Nairobi Metropolitan Area Mixed-Use Developments (MUDs) Report-2020 & Cytonn Weekly #51/2020

Focus of the Week

Last year in November, we released the Nairobi Metropolitan Area Mixed-Use Developments (MUDs) Report 2019, highlighting the performance of Mixed-Use Developments within the Nairobi Metropolitan Area and their comparison to single-use themes. According to the report, MUDs recorded an average rental yield of 7.3% in 2019 with retail, office, and residential themes within MUDs recording average rental yields of 8.4%, 7.9%, and 5.4%, respectively. This was in comparison to average rental yields of 8.0%, 7.7%, and 5.0%, for retail, office, and residential spaces, respectively, and an overall market average of 6.9% for single-themed developments.

This week, we update our report based on research conducted in 8 nodes in the Nairobi Metropolitan Area, comparing the Mixed- Use Developments performance against the market performance of the residential, commercial office, and retail sectors. The topical shall cover the following:

I. Overview of Mixed-Use Developments
II. Mixed-Use Developments Performance Summary in 2020
III. Mixed-Use Developments Investment Opportunity and Outlook

Section I: Overview of Mixed-Use Developments

As a recap of our definition on a Mixed-Use Development (MUD), it refers to a real estate development containing more than one real estate theme. Such a development would therefore have two or more uses, that is, residential, retail, office, and hospitality, all in one location, and whose functions are often physically and structurally integrated. They offer a variety of benefits such as housing, workplaces and other amenities within the same location and hence the real estate themes within the developments complement each other.

The growth of Mixed-Use Developments has mainly been driven by;

1. **Positive Demographics:** Kenya's current urbanization and population growth rates stand at approximately 4.0% and 2.2%, against the global averages of 1.9% and 1.1%, respectively, according to Word Bank. This influx has necessitated innovative real estate solutions to meet the growing demand for units that offer operational synergies in themes that complement each other,
2. **Relatively Higher Returns**: The project mix comprising of themes that perform differently has led to MUDs gaining traction over the past years as a result of the diversified portfolio offering a spread of risk and thus higher returns,
3. **Growth of the Middle Class:** Kenya's growing middle class with increased disposable income, has created a niche for developers to connect work stations and residence while targeting the equally growing demand for convenient lifestyles such as the live, work and play setting,
4. **Benefits of Economies of Scale to the Developer and the Buyer**: Due to the relatively large

scale of most MUDs, developers are able to offer amenities and services at a relatively lower unit cost, therefore benefiting both the developer and the buyer.

However Mixed-Use Developments face various challenges such as:

i. **High Development Costs:** The intricacies involved in incorporating various real estate themes together, coupled by soaring land prices in Nairobi and other urban areas, with the price per acre in Nairobi suburbs averaging at Kshs 138.6 mn as at September 2020, driven by demand due to population pressures and infrastructural improvements has led to high development costs thus discourages development of MUDs, and,
ii. **Inadequate infrastructure:** Mixed- Use Developments required well planned and developed infrastructure such as water, sewerage systems, and reliable electricity, which is currently inadequate to accommodate the rapid growth of urban populations therefore crippling development activities

Section II: Mixed-Use Developments Performance Summary in 2020

A. **Summary of Thematic Performance in Comparison to General Market Performance**

Mixed-Use Developments recorded average rental yields of 7.1%, 0.3% points higher than the respective single use retail, commercial office and residential themes with 6.8% in 2020. In 2020, retail, offices and residential spaces in MUDs recorded rental yields of 7.8%, 7.3% and 6.2%, respectively, compared to the single-use average of 7.5%, 7.2%, and 5.6%, respectively. The relatively better performance by MUDs is attributed to the prime locations, mostly serving the high and growing middle class supported by the concept's convenience as it incorporates working, shopping and living spaces. The retail and commercial themes in MUDs each recorded 0.6% points decline in rental yield, attributed to oversupply of 3.1 mn SQFT and 6.3 mn SQFT, respectively, amid reduced demand for physical retail and office spaces in the wake of a tough economic environment resulting in a decline in rental rates and occupancy. However, retail and office themes within MUDs performed better than the single- use themes which posted average rental yields of 7.5% and 7.2%, respectively, attributed the plethora of amenities offered by MUDs coupled with high quality finishes hence higher rental rates that offered higher returns. Residential units within MUDs, recorded 0.8% points increase in rental yield from 5.4% in 2019 to 6.2%, attributable to the incorporation of lifestyle developments in MUDs offering high returns and increased demand for rented residential units as opposed to units for sale within MUDs hence high occupancy rates.

On overall, MUDs recorded a 0.2% points y/y decline in average rental yield to 7.1% in 2020 from 7.3% in 2019 attributed to a tough economic environment caused by the Covid-19 pandemic that constrained consumer spending, led to reduced demand of space in MUDs amid reduced disposable income and reduced investor appetite in MUDs with sales dropping as investors adopt a wait and see attitude in the wake of market uncertainty.

The table below shows the performance of single-use and mixed-use development themes between 2019 and 2020:

Thematic Performance of MUDs in Key Nodes 2019-2020

	MUD Themes Average		Single-Use Themes Average			
	Rental Yield % 2020	Rental Yield % 2019	Rental Yield % 2020	Rental Yield % 2019	Δ in y/y MUD Rental yields	Δ in MUD vs Single-Use Rental Yield 2019

Thematic Performance of MUDs in Key Nodes 2019-2020

	MUD Themes Average		Single-Use Themes Average			
	Rental Yield % 2020	**Rental Yield % 2019**	**Rental Yield % 2020**	**Rental Yield % 2019**	**Δ in y/y MUD Rental yields**	**Δ in MUD vs Single-Use Rental Yield 2019**
Retail	7.8%	8.4%	7.5%	8.0%	(0.6%)	0.3%
Offices	7.3%	7.9%	7.2%	7.7%	(0.6%)	0.1%
Residential	6.2%	5.4%	5.6%	5.0%	0.8%	0.6%
Average	**7.1%**	**7.3%**	**6.8%**	**6.9%**	**(0.2%)**	**0.3%**

· ***Mixed-Use Developments recorded average rental yields of 7.1%, 0.3% points higher than the respective single-use retail, commercial office and residential themes with 6.8% in 2020***

Source: Cytonn Research 2020

B. Mixed-Use Developments Performance per Node

Westlands was the best performing node recording an average MUD yield of 8.5% with the retail, office and residential spaces recording rental yields of 9.8%, 8.2% and 7.0%, respectively, 2.0%, 0.9% and 0.8% points higher than the sector averages of 7.8%, 7.3% and 6.2%, respectively. The performance was driven by the prime office and retail spaces resulting in relatively high demand with occupancies averaging at 75.7%, while the average rental rates came in at Kshs 178 per SQFT, Kshs 117 per SQFT and Kshs 1,226 per SQM for the retail, office and residential themes, respectively, compared to the respective thematic MUD averages of Kshs 157 per SQFT, Kshs 112 per SQFT and Kshs 835 per SQM. This is in addition to Westlands being a prime commercial node with high demand for commercial and residential space supported by the improved infrastructure; i.e., construction of the Nairobi Expressway along Waiyaki Way which will increase business activities in the area.

Limuru Road and Karen came in second position with an average MUD rental yield of 7.3% each, largely driven by their attractiveness as retail destinations with malls such as Two Rivers and Galleria offering high quality retail spaces in addition to hosting high income earners with relatively high purchasing power especially in the case of Karen. Eastlands was the worst performing node recording an average rental yield of 5.5% attributed to low rental charges at Kshs 110 per SQFT, Kshs 100 per SQFT and Kshs 333 per SQM in the retail, office and residential themes, respectively. The low rates are attributable to unavailability of quality space and relatively high competition from informal Mixed-Use Developments.

The table below shows the performance of Mixed-Use Developments by node in 2020:

(All values in Kshs Unless stated otherwise)

Nairobi's Mixed-Use Developments Market Performance by Nodes 2020

	Retail Performance				Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occupancy %)**	**Rental Yield (%)**	**Price/SQM**	**Rent/SQM**	**Annual Uptake %**	**Rental Yield %**	**Average MUD yield**
Westlands	15,833	178	70.8%	9.8%	12,667	117	73.3%	8.2%	211,525	1,226	24.5%	7.0%	8.5%
Limuru Rd	23,900	223	85.0%	9.5%	13,500	130	65.0%	7.5%	147,496	1,166	20.0%		7.3%
Karen	23,333	143	88.5%	6.7%	13,200	123	80.0%	9.0%					7.3%
Kilimani	17,400	143	75.0%	7.5%	13,250	108	68.8%	6.6%					7.2%
UpperHill	15,485	120	65.0%	6.0%	12,500	107	65.0%	6.7%					6.6%

Nairobi's Mixed-Use Developments Market Performance by Nodes 2020

	Retail Performance				Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occupancy %)**	**Rental Yield (%)**	**Price/SQM**	**Rent/SQM**	**Annual Uptake %**	**Rental Yield %**	**Average MUD yield**
Msa Rd	20,000	150	70.0%	6.3%	13,000	100	70.0%	6.5%	157,440	874	14.3%	6.7%	6.5%
Thika Rd	26,250	200	85.0%	8.5%	13,750	105	64.0%	5.9%	143,803	705	22.5%	5.9%	6.4%
Eastlands	20,000	110	80.0%	5.3%	12,000	100	55.0%	5.5%	72,072	333	18.0%	5.6%	5.5%
Average	**18,857**	**157**	**75.7%**	**7.8%**	**12,957**	**112**	**69.9%**	**7.3%**	**146,023**	**835**	**20.3%**	**6.2%**	**7.3%**

- ***Westlands was the best performing node recording an average MUD yield of 8.5% with the retail, office and residential spaces recording rental yields of 9.8%, 8.2% and 7.0%, respectively, 2.0%, 0.9% and 0.8% points higher than the sector averages of 7.8%,7.3% and 6.2%, respectively***
- ***Thika Road and Eastlands were the worst performing areas recording yields of 6.4% and 5.5%, respectively attributed to low rental charges as a result of competition from informal Mixed-Use Developments***

Source: Cytonn Research 2020

C. Performance of Real Estate Themes in MUDs versus Single-themed Developments' Performance

In our Mixed-Use Development analysis, we looked into the performance of the retail, commercial office and residential themes:

i. Retail Space

Retail spaces in Mixed-Use Developments recorded average occupancy rates and rental yields of 75.7% and 7.8%, respectively, 1.2% and 0.3% points higher than the single use retail market average of 74.5% and 7.5% in 2020, respectively. The better performance of retail spaces in Mixed-Use Developments is attributed to their prime locations, serving the growing middle class with relatively high purchasing power while offering convenience as one-stop centres for consumers living and working in the area.

Westlands and Limuru Road were the best-performing nodes recording rental yields of 9.8% and 9.5%, respectively. This is mainly attributed to the presence of affluent residents with high consumer purchasing power as the areas host high-end and middle income earners, relatively good infrastructure, high footfall in Westlands as it is a prime commercial node and relatively high occupancy rates in Limuru road at 85.0% against MUD retail average of 75.7%. Eastlands recorded the worst performance with rental yields of 5.3%, 1.5% points lower than the MUD retail average of 7.8%, attributed to low quality spaces coupled with relatively poor infrastructure hence reduced rental rates amid the tough economic environment.

The table below provides a summary of the performance of retail spaces in MUDs against market performance in 2020;

(All values in Kshs unless stated otherwise)

Performance of Retail in MUDs versus Market Performance 2020

	MUD Retail Performance			Single Theme Retail Market Performance			
Location	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Westlands	178	70.8%	9.8%	208	80.9%	9.8%	(0.0%)
Limuru Rd	223	85.0%	9.5%	175	65.3%	6.8%	2.7%
Thika Rd	200	85.0%	8.5%	160	69.0%	6.2%	2.3%
Kilimani	143	75.0%	7.5%	170	83.0%	8.6%	(1.1%)
Karen	143	88.5%	6.7%	216	79.1%	9.2%	(2.5%)

Performance of Retail in MUDs versus Market Performance 2020

	MUD Retail Performance			Single Theme Retail Market Performance			
Location	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Mombasa Rd	150	70.0%	6.3%	141	70.8%	6.2%	0.1%
UpperHill	120	65.0%	6.0%				
Eastlands	110	80.0%	5.3%	138	69.2%	6.1%	(0.8%)
Average	**157**	**75.7%**	**7.8%**	**168**	**74.5%**	**7.5%**	**0.3%**

- ***Westlands and Limuru Road were the best-performing nodes in Mixed-Use Developments recording rental yields of 9.8% and 9.5%, respectively***
- ***Eastlands was the worst performing node recording rental yields of 5.3%***

Source: Cytonn Research 2020

ii. Commercial Office Space

Commercial office spaces in MUDs performed better than office spaces in single –use themes recording an average rental yield of 7.3%, 0.1% points higher than the latter at 7.2%. Office spaces in MUDS have in the past offered higher returns compared to those in single-use themes due to the quality spaces with differentiated concepts such as shared offices in some of the developments. The decline in performance of office spaces in MUDs was attributed to reduced demand for physical space with some firms downsizing due to financial constraints while others continued embracing working from home thus leading to reduced occupancy rates. Karen and Westlands were the best-performing office spaces in MUDs recording average rental yields of 9.0% and 8.2%, respectively, attributable to high quality spaces with above average rental rates, coupled with demand for office space by start-ups and freelancers in the shared offices concept. Eastlands was the worst performing node recording average occupancy rates and rental yields of 55.0% and 5.5%, respectively, attributed to introduction of concessions by landlords in a bid to retain tenants, and firms mainly small and medium-sized enterprises (SMEs) downsizing or shutting down operations in an effort to cushion themselves from the effect of the pandemic.

The table below shows the performance of office spaces in MUDs against the single use themed market in 2020;

(All values in Kshs unless stated otherwise)

Performance of Commercial Offices in MUDs in 2020 versus Single Theme Market Performance

	MUD Office Performance				Single Theme Residential Market Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Karen	13,200	123	80.0%	9.0%	13,665	108	86.3%	8.1%	0.9%
Westlands	12,667	117	73.3%	8.2%	12,262	104	78.9%	8.1%	0.1%
Limuru Rd	13,500	130	65.0%	7.5%	13,400	118	84.6%	9.0%	(1.5%)
UpperHill	12,500	107	65.0%	6.7%	12,592	93	79.9%	7.1%	(0.4%)
Kilimani	13,250	108	68.8%	6.6%	12,546	94	79.6%	6.8%	(0.2%)

Performance of Commercial Offices in MUDs in 2020 versus Single Theme Market Performance

	MUD Office Performance				Single Theme Residential Market Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Msa Rd	13,000	100	70.0%	6.5%	11,350	75	63.9%	4.9%	1.6%
Thika Rd	13,750	105	64.0%	5.9%	12,500	82	76.3%	6.0%	(0.1%)
Eastlands	12,000	100	55.0%	5.5%					
Average	**12,957**	**112**	**69.9%**	**7.3%**	**12,479**	**94**	**79.9%**	**7.2%**	**0.1%**

· ***Commercial office spaces in MUDs recorded average occupancy rates of 69.9%, 10.0% points lower than that of single-use themes at 79.9% attributed to reduced demand for physical space in MUDs***

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iii. Residential Space

Residential units within Mixed-Use Developments recorded average rental yields of 6.2% in 2020, 0.6% points higher than the single-use residential market rental yields of 5.6%. Residential units in MUDs also recorded an average price and rent per SQM of Kshs 146,023 and Kshs 835, respectively, above the single- use market average of Kshs 92,060 and Kshs 496, respectively. The relatively high rates within mixed-use developments are attributable to the incorporation of lifestyle communities, with high quality finishes and salient amenities thus high rates and resultant high returns. Westlands was the best performing node recording an average rental yield of 7.0% driven by the high rental rates, boosted by the presence of affluent clientele coupled with increased demand for units in the area supported by the growing middle class with increased purchasing power and need for convenient lifestyles.

The table below summarizes the performance of residential spaces in MUDs against the single themed market in 2020;

(All values in Kshs unless stated otherwise)

Performance of Residential Units in MUDs in 2020 versus Single Theme Market Performance

	MUD Residential Performance				Single Theme Residential Market Performance				
Location	**Price/SQM**	**Rent/SQM**	**Uptake %**	**Rental Yield %**	**Price/SQM**	**Rent/SQM**	**Uptake %**	**Rental Yield %**	**Rental Yield Difference**
Westlands	211,525	1,226	24.5%	7.0%	172,924	775	23.3%	5.8%	1.2%
Msa Rd	157,440	874	14.3%	6.7%	78,772	425	16.1%	5.9%	0.8%
Thika Rd	143,803	705	22.5%	5.9%	79,333	449	16.9%	5.4%	0.4%
Eastlands	72,072	333	18.0%	5.6%	71,993	396	16.6%	5.8%	-0.3%
Limuru Rd	147,496	1,166	20.0%		100,215	520	25.6%	5.3%	
Average	**146,023**	**835**	**20.3%**	**6.2%**	**100,647**	**513**	**19.7%**	**5.6%**	**0.6%**

· ***Residential spaces in Mixed-Use Developments recorded rental yields of 6.2% in 2020, 0.6% points more than the market rental yields of 5.6%***
· ***Westlands was the best performing area recording rental yields of 7.0%***

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Section III: Mixed-Use Developments Investment Opportunity and Outlook

The table below summarizes our outlook on Mixed-Use Developments (MUDs), where we look at the general performance of the key sectors that compose MUDs i.e. retail, commercial office and residential and investment opportunities that lies in the themes;

Mixed-Use Developments (MUDs) Outlook

Sector	2020 Sentiment and Outlook	2020 Outlook
Retail	• Retail spaces performance in Mixed-Use Developments (MUDs) was relatively higher compared to the single-use market average by 0.3% points recording average rental yields of 7.8% compared to the market's yield of 7.5% as at 2020 • Average occupancy rates for the spaces in MUDs stood at 75.7%, 1.2% points higher than the single-use retail market average of 74.5%, attributed to the preference of spaces in MUDs serving the growing middle class with increased purchasing power • We attribute the decline in the performance in MUDs to 7.8% in 2020 from 8.4% in 2019, to shift towards e-commerce which has led to reduced demand for physical space amid an oversupply of 3.1mn SQFT of retail space in Nairobi Metropolitan Area • However, we expect the sector's performance to be cushioned by continued improvement in infrastructure, Kenya's recognition as a Regional Hub, entry and expansion of both local and international retailers, changing consumer tastes and preferences, and, positive demographics increasing the need for formal retail • For investors, opportunity lies in Westlands which is a commercial node offering the best rental yields at 9.8% ,2.0% points higher than the market average of 7.8%	**Neutral**
Office	• Commercial office spaces in MUDs recorded slightly better performance compared to single-use office spaces recording an average rental yield of 7.3%, 0.1% points higher than the latter's average of 7.2% as at 2020 • Office spaces in MUDs recorded a 0.6% points y/y decline in average rental yield to 7.3% in 2020 from 7.9% in 2019 is attributed to a tough economic environment with some firms downsizing amid a 6.3 mn SQFT oversupply of office space while others continued embracing working from home during the pandemic • For investors, Karen and Westlands are the best investment nodes and incorporation of differentiated concepts such as serviced offices in the mixed –use developments is expected to cushion their performance as they offer relatively high returns at of up to 12.3% as at 2019	**Negative**
Residential	• Residential units in Mixed-Use Developments recorded an average rental yield of 6.4% in 2020, 0.8% points higher than the single- use market rental yield of 5.6% as at 2020 • Uptake of residential units in MUDs came in at 20.3%, 1.7% points higher than the single-use market average of 18.6% as at 2020 mainly attributed to increased demand by the growing middle class with increased purchasing power and need for convenient lifestyles • The investment opportunity lies in markets such as Westlands and Mombasa Road, offering average rental yields of 7.0% and 6.7%, respectively ,0.8% points and 0.5% points higher than the residential MUD average of 6.2%, respectively	**Positive**
Outlook	**The outlook for Mixed-Use Developments (MUDs) is NEUTRAL supported by the relatively high returns offered by the residential spaces amid subdued performance of the retail and office themes mainly constrained by oversupply 0f 3.1 mn SQFT and 6.3mn SQFT of retail and office spaces, respectively, within the Nairobi Metropolitan Area. The investment opportunity within the Nairobi Metropolitan Area lies in areas with relatively high returns such as Westlands which recorded an average MUD rental yield of 8.5%, and, Limuru Road and Karen recording average MUD yields of 7.3% each.**	

Source: Cytonn Research 2020