that offer most opportunity for investors, but there are other countries such as Ethiopia, Uganda, Tanzania and Côte D'Ivoire that are becoming more attractive investment destinations. The steps needed to accelerate this process include greater legal and market transparency, as well as improved valuation and easier capital repatriation.
- Real Estate valuation in Africa often confronts a range of unusual factors, including a shortage of comparables, rapid supply changes, currency volatility and price spikes at the upper end of the market. Process rigour to establish clean title is particularly vital.
- Capital repatriation and foreign exchange present challenges to investors, with regulatory restrictions in place in some countries. Advance planning and adherence to national and local regulations are essential. Above all investors will need to devise flexible long-term strategies for capital repatriation well ahead of deployment.



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