

The Westlands Retail Unit

Student brief

Grace Wanjiru is a long-standing Mountain River wealth-management client. She has recently sold a share in her veterinary practice and has about KSh 35 million to invest.

A commercial property broker has brought her an opportunity and she wants an independent read before committing.

The asset is a ground-floor retail unit in a Westlands shopping centre, currently let to the Kenyan subsidiary of a regional pharmacy chain. The lease has ten years to run. Under its terms the tenant pays the service charge, rates, and insurance, so Grace's income is net.

The rent is denominated in US dollars — standard for prime Nairobi commercial property — at \$40,000 per year, fixed for the remaining term. At the current rate of KSh 130 to the dollar that is KSh 5.2 million a year.

The asking price is KSh 34 million.

Grace intends to hold the unit until the lease expires and then sell. For planning purposes, assume a sale at the end of Year 10 for KSh 38 million. She has told the team that she would require a 15 percent annual return to commit her capital to this kind of asset.

Question 1 • 15 minutes

Lay out the cash flows year by year, from the purchase today to the sale at the end of Year 10. Discount each year's cash flow at Grace's required return of 15 percent and add them up to find the net present value. The case workbook sets out the cash flows for you; the discounting is yours.

Check your total another way: value the ten years of rent with the annuity formula, add the present value of the sale, and confirm you get the same NPV. Then state whether she should buy at the asking price.

Finally, find the rate at which the NPV equals zero. Getting within half a percent is fine.

Question 2 • 13 minutes

The investment has two cash-flow components with very different risk profiles: ten years of contracted rent from a regional chain, and a sale price ten years out that depends on the Nairobi property market, on whether the tenant renews, and on a buyer existing at that price.

Discount the rent at 13 percent and the sale at 20 percent, and report the NPV.

Then work backwards: holding the rent at 13 percent, how high would the rate on the sale have to go before the deal breaks even? Of the two rates, which would you fight hardest to defend to Grace, and why?

Question 3 • 9 minutes

The rent is in dollars. Grace's costs, her other assets, and her spending are all in shillings.

Which currency should the discount rate be in? What have we implicitly assumed by converting the rent at today's exchange rate and discounting at a shilling rate?