The Nigerian Economy is gradually emerging from recession into a period of fragile economic growth. Oil price and production increases since the beginning of the year have led to increasing revenues, a gradual accrual of foreign reserves, a stronger Naira and increased foreign exchange liquidity. However, the fragile economic recovery is heavily dependent on the continued strength of oil. Our latest report highlights the constraints in the real estate industry created by reduced oil revenues and makes the case for a rotation away from high-end demand driven by the International Oil Companies (IOC’s) towards domestic demand which is much more sustainable and broad based.

MARKET SUMMARY:

- **Investment**: Foreign Direct Investment (FDI) is currently at historical lows on the back of foreign exchange volatility, high inflation, a fragile economy and weak demand
- **Prime Land**: Prime land prices have remained relatively strong over the year with an average 9 per cent appreciation in Naira terms
- **Hospitality**: The hospitality market has proved resilient through the recession with strong support provided by local rather than foreign demand

1. **INTRODUCTION**

In our current report, we look at the impact of the challenging economic environment on institutional real estate and how to define a strategic position to take advantage of the long term structural changes starting to play out in the economy largely driven by changes in the global oil markets. We trust that you will find our latest report insightful and ask that you forward it to colleagues who have an interest in African real estate markets. For data on the residential, office and retail sectors, kindly review our Q1 2017 Report which can be found on our website at mcorealestate.com/research. Our next update on these sectors will be in our Q3 Report due out in October.

MCO Real Estate (‘MCORE’) is a real estate investment and advisory firm that offers services to a global audience of investors, developers and third party advisors. Please read ‘About Us’ below for further information on our range of services.

2. **ECONOMIC OVERVIEW**

The inflation rate was 16.25 per cent (year-on-year) in May 2017. This was a fall on the April rate of 17.24 per cent. This figure represents the fourth consecutive decline in the rate of inflation since January 2017 when the rate spiked to 18.72 per cent, the highest rate since 2005. Inflation is currently moderating on a year-on-year
basis, however on a month on month basis, inflation returned to a negative trend as it increased by 1.88 per cent in May indicating that upward inflationary pressures are still at work.

### Nigeria 5YR Economic Indicators

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>Q2 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil Price ($/barrel)</td>
<td>113</td>
<td>111</td>
<td>100</td>
<td>53</td>
<td>42</td>
<td>46</td>
</tr>
<tr>
<td>Oil Production (bpd/$'m)</td>
<td>2.5</td>
<td>2.4</td>
<td>2.4</td>
<td>2.1</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>External Reserves (Dec, US$Bn)</td>
<td>43.8</td>
<td>42.8</td>
<td>35.2</td>
<td>28.3</td>
<td>25.8</td>
<td>30.3</td>
</tr>
<tr>
<td>Exchange Rate, Official (Dec, US$1/N)</td>
<td>157</td>
<td>158</td>
<td>180</td>
<td>197</td>
<td>305</td>
<td>306</td>
</tr>
<tr>
<td>Exchange Rate, Parallel (Dec, US$1/N)</td>
<td>159</td>
<td>171</td>
<td>188</td>
<td>258</td>
<td>487</td>
<td>367</td>
</tr>
<tr>
<td>Monetary Policy Rate (MPR, %)</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>13</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>GDP Growth Rate (%)</td>
<td>4.21</td>
<td>5.49</td>
<td>6.22</td>
<td>2.79</td>
<td>-1.51</td>
<td></td>
</tr>
<tr>
<td>GDP Growth Rate (Y-o-Y, %)</td>
<td>2016</td>
<td>Q2 2016</td>
<td>Q3 2016</td>
<td>Q4 2016</td>
<td>Q1 2017</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-0.67</td>
<td>-1.49</td>
<td>-2.34</td>
<td>-1.73</td>
<td>-0.52</td>
<td></td>
</tr>
<tr>
<td>Inflation Rate (Y-o-Y, %)</td>
<td>Dec</td>
<td>Jan</td>
<td>Feb</td>
<td>Mar</td>
<td>Apr</td>
<td>May</td>
</tr>
<tr>
<td></td>
<td>18.55</td>
<td>18.72</td>
<td>17.78</td>
<td>17.26</td>
<td>17.24</td>
<td>16.25</td>
</tr>
</tbody>
</table>

CBN, NBS, OPEC Prices are averages unless otherwise stated

During the period up until mid 2014, during which oil prices were over US$100 p/b, the Nigerian economy experienced strong growth, buoyed by strong oil revenues. We failed to foresee that oil prices would fall and it now appears that prices above US$100 p/b were an aberration. Unfortunately during the period of strong oil prices, Nigeria lacked the will to save. A quote attributed to the investor Warren Buffet states that “only when the tide goes out do you discover who's been swimming naked”. It has now become clear that Nigeria’s inability to save for a rainy day meant that we were swimming naked and are now left at the mercy of a volatile oil price.

Our mono-economy has left us pegged to global oil price movements. As the oil price improves, our economy rebounds and as the oil price falls, we expect our economy to re-enter a period of stress. The oil price in turn is subject to the vagaries of OPEC production cuts, American shale oil producers ability to pump at ever lower oil prices, improved drilling technologies allowing deep-water drilling in areas where it was earlier impractical to drill for oil, the growth in electric car development and recent advances in renewable energy technology all leading to a long term downward trend in petroleum demand and a long term inexorable decline in oil prices.

Additionally, the high costs and risks of doing business in Nigeria and falling production costs and relative stability involved in doing business elsewhere has led to a gradual withdrawal of the IOC’s from onshore to offshore fields and the selling off of assets by the IOC’s and their moving elsewhere to alternative geopolitical zones where there is greater stability and risks are lower.

### 3. REAL ESTATE

#### OVERVIEW

The upshot of this upheaval in oil economics is that Nigeria needs to diversify into alternative revenue sources to sustain economic growth and the real estate sector needs to look beyond oil driven demand and particularly beyond the expectation of a return of IOC demand to the high end residential market.

In the current market, demand is driven from the bottom up. It behoves the developer/investor to create the right product that can satisfy domestic demand that is much deeper and broad based rather than a focus on the high end market supported by IOC driven demand that continues to weaken.
INVESTMENT

The high inflation rate coupled with volatile foreign exchange movements and lingering doubts about fx liquidity and convertibility remain a deterrence for international investors. The high inflation rate means that building material prices will continue to rise making material purchases at a fixed price a challenge. This coupled with historically volatile fx rate movements means that there are uncertainties on both entry costs and exit prices with an expectation of rising costs and falling exit values both negatively impacting returns.

High risks to investment were reflected in weak capital importation figures with the Q1 2017 total capital importation figure of US$908m being the second lowest value since 2007. This figure is made up of portfolio investment, Foreign Direct Investment (FDI) and other investments. Of this amount, a paltry sum of US$211m was FDI within which international investment into real estate falls and 99.4 per cent of this amount or US$210m was equity FDI.

PRIME LAND

Prices have rebounded over the last year growing an average of 9 per cent following falls a year ago.

### Lagos Island Prime Land Prices (N/psqm, Jul 2016 - Jun 2017)

![Lagos Island Prime Land Prices Graph](image)

Notes

1. Land value data is derived from advertised sales prices
2. Eko Atlantic prices are benchmarked in US$ and are blended waterfront and non-waterfront prices
3. Official USD/NGN rates are used for conversion

Ikoyi has shown the strongest growth over the year, growing by 22 per cent from US$1,039 / N316,000 psqm to US$1,226 / N409,000 psqm. Eko Atlantic land prices which are pegged to USD and currently stand at c.US$1,720 / N523,000 psqm are the most expensive prime land prices in Lagos and are now 40 per cent higher than prices of neighbouring Victoria Island. Victoria Island at US$1,244 / N379,000 psqm and Lekki at US$81 / N207,000 psqm have risen by 14 and 15 per cent over the year respectively. Oniru at US$579 / N176,000 psqm
has grown by 7 per cent over the year while Banana Island US$1,81 / N359,000 psqm has remained stable through the year.

HOSPITALITY

A recent report by the W Hospitality Group states that Lagos has the largest pipeline in Africa of international branded hotels scheduled for development in 2017. Although, a significant proportion where signed in 2009-2014 and are yet to progress to construction stage. The report also states that Lagos continues to lead in hotel pipeline development across Africa with over 4,000 planned rooms in branded hotels and with around another 1,000 rooms in unbranded properties. Abuja sits in 3rd place with over 3,700 rooms in the pipeline as at 2017.

A separate report undertaken by PWC suggests that the hospitality industry performed above expectations through 2016 largely on the strength of the support of the domestic market as foreign tourism took a back seat through the recession. Occupancy rate steadied at 44 per cent while 2017 occupancy rates are estimated at 42 per cent through the year. Room revenues rose by 5.2 per cent in 2016. Even within a challenging economic environment, the research still suggests available rooms in Nigeria, including other brands and independents, will rise from 9,400 in 2016 to 13,200 in 2021 a 7 per cent compound annual increase over the next five years, the largest expansion of any country in their analysis.

Average 2016 room rates for 3 and 4 Star Hotels, which account for c.50 per cent of all rooms stood at US$182 per night. With the strong link between hospitality and international tourism, we expect there to be strong inflation in room rates in 2017 to offset the recent depreciation in the Naira. All in all, the Nigerian hospitality sector has appeared to have managed the recession period well via the support of domestic demand.

4. ABOUT US

MCO Real Estate (‘MCORE’) (mcorealestate.com) is a real estate investment and advisory firm that offers services and solutions to a global audience of investors, developers and other third party institutions. We evaluate, package and sell investment opportunities, we source funding for large projects and we acquire and sell institutional assets on behalf of and to a global audience. Our in-depth expertise, market driven research and rigorous due diligence enable us make the right investment decisions at the right times in the volatile markets within which we operate. If you require an independent and professional project feasibility study or wish to sell or acquire investment grade assets or are seeking funding for a real estate project, please contact us now for further information about our range of services.

CONTACT US

Munachi C Okoye
Managing Director
MCO Real Estate Limited
5th Floor Mulliner Towers,
39 Alfred Rewane Road
Ikoyi, Lagos, Nigeria

Tel: +234(0)806 924 5688
Email: info@mcorealestate.com
Web: www.mcorealestate.com
Important Risk Warnings and Disclaimers

This document includes information obtained from sources which MCO Real Estate Limited (‘MCORE’) believes to be credible but which it has not independently confirmed. MCORE, its advisors, directors or employees do not make any assurances, guarantees, representations or warranties as to its accuracy, reasonableness or completeness and neither MCORE nor its advisors, directors or employees accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from the use of this document or its contents or otherwise arising in connection with this document. The opinions presented in this report may be changed without prior notice or cannot be depended upon if used in the place of the investor’s independent judgement.