Nairobi Metropolitan Area Land Report 2017 &, Cytonn Weekly #23/2017

Cytonn Weekly

Executive Summary

Fixed Income: During the week, T-bills subscriptions increased to 209.2% compared to 157.5% recorded the previous week. Yields on the 91 and 364-day papers remained unchanged at 8.5% and 10.9%, respectively, while that of the 182-day paper declined by 10 bps to 10.3%, from 10.4% the previous week. Meanwhile, the National Treasury has proposed a second Supplementary Budget for the financial year 2016/17 amounting to Kshs 64.1 bn;

Equities: The equities market recorded mixed trends with NASI and NSE 25 gaining 0.3% and 0.1%, respectively, while NSE 20 lost 0.1%, taking their YTD performance to 12.9%, 12.8% and 8.9% for NASI, NSE 25 and NSE 20, respectively. The performance was driven by gains in large cap stocks such as Standard Chartered Bank, Cooperative Bank, and Safaricom, which gained 2.0%, 1.5% and 1.1%, respectively. The government and eleven Kenyan banks moved to convert their existing loans to Kenya Airways to equity as part of the airline?s capital restructuring plan;

Private Equity: Private equity activity for the week includes (i) investment in Ghana?s International Community School by AfricInvest, and (ii) the contribution of IFC and FSD Africa to the Africa Local Currency Bond?s fundraising efforts;

Real Estate: Kilimani continues to witness increased investment, with Eritrean investors planning to open a 15-floor mixed-use development in the suburb. Investment in the industrial real estate theme continues to gather pace, as Africa Logistics Park (ALP) purchase 49-acres in Tilisi for development of a Light Industrial Park;

Focus of the Week: This week we look at the performance of land in various regions in Nairobi Metropolitan Area. We start by an introduction to the sector, the factors driving the performance, the performance of the sector according to zones and locations, and identifying the investment opportunity in the sector and conclude by giving an outlook for 2017.

Company Updates

- Cytonn Foundation, the CSR arm of Cytonn Investments on Friday 9th June 2017 announced a partnership with the Nairobi County Government that will see Friends Secondary School, Dandora, receive a facelift worth over Kshs 10.0 mn towards construction of four classrooms and an ablution block as well as refurbishment of some existing classes in its first phase of engagement. See Event Note
- Our Senior Manager, Regional Markets, Johnson Denge, discussed recent trends in the real estate sector. Watch Johnson on KTN News here
- We continue to showcase real estate developments by our real estate development affiliate, Cytonn Real Estate, through weekly site visits. Here are progress videos and pictures on The Alma

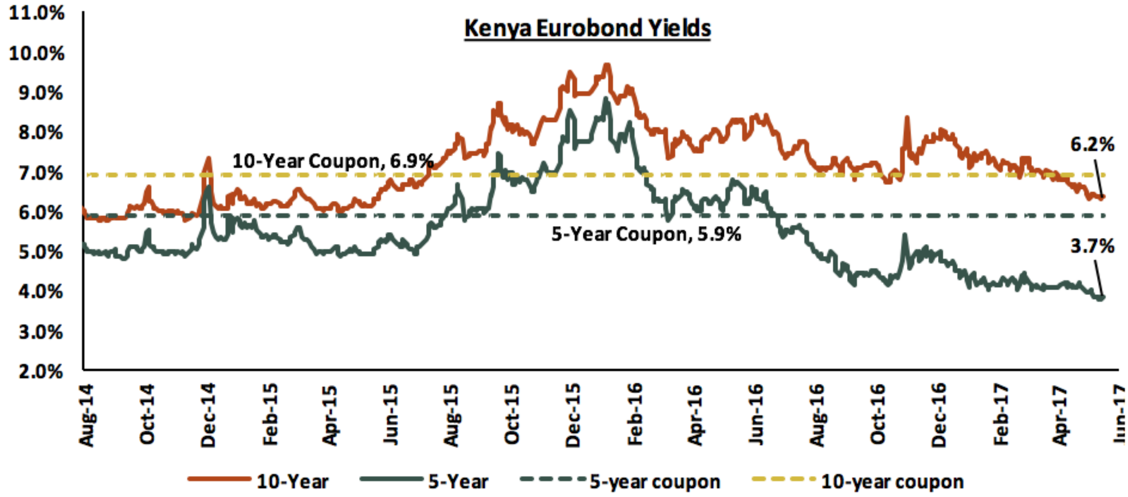
and Amara. The site visits target both investors looking to invest in real estate directly, and also those interested in high yield investment products to familiarize themselves with how we support the high yield returns. If interested in attending the site visits, kindly register here

- We continue to see very strong interest in our Private Wealth Management training, which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. The training can also be offered to institutions that would like their employees to be trained on Private Wealth Management. To get further details contact our Client Services team at clientservice@cytonn.com
- For recent news about the company, see our news section here
- We have 13 investment-ready projects, offering attractive development and buyer targeted returns of around 25.0% p.a. See further details here: Summary of investment-ready projects
- To invest in any of our current or upcoming real estate projects, please visit Cytonn Real Estate
  - The Alma, which is over 55.0% sold, has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. See The Alma
  - Amara Ridge is currently 100.0% sold and has delivered 33.0% p.a. returns to investors. See Amara Ridge
  - Situ Village is currently 15.0% sold. See Situ Village
  - The Ridge Phase One is currently 31.0% sold. See The Ridge
  - Taraji Heights is currently 10.0% sold. See Taraji Heights
- We are currently looking for 3-10 acres in Kikuyu, Lower Kabete, Upper Kabete, Loresho or Mountain View, and 7-10 acres of land in Karen, Garden Estate and Langáta for development of villas. Contact us at rdo@cytonn.com if you have any land for sale or joint ventures in the above areas.
- We continue to beef up the team with the ongoing hires: Careers at Cytonn

Fixed Income

T-bills subscriptions remained high during the week increasing to 209.2%, from 157.5% recorded the previous week. Subscription rates for the 91, 182 and 364-day papers came in at 381.5%, 255.5% and 94.1% compared to 209.2%, 155.0% and 139.3% the previous week, respectively. The 364-day paper was undersubscribed during the week as investor preference was skewed towards 91 and 182-day papers with investors remaining short in duration due to uncertainties in the interest rates environment. Yields on the 91 and 364-day papers remained unchanged at 8.5% and 10.9%, respectively, while that of the 182-day paper declined by 10 bps to 10.3% from 10.4% the previous week. The overall acceptance rate was at 85.6% compared to 75.7% the previous week, an indication that the market has reacted to the government?s efforts to maintain the yields low by bidding at rates equivalent to the accepted weighted average yields. The government accepted Kshs 43.0 bn of the Kshs 50.2 bn worth of bids received against the Kshs 24.0 on offer in this auction, an indication of the governments? appetite for funds to bridge the budget deficit.

According to Bloomberg, yields on the 5-year and 10-year Eurobonds, with 2.1 years and 7.1 years to maturity, declined by 10 bps w/w for both bonds, to close at 3.7% and 6.2%, from 3.8% and 6.3%, the previous week, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 5.1% points and 3.4% points for the 5-year and 10-year, respectively, due to stable macroeconomic conditions. The declining Eurobond yields and Standard & Poor?s (S&P) having maintained Kenya?s foreign and local currency sovereign credit ratings for the short and long term at ?B+/B?, respectively, are indications that Kenya remains stable and hence an attractive investment destination.



The Kenya shilling remained stable against the dollar during the week closing at Kshs 103.3, unchanged from the previous week. On a year to date basis, the shilling has depreciated against the dollar by 0.8%. With the forex reserve level currently at USD 8.3 bn (equivalent to 5.5 months of import cover), and the IMF precautionary credit facility of USD 1.5 bn (equivalent to 1.0 more month of import cover) that Kenya can draw into in case of adverse movement in the forex market, we believe that the shilling should remain relatively stable in the short term. The Shilling is also set to be supported by diaspora remittances and inflows from horticultural exports, offsetting the demand from oil importers. In the first quarter of 2017 diaspora remittances increased by 6.2% to Kshs. 44.7 bn from Kshs 42.1 bn in the first quarter of 2016.

For the month of June, the government has re-opened a 15-year fixed-coupon bond (FXD 2/2007/15) with an effective tenor of 5.0 years, in a bid to raise Kshs 30.0 bn for budgetary support. Investors will participate until 20th June, and we shall provide the bidding recommendation for the bond in our next report.

The National Treasury has proposed a second Supplementary Budget for the financial year 2016/17 amounting to Kshs 64.1 bn, bringing the total budget for the current financial year to Kshs 2.3 tn from Kshs 2.2 tn, previously. The supplementary budget is intended to finance (i) replenishing of food reserves to control the prevailing food shortage in the country, (ii) election-related security operations, and (iii) infrastructural development projects. The supplementary budget has provided an allocation of 65.7% to development expenditure, 10.1% to recurrent expenditure and 24.2% to consolidated fund services. The supplementary budget is anticipated to be funded through debt from the domestic market as the government has managed to maintain interest rates low making borrowing less expensive, further increasing the country?s debt burden. The current government debt level to GDP is at 52.6%, which is 2.6% higher than the IMF-recommended public debt to GDP threshold for frontier markets of 50.0%. For comprehensive analysis on the same, see our Supplementary Budget 2016/2017 Note.

The United States Federal Open Market Committee (FOMC) is set to meet on 13th and 14th June, 2017 to assess the current state of the US economy and shed light on a possible rate hike. During the Fed?s previous meeting held last month, the committee decided to maintain the fed rate within the band of 0.75% - 1.00% due to a slowdown in GDP growth to 0.7% in Q1?2017 from 0.8% in Q1?2016, despite a strong labor market growth and rising core inflation. Previously, the Fed highlighted plans to accelerate its rate-hiking pace, hinting at three rate hikes in 2017 on expectations of an improved economic performance this year. We expect the Fed to raise the rates to a band of 1.00% - 1.25%, given that, (i) core inflation rose to 1.9% y/y in April close to the federal target of 2.0%, (ii) a relatively strong labor market adding approximately 211,000 new jobs in April, from 98,000 in March, with the economy operating at a full employment of 5.0% and currently operating at unemployment rate of 4.4%, and (iii) a strengthening global economy. With the expected rate hikes, we are likely to see the dollar strengthen in the international markets against other major world currencies.

Conclusions: Rates in the fixed income market have remained stable supported by,

i. *The government is ahead of its domestic borrowing target for the current fiscal year, having borrowed Kshs 405.6 bn against a target of Kshs 277.6 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 294.6 bn budgeted for the full financial year), and*
ii. *The government may also be looking at concessionary loans to finance the expenditure rather than borrowing from the foreign market.*

Some of the factors putting upward pressure on interest rates are:

i. *The government has only borrowed Kshs 205.8 bn of the budgeted foreign borrowing, representing 44.5% of its foreign borrowing target of Kshs 462.3 bn, and*
ii. *The Kenya Revenue Authority (KRA) is expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year, having collected Kshs 989.9 bn, representing 64.7% of the overall target, over the first 10 months of the fiscal year.*
iii. *Increased budget spending after the tabling of the supplementary budget last week, which is anticipated to be sourced from the domestic market through debt.*

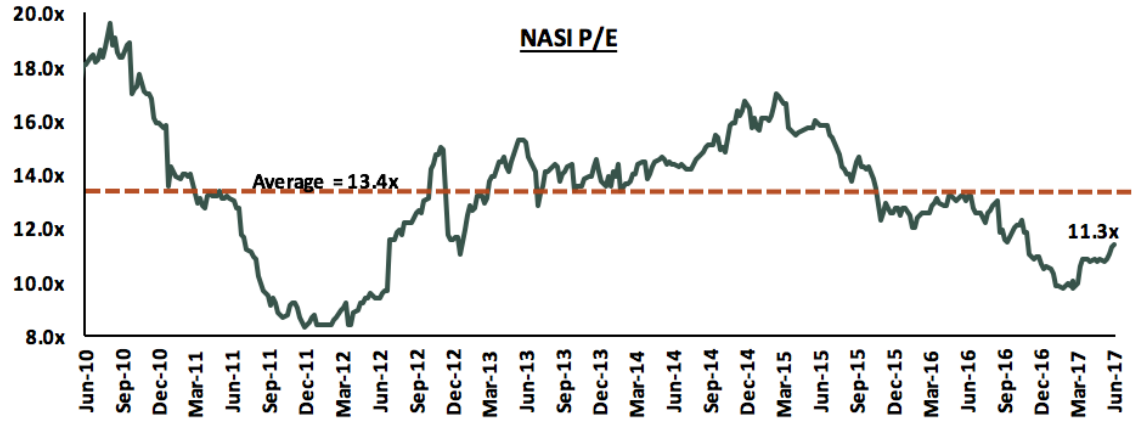
Overall, the possible budget deficit and the high inflationary environment that we are currently in, create uncertainty in the interest rate environment. Our view is that investors should be biased towards short-term fixed income instruments to reduce duration risk.

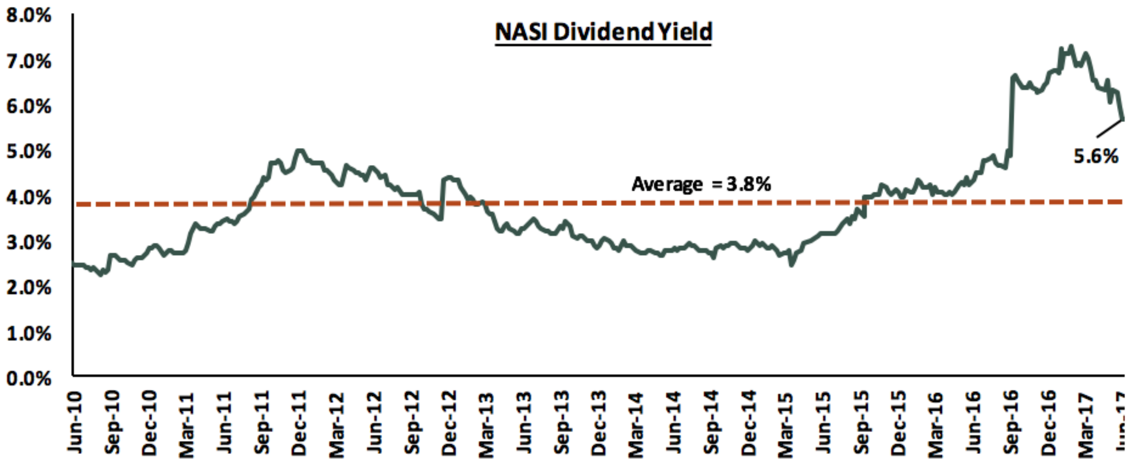
Equities

During the week, the equities market registered mixed trends with NASI and NSE 25 gaining 0.3% and 0.1%, respectively, while NSE 25 lost 0.1%, taking their YTD performance to 12.9%, 12.8% and 8.9% for NASI, NSE 25 and NSE 20, respectively. This performance was driven by gains in large cap stocks such as Standard Chartered Bank Ltd, Co-operative Bank Ltd, and Safaricom Ltd, which gained 2.0%, 1.5% and 1.1%, respectively. Since the February 2015 peak, the market has lost 36.9% and 15.2% for NSE 20 and NASI, respectively.

Equities turnover increased by 4.9% to close the week at USD 33.4 mn from USD 31.8 mn the previous week. Foreign investors turned net sellers with net outflows of USD 6.0 mn compared to a net inflow of USD 0.2 mn recorded the previous week. Foreign investor participation decreased to 62.5% from 69.8% recorded the previous week. Safaricom was the top mover for the week, accounting for 47.5% of market activity. We expect earnings growth to be slower in 2017 and neutral investor sentiment mainly due to the forthcoming general elections.

The market is currently trading at a price to earnings ratio of 11.3x, compared to a historical average of 13.4x, and a dividend yield of 5.6%, compared to a historical average of 3.8%. The current 11.3x valuation is 16.5% above the most recent trough valuation of 9.7x experienced in the first week of February 2017 and 36.1% above the previous trough valuation of 8.3x experienced in December 2011, indicating substantial recovery since February 2017. The charts below indicate the historical P/E and dividend yields of the market.





During the week, the government moved to convert its existing debt in Kenya Airways (KQ) to equity, as part of KQ?s capital restructuring plan. The government, which is the major shareholder in KQ, with an ownership of 29.8%, is set to convert debt amounting to Kshs 25.0 bn into equity. In addition, eleven Kenyan banks are also set to convert Kshs 23.2 bn worth of outstanding debt to KQ into equity, by forming a special purpose vehicle (SPV) through which they will have a stake in the airline. The banks include Equity Group, KCB Group, Co-operative Bank, I&M Holdings, NIC Bank and Diamond Trust Bank. The banks will be free to offload their equity in the open market over the next 10 years to recover their outstanding funds. While there will be significant share dilution for existing shareholders, the capital restructuring will improve KQ?s equity position, as it had negative shareholders? equity of Kshs 44.9 bn in FY?2017. Treasury also announced that it will guarantee long-term loans amounting to Kshs 77.3 bn that KQ owes Export-Import Bank of the United States of America and local lenders. These guarantees are being made in exchange for material concessions, including extension of debt tenures, which will improve the airline?s repayment obligations. This move will reduce the overall debt burden, thus stabilizing the company and facilitating long term growth, in line with its turnaround strategy.

Kenya Airways signed a codeshare agreement with EgyptAir during the week, which will allow EqyptAir passengers to use the Kenya Airways code for its weekly flights between Cairo and Nairobi, thus making it easier for the passengers to connect to other destinations in East Africa including Mombasa, Dar es Salaam, Lusaka and Harare. This will allow KQ to resume direct market access between Nairobi and Cairo since August 2013 when its own operations were suspended. The open access between Cairo and Nairobi will lead to an increase in passenger numbers and passenger traffic, which will ultimately increase KQ?s revenues. The national carrier recently reported a 60.9% improvement in net losses to Kshs 10.2 bn for the year to March on account of declining operation costs and rising passenger numbers.

Britam employees will now own shares in the company after its shareholders approved a proposal for the creation of an Employee Share Ownership Plan (ESOP). On approval of the plan by CMA, Britam employees will own 2.0% of the issued shares, which is substantive, given in Kenya most of the corporate ESOPs as a percentage of issued shares are negligible, tending to be less than 1.0%. With this positive development, Britam will join 13 other listed companies with active ESOP schemes including Equity, Safaricom and KCB. This move will warrant the employees to be aligned to the company?s strategy and invested in the company?s growth and performance, and act as a staff retention scheme. As highlighted in our Cytonn Weekly #31.2015, we believe that the establishment of more ESOP programs by both listed and private companies should improve corporate performance and also help with attracting and retention of talent, not just from the local market but also from the global markets.

South African Global Credit Rating (GCR) revised their outlook on CIC Group Life assurance and General insurance to negative from stable, based on the decline in the insurer?s operating margin from 10.0% at the start of FY?2014 to an average of 6.0% in FY?2016, despite the firm retaining financial strength and claims paying ability at ?A+? and ?A? ratings, respectively. GCR further noted (i) CIC?s weakening capital adequacy in recent years as a result of a reduction in earnings and higher dividend distribution, and (ii) constrained ability of the insurer to achieve enhanced cost efficiencies in the lower yielding investment environment, to be a key credit consideration over the rating horizon. We expect the insurer?s earnings to further weaken in the short term, as the firm is set to step in to support operations of its loss-making regional subsidiaries in South Sudan, Uganda and Malawi, which were rendered technically insolvent from years of losses of more than Kshs 300.0 mn since their formation between 2013 and 2014. The firm?s regional expansion is yet to pay off, and the poor performance has depressed operating margins and led to an erosion of shareholder wealth; like most Kenyan companies pursuing regional expansion, CIC Group should reevaluate their regional expansion strategy.

Below is our Equities Universe of Coverage:

- We have placed ARM Cement and Bamburi Cement under review, as we update the valuation.

All prices in Kshs unless stated otherwise								
Our Equity Universe								
No.	Company	Price as at 2/06/17	Price as at 9/06/17	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	Liberty	10.5	10.4	(0.5%)	(21.2%)	13.0	0.0%	24.8%
2.	Jubilee Insurance	426.0	429.0	0.7%	(12.4%)	490.5	1.8%	16.2%
3.	KCB Group***	40.0	40.0	0.0%	39.1%	41.9	6.3%	11.1%
4.	Britam	11.5	11.6	1.7%	16.5%	11.9	2.3%	4.4%
5.	Kenya Re	20.3	20.7	2.5%	(7.8%)	20.5	4.4%	3.2%
6.	CIC Group	3.7	3.8	4.1%	0.0%	3.7	3.2%	0.8%
7.	SCBK	202.0	206.0	2.0%	9.0%	191.7	6.7%	(0.2%)
8.	I&M Holdings	100.0	93.0	(7.0%)	3.3%	88.0	4.0%	(1.4%)
9.	HF Group	9.8	10.2	5.1%	(26.8%)	9.2	4.7%	(5.4%)
10.	Barclays	9.0	9.7	8.3%	15.0%	8.2	10.0%	(5.9%)
11.	Stanbic Holdings	70.0	72.0	2.9%	2.1%	60.2	8.1%	(8.3%)
12.	Safaricom	22.5	22.7	1.1%	18.8%	19.8	4.7%	(8.4%)
13.	Co-op Bank	17.1	17.3	1.5%	31.1%	14.6	5.7%	(9.9%)
14.	NBK	7.0	7.0	0.0%	(2.8%)	6.2	0.0%	(11.4%)
15.	NIC	32.0	31.0	(3.1%)	19.2%	26.4	3.0%	(11.8%)
16.	Equity Group	39.3	39.0	(0.6%)	30.0%	30.9	5.1%	(15.7%)
17.	DTBK	143.0	142.0	(0.7%)	20.3%	114.6	2.2%	(17.1%)

18.	Sanlam Kenya	27.3	29.0	6.4%	5.5%	21.1	0.0%	(27.4%)
***Upside / (Downside) is adjusted for Dividend Yield*								
****For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group, ranking as the 14th largest shareholder*								

We remain "neutral with a bias to positive" for investors with short to medium-term investments horizon and are "positive" for investors with a long-term investment horizon.

Private Equity

AfricInvest, through its AfricInvest Private Equity Fund III, has invested an undisclosed amount in International Community School Limited (ICS), a leading private school in Ghana offering pre-school to high school education. AfricInvest Private Equity Fund III is a USD 304.8 mn fund that had its final close early this year. This is the fund?s fourth investment after its investment in (i) Azalai, a group focusing on hotel development and management in West Africa, headquartered in Mali, (ii) Silafrica, a plastics and packaging group based in East Africa, headquartered in Kenya, and (iii) Salvador Caetano Auto Africa. ICS has 1,200 enrolled students and operates out of three main campuses in Accra, Kumasi and Obuasi. The investment will benefit ICS as (i) it will support the growth of ICS by upgrading its facilities and funding its expansion plans to other cities in Ghana, and (ii) ICS will draw from AfricInvest?s accumulated experience and knowledge in the education sector, this being their third investment in the sector after their acquisition of Brookhouse Schools in Kenya and their venture capital investment in Esprit, a private engineering school in Tunisia, through their AfricInvest II and Tuninvest Innovations Sicar Funds respectively. The continued investment in the region?s education sector by private equity investors indicates increased interest and confidence in the sector with a bias towards schools that aim to offer an education experience that focuses on talent development, leadership and entrepreneurship, in addition to and above the curriculum offered.

The African Local Currency Bond Fund (ALCB), an investment vehicle established by the KfW Development Bank, has received a total of USD 40.0 mn in debt and equity commitments from International Finance Corporation (IFC) and Financial Sector Deepening Africa (FSD Africa), a non-profit fund supported by the UK Government. The fund aims to have its final close of USD 150.0 mn by the end of 2017, with USD 70.0 mn of it being equity. ALCB helps mobilize domestic capital in Africa to invest in local currency bonds on the continent, providing companies with access to capital. The Fund prices to market, as it co-invests alongside local investors and invests in local currency bonds in the form of listed or private Medium Term Note programs, private placements and local currency club deals in countries where bonds are not possible. ALCB has previously invested in 13 financial sector companies in 7 countries, deploying USD 42.6 mn across 19 issuances, including Kenya?s Shelter Afrique?s 2013 issuance of USD 91.4 mn, in which ALCB invested USD 2.4 mn. We remain optimistic about the performance of fundraising initiatives in the region, as more international investors continue to show interest and seek inclusion, encouraged by the better economic projections in Sub Sahara Africa compared to global markets.

Private equity investments in Africa remains robust as evidenced by the increased deals and fundraising activities. The increasing investor interest is attributed to (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in private markets compared to global markets, and (iii) better economic projections in Sub Sahara Africa compared to global markets. We remain bullish on PE as an asset class in Sub-Sahara Africa. Going forward, the increasing investor interest and stable macro-economic environment will continue to boost deal flow into African markets.

Real Estate

In our Cytonn Weekly #7/2017, we analyzed the effects the upcoming election in Kenya was likely to have on the real estate sector. Our analysis expected an increase in the number of building approvals as developers position themselves to begin construction immediately after the election. This has been evident in the year so far, with two key developments seeking National Environment Management Authority (NEMA) approvals in the last week alone. The first, Hearan Enterprises, a group of Eritrean investors, are seeking approval to construct a 15-storey, Mixed Use Development (MUD) in Kilimani. The development will be on a 2.2-acre parcel in Kilimani along Lenana Road, which is opposite the Nigerian High Commission. The second development is by Eris Property Developers Limited, a joint venture between MMI holdings and Eris Property Group, which filed their NEMA application for development of a 345-unit residential development off Ngandu Laneon Ngong Road. The project will be funded under the investment vehicle Momentum Africa Real Estate Fund (MAREF), which raised Kshs 25.0 bn for real estate projects in Mozambique, Zambia, Kenya, Nigeria and Ghana. Eris is the fund adviser for MAREF. Both developers are international, showing increased investor confidence in the country.

The developments are both within the vicinity of the Kilimani area, which has witnessed increased development, both commercial and residential, due to: (i) its proximity to the CBD and Upperhill, (ii) sufficient infrastructure with roads and sewer connections, (iii) relaxation of zoning regulations, and (iv) attractive returns, as shown below:

Summary of Real Estate Returns of various Themes in Kilimani	
Theme	Average Yield
Serviced Apartments	11.6%
MUD (Office and Retail)	11.0%
Retail	10.7%
Offices	9.6%
Hotel	9.4%
Unserviced Apartments	4.7%
Kilimani has high returns across all themes with serviced apartments and mixed-use developments having the highest returns with yields of more than 11.0% and hence their growing popularity in the area	

Due to Kilimani?s attractiveness, we expect to witness increased developments in the area as developers seek to earn these high returns and expand outside of the CBD and away from Upperhill due to scarcity of land and the available being expensive at around Kshs 550.0 mn (asking prices).

Industrial real estate continues to attract investment in Kenya, with investors seeking to leverage off the growth of the country as a regional hub. This week, Tilisi developers announced that they were going to invest Kshs 750.0 mn in the infrastructural development of their 100-acre logistics park, which is part of the greater Tilisi Masterplan. The funds will cater for provision of services such as road paving, construction of drainage trenches, connection of water and electricity, as well as provision of 24-hour internet. This is in a bid to increase the attractiveness and ease use of the park for investors. The developers recently sold 49 acres in the Park to Africa Logistics Property (ALP) which also has land in Tatu City. Serviced industrial land or self-built logistics parks are growing in popularity in the country as (i) developers find them a better alternative to independent construction due to lower land costs as they are located on the outskirts of towns, and (ii) ease of use as the master developers provide infrastructure and acquire the necessary approvals. With improved infrastructural development and increased investment in the country, we expect to continue witnessing increased investment in logistics parks.

Other real estate highlights of the week include:

1. African Property Awards appointed four Kenyan executives working in various fields to a panel of judges in the continental real estate competition. The four are Esham Park Group Director, David

Kinyua, WEB Ltd Chief Executive, Elizabeth Wangeci, IFC Kenya Director, Godfrey Tapela, RICS East Africa Regional Director, Wafula Nabutola and African Laughter Managing Director and Business Daily Columnist, Jenny Luesby. The awards are held bi-annually and seek to recognize excellence in the real estate sector, enhance quality standards and promote confidence in the African real estate industry
2. Bechtel, a San Francisco based engineering and construction firm opened its African office in Nairobi. The firm offers financing, design, construction and project management services in construction and mining and has been named the top contractor in the United States by Engineering News Record 19 years in a row. The firm joins other major contractors who have set up offices in Nairobi including AVIC from China, Arab Contractors from Egypt, X-Calibur Construction Chemistry Inc from US among others. The entrance of these firms cements Nairobi?s position as not only a regional but also a continental hub increasing demand for commercial real estate especially warehousing and office space.
3. The National Construction Authority and Savannah Cement have joined hands to improve technical skills for local contractors through training. The deal will involve training of skilled and unskilled workers on best practices of masonry, excavation, concrete mixing, mortar application and other similar techniques and is expected to cost Kshs 30.0 mn. The training is aimed at improving the level of skills in the market and hence improve the quality and increase the longevity of buildings. The trainings will be a requisite for contractors before renewal of annual licenses by contractors.

We expect to continue witnessing increased real estate development activity especially of mixed use developments and in the industrial sector by both local and international developers. Our outlook remains positive for the real estate sector especially if calm elections are held.

Focus of the Week: Nairobi Metropolitan Area Land Report 2017

Over the course of last year, we covered real estate performance across the various themes, including commercial office, residential, retail and hospitality. We saw that these sectors have over the last 5-years delivered high returns of over 25.0% p.a, driven by continued improvement of the Kenyan economic climate, improved infrastructure and the growth of the middle-class, leading to increased disposable income. This week we turn our focus to land, the capital asset on which real estate is developed.

We carried out research on the land sector performance in Nairobi Metropolitan Area over the last 5-years, between 2011 and 2016. The research was carried out in 18 suburbs and 11 satellite towns in the Nairobi Metropolitan Area as classified below. The findings and analysis are presented in the analysis below. We start by an introduction to the sector, the factors driving the performance, the performance of the sector according to zones and locations, and concluding by identifying the investment opportunity in the sector in terms of areas with the potential future highest capital appreciation.

The land sector performance over the years has been driven by (i) high population growth, which is at 2.6%, (ii) urbanization rate at 4.4%, compared to a global average of 2.1%, (iii) improved infrastructure through the development of roads and rail links, (iv) limited development land, (v) GDP growth rate of consistently above 5.0%, and (vi) legal reforms in the Land Ministry.

The performance of the land sector is as summarized below:

Based on the zoning regulations and location, we classified the sub markets as follows, and analyzed their price change over the last 5-years between 2011 and 2016:

1. Commercial Zones: These are areas characterized with commercial buildings such as Nairobi

CBD, Kilimani, Westlands, Upper Hill and Riverside;

2. High Rise Residential Areas: These are the areas characterized with high rise residential developments mainly apartments such as Kileleshwa, Kilimani, Dagoretti, Ridgeways, Githurai, Embakasi, Kasarani and Kahawa;
3. Low Rise Residential Areas: These are areas zoned for low rise residential developments, mainly villas, townhouses and Maisonettes. The areas considered under this category are Spring Valley, Kitisuru, Runda, Nyari, Karen and Old Muthaiga; and;
4. Satellite Towns: The land in this area was categorized into serviced (Site and Service Schemes) and unserviced land.

Land prices indicated a positive growth rate across all areas in the Nairobi Metropolitan Area, with an average 5-year Compounded Annual Growth Rate ?CAGR? of 19.4%, which equates to an absolute price increase of 2.5x over the same period. Commercial zones recorded the highest 5-years growth, with a CAGR of 24.3%, followed by site and service schemes at a 5-year CAGR of 20.4%, while low rise residential areas recorded the lowest 5-year CAGR at 14.6%. This price change is attributable to the value add and the convenience attributed to the amenities provided in site and service schemes, while the commercial zones are attracting investors due to relaxed zoning regulations allowing for densification hence maximizing on the land usage compared to low rise residential areas.

From our survey and analysis on the land performance, we have the following takeaways based on capital appreciation by various classifications:

1. Commercial zones and site and service schemes have the highest 5-year CAGR of 24.3% and 20.4%, respectively, as shown below:

All values in Kshs per acre unless stated otherwise				
Location	*Price in 2011	*Price in 2015	*Price in 2016	5 YR CAGR
Commercial Zones				
Kilimani	114m	294m	360m	25.8%
Riverside	116m	343m	362m	25.6%
Westlands	150m	300m	453m	24.7%
CBD	200m	450m	600m	24.6%
Upper Hill	200m	450m	512m	20.7%
Average				24.3%
High Rise Residential Area				
Dagoretti	28m	81m	95m	28.0%
Ridgeways	24m	51m	62m	21.0%
Kilimani Residential	114m	238m	280m	19.6%
Githurai	21m	37m	45m	16.8%
Embakasi	33m	61m	69m	16.2%
Kileleshwa	149m	227m	286m	13.9%
Kasarani	32m	51m	60m	13.3%
Kahawa	33m	51m	60m	12.7%
Average				17.7%
Low Rise Residential Area				
Spring Valley	64m	131m	147m	18.0%
Kitisuru	32m	59m	70m	16.9%
Runda	33m	58m	67m	15.0%
Nyari	54m	93m	109m	14.9%
Karen	25m	40m	46m	13.0%
Old Muthaiga	125m	164m	197m	9.6%
Average				14.6%
Satellite Towns				
Ongata Rongai	2m	10m	10m	33.20%

Limuru	4m	11m	13m	25.00%
Juja	3m	7m	9m	22.40%
Ngong	7m	12m	14m	16.00%
Ruaka	40m	58m	83m	15.70%
Athi River	2m	3m	4m	13.90%
Utawala	6m	9m	11m	13.70%
Average				20.0%
Site and service Schemes				
Athi River	3m	11m	13m	34.00%
Syokimau-Mlolongo	3m	12m	12m	30.00%
Ruiru	7m	15m	19m	23.90%
Ongata Rongai	7m	16m	19m	21.80%
Ngong	11m	18m	19m	12.70%
Thika	5m	7m	8m	10.50%
Ruai	8m	12m	13m	10.20%
Average				20.4%
Nairobi metropolitan Area Average				19.4%
*Asking price per acre · Land in Nairobi Metropolitan Area grew with an average 5-year CAGR of 19.4% between 2011 and 2016 · Serviced land in satellite towns recorded the highest capital appreciation with a 5 year CAGR of 20.4%, attributable to the value add associated to the services provided such as water, electricity roads among others				

Source: Cytonn Research

2. Ongata Rongai and Athi River recorded the highest 5-year CAGR above 30.0% due to the speculative environment experienced in the area between 2011 and 2016.

Un-serviced Land Capital Appreciation	
5-YR CAGR	Location
>30%	Ongata Rongai
26 -30%	Dagoretti and Kilimani
20 - 25%	Nairobi CBD, Westlands, Ridgeways, Limuru and Juja, Riverside
16 -20%	Upper Hill, Embakasi, Githurai, Spring Valley, Kitisuru and Ngong, Kilimani Residential
11 - 15%	Kasarani, Kileleshwa, Kahawa, Karen, Nyari, Runda, Ruaka, Utawala and Athi River
6 - 10%	Old Muthaiga
Serviced Land Capital Appreciation	
5-YR CAGR	Location
> 30%	Athi River
26 - 30%	Syokimau ? Mlolongo
21 - 25%	Ruiru and Ongata Rongai
16 - 20%	N/A
11 - 15%	Ngong
6% - 10%	Thika and Ruai
· *Ongata Rongai and Athi River recorded the highest capital appreciation due to the speculative environment experienced in the area between 2011 and 2016 driven by infrastructural development in the area*	

Source: Cytonn Research

3. Areas likely to experience a CAGR above 25% in the next 5-years are Ruiru, Kikuyu, Kabete and Dagoretti among others due to planned infrastructure developments, as shown below;

Infrastructural Developments	Areas to Benefit
Western Bypass	Kikuyu, Kabete, Tigoni, Wangige and Dagorreti
Outer Ring Road Upgrade	Kasarani, Donholm, Embakasi and Buruburu
Relaxed Zoning Regulations	Spring Valley, Kilimani, Parklands & Ngara
Trunk Sewer Lines	Ruiru
· The above areas are likely to experience a CAGR above 25% in the next 5-years due to planned infrastructure developments	

Source: Cytonn Research

From our analysis, we expect increased investments and developments in satellite towns as investors and developers tap to earn the good returns of up to 20.4% CAGR.

Land Sector Performance Conclusion and Outlook	
Measure	Sentiment
Factors affecting Land Price	· The key drivers for land sector are mainly population growth, urbanisation, improved infrastructure, land supply, economic growth with an average GDP growth rate of more than 5.0% over the last five years and legal reforms in the land administration · The key challenges such as corruption in the land ministry, high land costs, communal ownership of land hindering land transfer, difficult legal environment and physical challenges mainly in satellite towns
Land Sector Performance	· Land in Nairobi Metropolitan Area grew with an average 5-years CAGR of 19.4% between 2011 and 2016 · Serviced land in satellite towns recorded the highest capital appreciation with a 5-years CAGR of 20.4%, attributable to the value add associated to the services provided such as water, electricity roads among others
Land Price	· Land in Nairobi Metropolitan recorded an overall 5-years price change of 2.50x due to increased developments in real estate and improved trunk infrastructure · Site and Service schemes in satellite towns attracted the highest 5-years land price change at 2.67x
Outlook	· We expect increased investments and developments in satellite towns as investors and developers tap to earn the good returns of up to20.4%CAGR
Opportunity	· Investors should tap into the sector through, Land banking mainly in satellite towns to enjoy the capital appreciation at 20.0% and invest in site and service with capital appreciation20.4% · Areas likely to experience a CAGR above 25% in the next 5-years are Ruiru, Kikuyu, Kabete and Dagoretti among others due to planned infrastructure developments

Source: Cytonn Research

In conclusion, land prices indicated a positive growth rate across all areas in the metropolitan, with an average 5-year CAGR of 19.4%, with commercial zones outperforming other areas. This growth is mainly due to improved infrastructure, relaxed zoning regulations and legal reforms in the land ministry. The opportunity is still largely in Nairobi satellite towns, which are experiencing heavy investment in infrastructure. However, there is likely to be a slowdown in transaction volumes being witnessed in the 3rd quarter of 2017, just at the run up to the election date, but with relatively stable pricing. Nairobi Metropolitan Area Land Report 2017.

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