Cytonn INVESTMENTS

Mortgage and Rental Affordability in Nairobi Metropolitan Area Report 2017, & Cytonn Weekly #36/2017

Cytonn Weekly

Executive Summary

Fixed Income: T-bills were oversubscribed during the week, with the overall subscription rate coming in at 153.5%, compared to 136.1% recorded the previous week. Yields on the 91, 182 and 364-day papers remained unchanged from the previous week at 8.1%, 10.3% and 10.9%, respectively. The Energy Regulatory Commission (ERC) has rejected an application by the Kenya Power & Lighting Company (KPLC) to have the electricity tariff increased, as the regulator seeks to preserve Kenya's competitive edge as a business hub;

Equities: During the week, the equities market recorded mixed trend with NASI gaining 1.7% while NSE 25 and NSE 20 lost 0.1% and 1.2%, respectively, taking their YTD performance to 24.2%, 22.5% and 20.5% for NASI, NSE 25 and NSE 20, respectively. The Central Bank of Kenya (CBK) released a report on the commercial banks' credit survey for the second quarter of 2017, which showed that demand for credit increased in two sectors; Trade and Personal/Household economic sectors, attributed to reduced cost of borrowing as a result of interest capping;

Private Equity: We continue to witness increased investment in the Sub-Saharan Africa private equity space with (i) French based Amethis finance, through its subsidiary Amethis West Africa, has acquired an undisclosed minority stake in Sodigaz Group, an LPG gas distributor based in Bukina Faso, and (ii) Fairfax Africa, an investment holding company of Canadian life insurer Fairfax Financial, has completed the acquisition of a 42.4% stake in Atlas Mara, a private equity firm that invests in the financial services sector in Sub- Sahara Africa;

Real Estate: Commercial real estate sector's performance remained stable in the first half of 2017 despite the political headwinds with asking rents averaging at Kshs 93 per square foot and Kshs 126 per square foot for Grade B and A office spaces, respectively, and Kshs 35 per square foot for industrial space according to a report by Broll;

Focus of the Week: Last week we released a report on the performance of the residential market in Nairobi, Nairobi Metropolitan Area Residential Report 2017, and this week we complete the report by showing what this means for someone looking to buy or rent a house in the various markets in terms of affordability in our Nairobi Metropolitan Area Mortgage and Rental Affordability Report 2017. In the report the Mortgages are unaffordable in the Nairobi Metropolitan Area with an Index of 65, with Satellite Towns being the most affordable with an Index of 82, out of a requisite 100. Rents are however affordable in the Nairobi Metropolitan Area with an Index of 124, out of a requisite 100.

Company Updates

- On Saturday, September 23rd, 2017 we shall host the Cytonn Investments Golf Competition at Muthaiga Golf Club. If interested in playing, email clientservices@cytonn.com. Priority will be given to our clients.
- On Thursday, September 28th, 2017 we shall hold a training on the need for Alternative Investments in portfolios. The training is restricted to institutional investors such as Trustees of Pension schemes, Investment Committee members and portfolio decision makers. The event will be held at Sarova Panafric Hotel in Nairobi. If interested in attending, please email pf@cytonn.com to register
- At Cytonn we thrive by building strong teams. On Saturday, 9th September 2017, the Cytonn team held a team building cum sports day at Parklands Sports Club, that provided staff with the opportunity to have fun and interact with colleagues from other departments in a bid to improve work relations while enhancing efficiency in service delivery. See Event Note
- Cytonn Foundation continues to train young entrepreneurs through the Cytonn e-Hub. This week the participants were taken through a mentorship session on Identifying a business opportunity and developing a business strategy. See Event Note
- Our Investment Manager, Maurice Oduor, discussed the effects of the polls on the economy. Watch Maurice Oduor on Citizen TV here
- Our Investment Analyst, John Ndua, discussed the banking sector performance with a key focus on the increased levels of Non-Performing Loans (NPLs) in the first half of 2017 as well as the effect of interest rate capping on lending to SMEs. Watch John Ndua on CNBC here
- Our Research Analyst, Nancy Murule discussed trends in Real Estate market with a focus on the residential market in the Nairobi Metropolitan Area. Watch Nancy Murule on CNBC here
- We continue to showcase real estate developments by our real estate development affiliate, Cytonn Real Estate, through weekly site visits. Watch progress videos and pictures on The Alma, Amara, The Ridgeand Taraji Heights. 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. To deliver high yield returns, our cost of capital is priced off the loan markets where all-in pricing ranges from 16.0% to 21.0% and our yield on real estate developments ranges from 23.0% to 25.0%, hence our top-line gross spread is about 6%. If interested in attending the site visits, kindly register here

- We continue to see very strong interest in our Private Wealth Management training (largely covers Financial planning), which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. We also continue to see institutions and investment groups interested in the trainings for their teams, if interested in the training for your employees or investment group please get in touch with us through our Client Services team at clientservices@cytonn.com To view the wealth management training topics click here
- For recent news about the company, see our news section here
- We have 10 investment-ready projects, offering attractive development and buyer targeted returns of around 23.0% to 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 over 20.0% 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
  - RiverRun Estates (Phase One) is currently 8.7% sold after the recent launch. See RiverRun

Estates

- We continue to beef up the team with ongoing hires: Careers at Cytonn

Fixed Income

During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 153.5%, compared to 136.1% recorded the previous week due to increased liquidity in the money market. The subscription rates for the 91, 182 and 364-day papers came in at 101.1%, 226.7%, and 101.3% compared to 69.3%, 145.4% and 153.4% respectively, the previous week. Yields on the 91, 182 and 364-day papers remained unchanged from the previous week at 8.1%, 10.3% and 10.9%, respectively. The 182-day paper remains the most attractive on a risk-return proposition and continues to witness great interest from investors. The overall acceptance rate came in at 93.4% compared to 91.1% the previous week, with the government accepting a total of Kshs 34.4 bn of the Kshs 36.8 bn worth of bids received, against the Kshs 24.0 bn on offer in this auction. Despite this, the government is behind its domestic borrowing target for the current fiscal year, having borrowed Kshs 18.4 bn, against a target of Kshs 61.1 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 317.7 bn budgeted for the full financial year), the deficit has been covered by an overdraft from the Central bank now currently at Kshs 21.2 bn. We expect the government to meet its domestic borrowing target for the fiscal year, as banks and institutions channel funds more actively towards government securities following the capping of interest rates.

The market was relatively liquid this week due to huge government payments and we saw the Central bank very active in the market mopping out liquidity through Repos, worth Kshs 20.0 bn in total. There was a net liquidity injection of Kshs 4.2 bn this week, compared to a net injection of Kshs 9.0 bn the previous week, with the bulk of it coming from Government Payments and T-Bill Redemptions at Kshs 50.9 bn and Kshs 35.5 bn, respectively. The average interbank rate declined marginally to 5.3% from 5.5% the previous week. Despite this, the average volumes traded in the interbank market declined by 40.7% to Kshs 10.2 bn, from Kshs 17.2 bn the previous week an indication that the liquidity distribution among the banks must have improved during the week.

Below is a summary of the money market activity during the week:

all values in Kshs bn, unless stated otherwise			
Weekly Liquidity Position – Kenya			
Liquidity Injection		**Liquidity Reduction**	
Government Payments	50.9	Transfer from Banks - Taxes	15.0
T-bill Redemption	35.5	T-bill (Primary issues)	29.7
Reverse Repo Purchases	2.7	Reverse Repo Maturities	2.7
		OMO Tap Sales	17.5
		Repos	20.0
Total Liquidity Injection	**89.1**	**Total Liquidity Withdrawal**	**84.9**
		Net Liquidity Injection	**4.2**

For the month of September, the government has issued a new 2-year bond (FXD 1/2017/2) and re-opened a 10-year bond (FXD 1/2017/10) in a bid to raise Kshs 30.0 bn for budgetary support. Investors will participate until the 19th of September, and we shall provide our view on the bidding ranges for the bonds in our next report.

According to Bloomberg, yields on the 5-year and 10-year Eurobonds, with 1.9-years and 6.9-years to maturity, declined by 10 bps and 20 bps, to close at 3.9% and 6.0% from 4.0% and 6.2%, respectively, the previous week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.9% points and 3.6% points for the 5-year and 10-year Eurobonds, respectively, due to stable macroeconomic conditions in the country. The declining Eurobond yields and stable rating (Fitch Ratings having affirmed Kenya’s long-term foreign and local currency issuer default ratings (IDRs) at “B+”, while Standard & Poor’s (S&P) maintained Kenya’s foreign and local currency sovereign credit ratings for the short and long term at “B+/B”, respectively), are

indications that Kenya's macro-economic environment remains stable and hence an attractive investment destination.

The Kenya Shilling appreciated against the USD by 0.1% during the week to close at Kshs 103.0 from 103.1 the previous week, primarily due to dollar inflows from foreign investors to the local equity and debt markets. On a year to date basis, the shilling has depreciated against the dollar by 0.4%, while according to the International Monetary Fund (IMF), the dollar is overvalued by between 10.0% and 20.0%, based on near-term economic fundamentals. In our view, the shilling should remain relatively stable to the dollar in the short term, supported by CBK's activity as they have sufficient forex reserves, currently at USD 7.5 bn (equivalent to 5.0 months of import cover), but we have seen forex reserves decline significantly from USD 8.3 bn at the peak in April this year, but not to a worrying level, as import cover currently stands at 5.0 months.

The Energy Regulatory Commission (ERC) has rejected an application by the Kenya Power & Lighting Company (KPLC) to have the electricity tariff increased as a result of rising costs brought about by increased customer connections and power leakages on its ageing infrastructure. The regulator has urged the utility firm to enhance efficiency in its operations as an avenue for boosting profitability. In Uganda, the Electricity Regulatory Authority (ERA) reduced the price of electricity by 1.5% in the second quarter of 2017, to keep the cost of goods low and enhance growth in the economy, whereas in Tanzania, the regulator was forced to approve a power tariff increase in order to maintain the operations of the Tanzania Electric Supply Company (TANESCO), with inflation edging higher as a result of the power tariff increase. The ERC has been steadfast in keeping the cost of power low and in the process, preserving Kenya's competitive edge as a business hub, in a bid to boost the country's subdued economic growth, that came in at 4.7% in Q1'2017. So far, growth has been slow, instigated by (i) the drought, brought about by depressed rainfall in the first half of the year, (ii) the interest rate caps, which have further subdued private sector credit growth, currently at 2.1% as at May, from 2.4% recorded in April, and 20.9% registered in the same period in 2015, and (iii) increased political uncertainty forcing investors to take a wait and see stance. Despite this, we expect 2017 GDP growth to come in between 4.7% and 5.2%, supported by (i) government continued expenditure on infrastructure, (ii) the recovery of the tourism sector, and (iii) the continued growth of the construction sector.

Rates in the fixed income market have remained stable, and we expect this to continue in the short-term. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rates environment as any additional borrowing in the domestic market to plug the deficit could lead to upward pressures on interest rates. Our view is that investors should be biased towards short-to medium term fixed income instruments to reduce duration risk.

Equities

During the week, the equities market recorded mixed trend with NASI gaining 1.7% while NSE 25 and NSE 20 lost 0.1% and 1.2%, respectively, taking their YTD performance to 24.2%, 22.5% and 20.5% for NASI, NSE 25 and NSE 20, respectively. This week's performance is attributable to mixed performance by select large cap stocks with KCB Group, Equity Group and Co-op Bank losing 3.4%, 2.5% and 1.5%, respectively while Safaricom gained 6.0%. Since the February 2015 peak, the market has lost 6.7% and 30.2% for NASI and NSE 20, respectively.

Equities turnover increased by 36.9% to close the week at USD 55.4 mn from USD 40.5 mn the previous week. Foreign investors remained net sellers with a net outflow of USD 27.0 mn compared to a net outflow of USD 13.0 mn recorded the previous week. We expect the market to record subdued activity over the coming few weeks with reduced volumes as market players are cautious of the renewed political uncertainty in the country. Despite this, we expect the market to remain

supported by improved investor sentiment once the country takes to the polls for the presidential elections scheduled for mid-October, and fears and uncertainty dissipates, as investors take advantage of the attractive stock valuations

The market is currently trading at a price to earnings ratio (P/E) of 13.2x, versus a historical average of 13.3x, and a dividend yield of 3.7%, compared to a historical average of 3.8%. The current P/E valuation of 13.2x is 36.2% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 59.0% above the previous trough valuation of 8.3x experienced in December 2011. The charts below indicate the historical P/E and dividend yields of the market.

According to the Central Bank of Kenya (CBK) Commercial Banks' Credit Survey for the second quarter of 2017, the overall demand for credit remained largely unchanged; with only two out of the eleven sectors recording an increase in demand; Trade and Personal/Household economic sectors. This increase in demand for credit in the two sectors was attributed to reduced cost of borrowing as a result of interest rate capping. The increased demand for credit, however, had little impact on the actual credit advanced as evidenced by a 0.8% decrease in gross loans during the quarter to Kshs 2.36 tn in Q2'2017 from Kshs 2.38 tn in Q1'2017. This decrease was mainly attributable to a reduction in loans granted to the Transport and Communication, Trade, Agricultural, Real Estate, and Mining and Quarrying sectors. The decline is also attributable to political risk as investors adopted conservative strategies as the country approached the general elections. Year-on-Year, the gross loans increased by 4.0% to Kshs 2.4 tn in Q2'2017 from Kshs 2.3 tn in Q2'2016, driven by reduced cost of borrowing, which is however lower than the 5.1% growth of the gross loans recorded over the same period in the previous year. This is an indication that despite the reduced cost of borrowing, through the implementation of interest rate caps, commercial banks are hesitant to disburse loans to consumers. The ratio of gross non-performing loans to gross loans increased to 9.9% in Q2'2017 from 9.5% in Q1'2017 mainly as a result of a challenging business environment. The rise in non-performing loans is expected to persist in the third quarter due to effects of slowdown in economic activities; the slowdown is mainly attributed to the industry's perception of increased political uncertainty.Imperial Bank Limited is set to be out of receivership by the end of H1'2018, dependent on the bank's ability to obtain a strategic investor. The bank was previously under statutory management by The Central Bank of Kenya (CBK) and Kenya Deposit Insurance Corporation (KDIC) since October 2015 when the bank was placed under receivership following what was described as unsound banking practices. We are of the view that the reopening of Imperial Bank after Chase Bank will improve confidence in the banking industry. This, coupled with the recent process of lifting of the bank licensing moratorium, is also bound to improve competitiveness in the local banking sector.

Another key highlight that stood out in the survey is the impact of interest rate capping on demand for credit, its effect on lending to SMEs, as well as its effect on the actual credit granted over the quarter to June 30, 2017. The findings were as summarised below:

a. 54.0% of the commercial banks indicated that interest rate capping negatively affected their lending to SMEs. Interest rate capping has compelled banks to increase their risk mitigation measures. As a result, this has locked out potential customers below certain risk thresholds;
b. 35.0% of the respondents indicated that interest rate capping led to increased demand for credit. However, this increased demand for credit had little impact on the actual credit advanced; and
c. In terms of actual credit granted, the survey depicted a situation of mixed reactions as the commercial banks take a wait and see approach on how the market will react to the capping of interest rates.

As highlighted in our Cytonn Weekly #29/2017, despite the positive intention behind the Banking (Amendment) Act 2016, the capping of the interest rates has not achieved its intended goal which was to improve lending to the consumer, but so far the cap has curtailed lending as evidenced by: (i)

The declining private sector credit growth from a high of 25.8% in June 2014 to 2.1% recorded in May 2017, (ii) Decline in total amounts of commercial banks loan growth, with listed banks recording a loan growth of 5.0% in Q2'2017, compared to 6.6% in Q2'2016, and, (iii) Increase in the average cost of loans by banks, as banks are now charging excessive fees and additional costs on their loans, which would only serve to discourage potential borrowers. For a comprehensive analysis of banking sector performance, we shall be releasing the Kenya Listed Banks H1'2017 Report on 18th September, 2017.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise								
No.	**Company**	**Price as at 01/09/17**	**Price as at 08/09/17**	**w/w Change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****
1.	DTBK	179.0	179.0	0.0%	51.7%	241.1	1.7%	36.4%
2.	KCB Group***	43.8	42.3	(3.4%)	47.0%	54.0	7.1%	34.9%
3.	NIC***	38.8	39.0	0.6%	50.0%	51.2	3.2%	34.5%
4.	Barclays	10.3	10.4	0.5%	22.1%	12.1	9.6%	26.5%
5.	HF Group***	11.6	11.5	(0.4%)	(17.9%)	13.9	3.3%	24.2%
6.	I&M Holdings	124.0	124.0	0.0%	37.8%	147.5	2.3%	21.3%
7.	Co-op Bank	16.7	16.5	(1.5%)	24.6%	18.5	5.6%	18.1%
8.	Jubilee Insurance	468.0	476.0	1.7%	(2.9%)	490.5	1.8%	4.9%
9.	Equity Group	40.3	39.3	(2.5%)	30.8%	38.4	5.1%	2.9%
10.	Stanbic Holdings	79.5	80.0	0.6%	13.5%	77.0	5.2%	1.4%
11.	Kenya Re	21.5	21.3	(1.2%)	(5.6%)	20.5	3.5%	0.0%
12.	Britam	14.3	14.0	(2.4%)	39.5%	13.2	1.9%	(3.4%)
13.	Liberty	13.7	13.5	(1.5%)	1.9%	13.0	0.0%	(3.5%)
14.	StanChart	231.0	234.0	1.3%	23.8%	209.3	4.4%	(6.2%)
15.	Safaricom	24.3	25.8	6.2%	34.5%	19.8	4.7%	(18.5%)
16.	Sanlam Kenya	28.8	28.5	(0.9%)	3.6%	21.1	1.1%	(25.1%)
17.	CIC Group	5.6	5.8	4.5%	52.6%	3.7	1.7%	(34.3%)
18.	NBK	11.4	10.5	(7.5%)	45.8%	4.0	0.0%	(61.7%)
Target Price as per Cytonn Analyst estimates								
****Upside / (Downside) is adjusted for Dividend Yield***								
*****Banks in which Cytonn and/or its affiliates holds a stake***								
For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group, ranking as the 5th largest local institutional investor								

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

French based Amethis finance, a private equity firm, through its subsidiary Amethis West Africa, has acquired an undisclosed minority stake in Sodigaz Group, a distributor of LPG bottled gas in Bukina Faso. Sodigaz Group has a 60.0% market share of gas distribution in Bukina Faso having established a network of approximately 2,000 resellers with annual sales of over 45,000 tons of gas. This acquisition will (i) assist in the value creation in Sodigaz Group through active participation in management by Amethis finance, (ii) assist in the growth of Sodigaz Group through the expansion of its market share in Bukina Faso and other international territories by taking advantage of the new

capital injection, and (iii) diversify Amethis finance's investment portfolio in the Energy sector. Investment in the energy sector and most specifically in LPG gas in Sub-Sahara Africa is being driven by (i) an increase in the middle income population that has led to the increase consumption expenditure, and (ii) support by national Governments of countries in Sub-Saharan Africa through the reduction of excise tax on LPG gas in order to encourage households to use this commodity hence the reduction of deforestation.

Fairfax Africa, an investment holding company of Canadian life insurer Fairfax Financial has completed the acquisition of a 42.4% stake of Atlas Mara valued at USD 159.0 mn effectively valuing the company at USD 375.0 mn. Atlas Mara Limited is a private equity firm based in the British Virgin Islands that invests in Sub-Sahara African financial services firms. The acquisition is part of Atlas Mara's strategy to raise USD 200 mn in order to increase its stake in Union Bank of Nigeria and expand its operations. The growth in the financial services sector in Sub-Saharan Africa is being driven by (i) Growth in the middle-class population hence an inherent increase in consumption expenditure and an increase in the percentage of the population which will require banking services, and (ii) Increased adoption of technology to improve efficiency.

Private equity investments in Africa remain robust as evidenced by the increased deal volume. The increasing investor interest is attributed to (i) rapid urbanization, (ii) a resilient and adapting middle class and increased consumerism, (iii) the attractive valuations in Sub Saharan Africa's private markets compared to its public markets, (iv) the attractive valuations in Sub Saharan Africa's markets compared to global markets, and (v) 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:

Over the week, Broll Property Group launched the Broll Sub-Saharan Africa Snapshot Report 2017. The report focused on the performance of office, retail and industrial sectors in 9 countries in Sub-Saharan Africa namely, Ghana, Kenya, Malawi, Mauritius, Mozambique, Namibia, Nigeria, South Africa and Zambia for the first half of 2017. The key takeout from the report were:

i. For commercial office sector in Kenya, occupancy levels for buildings more than 2 years old averaged at more than 85.0% with the new stock struggling to get clients as a result of huge supply in major commercial nodes. The rentals averaged at Kshs 126 and Kshs 93 per sqft for Grade A and Grade B offices, respectively. The sale price ranged between Kshs 9,500 and Kshs 14,500 depending on the location and developer and not subject to the grade of the building. The report also highlighted that Upperhill is becoming increasingly unpopular, despite being close to the CBD, due to traffic congestion and increased supply in the zone. Performance of other countries in the office sector is as tabulated below:

Country	Market Performance in H1'2017	Outlook
Ghana	Relatively flat due to tough economic times	Stable in the short – term with market activity tied to currency performance
Kenya	**Relatively stable rents & occupancy levels with supply being higher than demand**	**Conditions to remain the same as effects of General Elections wear off**
Malawi	Office demand outweighs supply in both cities (Lilongwe & Blantyre)	Supply expected to increase in the next 3 years & supply is envisioned to outstrip demand

Mauritius	Demand is stable with occupancy levels at 73%. Ebene Cyber City dominates the office market in Mauritius	Speculation is high over government's plans to relocate central services which could increase vacancy rates of office buildings in the medium term
Mozambique	Increased supply with new stock being taken up by multi-nationals & banks	A slowdown in demand resulting from delay in mega-projects
Namibia	Stagnant with users seeking to consolidate & reduce office requirements. However, smaller offices are still in demand	Rising construction costs straining the feasibility of projects & developers are expected to charge above premium rentals
Nigeria	Increased demand from existing corporates & new entrants	Emerging confidence in the market but too early to determine the long-term performance.
South Africa	Lots of pressure from current economic conditions with corporates adopting cautious attitude	Infrastructural upgrades in some office nodes expected to increase their attractiveness
Zambia	N/A	N/A

ii. For the commercial retail sector in Kenya, occupancy levels for newer and lesser established malls was 75% whereas more prime malls, the average was 90% let for H1'2017. Rental prices range from Ksh 300 and 350 per sqft depending on the retails centre and the tenant. Below is a tabulation of other countries' performance in the retail sector: -

Country	Market Performance in H1 2017	Outlook
Ghana	Facing challenges due to deterioration of the local currency	Performance in future is strongly tied to the performance of macroeconomic factors
Kenya	**Occupancy levels in prime retail centers at 90% with less established ones achieving occupancy below 75%**	**Investors taking a county based approach due to devolution**
Malawi	High demand at over 95%	Supply in the next 2-3years will affect occupancy levels of existing stock
Mauritius	Demand for prime retail space is strong with vacancies of less than 5%	Plans for future developments still at pre-conception stage
Mozambique	Increased demand on the back of rising middle class & increased consumer base	Evolution of the sector from informal retail to shopping centers depending on improved transportation & logistics
Namibia	The sector is advanced even though small to medium sized shops experiencing the punch due to current economic climate	Increased demand for retail upgrade & expansion is expected as a result of anticipated improved economic condition
Nigeria	Harsh reality facing the sector remained relatively unchanged	Sector stands to benefit with positive macroeconomic performance gains traction
South Africa	Increased pressure on sector due to current economic conditions leading to increased cost of living	Retail cannibalization will become a reality due to huge current & proposed retail space hence necessitating differentiation
Zambia	Increased demand for space by major regional retailers	Positive outlook with current vacancy rates at 15%

iii. For the industrial sector, the supply in the Kenyan market is predominantly grade B and C warehousing with rents averaging at Kshs 35 per sqft and occupancy levels of on average 93.0%. The market is witnessing a shift in preferred location with industries moving away from the congested industrial area to nodes such as The Eastern Bypass, Mombasa Road and Thika Road.

There is a huge opportunity in the provision of quality Grade A warehousing with the construction of the first pure Grade A warehousing being underway at the Tatu City's Industrial park with completion envisaged to be the year 2020, the park is currently 65% occupied. Performance of other countries in the industrial sector is as tabulated below: -

Country	Market Performance in H1 2017	Outlook
Ghana	Sluggish in comparison to other sectors with general elections having caused an economic slowdown	Sector on recovery path with projections of improved performance
Kenya	**Stable growth in demand especially in Nairobi & immediate environs**	**Industrial warehousing expected to change from owner occupied to a renters market due to high demand**
Malawi	Increased demand for storage space of agricultural produce by companies after a bumper harvest	Market expected to grow should government implement its policies geared towards increasing exports & reducing imports
Mauritius	Unattractive characterized by limited rental growth & ageing stock	No major developments on the horizon & a status quo of the market is expected into the foreseeable future
Mozambique	Fast growing demand especially due to lack of modern industrial buildings	Increased infrastructure spend & economic growth in neighboring landlocked countries will put pressure in the sector beyond current capacity
Namibia	Sluggish with numerous unserviced plots available for sale at exceptionally high selling prices	Market to remain stable in the remaining half of the year
Nigeria	Little noteworthy activity owing to largely underdeveloped industrial & manufacturing base	Increased activity hinged on sustainable policies to revive the country' industrial & manufacturing sector
South Africa	Lots of pressure due to continued labor strikes , increased electricity & fuel costs	Online marketing increasing demand for decentralized warehousing
Zambia	N/A	N/A

These findings are in tandem with Cytonn H1'2017 Markets Review, which indicated asking rents remained stable declining by only 0.2% in the first half of 2017 and occupancy rates averaging at 86.0%. This is as a result of the mismatch between supply and demand with the market having an oversupply of 3.2 mn sqft of office space. The market is thus a tenants' as opposed to a buyers' market and the opportunity in the sector lies in certain pockets of value such as areas with low supply like Gigiri and adoption of differentiated concepts such as green buildings and serviced offices in order to woo more tenants and buyers. For the retail sector, developers need to focus on product differentiation which will ease the process of sourcing for tenants in new developments. As at now, the local scene is characterized by a narrow tenant base hence newer developments rely on the same retailers to take up space in these malls. In the industrial sector the supply of warehousing is anticipated to increase following the completion and launch of the Standard Gauge railway resulting in a boost in the cargo handling ability in the country.

Still in the industrial sector, the Kirinyaga County Government announced plans to enter into a Kshs 5.0 bn Public Private Partnership (PPP) with private investors to set up 10 industrial parks aimed at value addition of agricultural produce. Under partnership, the county government will provide the development land and equity of Kshs 1.0 bn. The private entities will then provide the rest of the development funds, facilities and equipment as well as the construction of the warehouses and

eventually manage them. The project is expected to benefit horticultural farmer groups and cooperative societies who will have better storage and not have to rely on middle-men for storage facilities. Food processing industry, just like any other business in the manufacturing sector is one of the demand drivers for warehousing space even though it requires specialized facilities. A research by JLL predicts that total demand for industrial space in East Africa will increase by 3.6% year on year and by Q1 2018 the demand will surpass the total demand in West Africa for the first time, which despite having higher demand estimates, has a slower growth rate of 2.5%. The growth in demand in East Africa is attributed to increased industrial production potential. In Kenya, the growth in demand for warehousing is expected to grow given that over 62% of the manufacturers in the country experience warehousing shortage and increased infrastructural development will make it easier to develop warehouses through ease of access. We however remain sceptical about the viability of real estate PPPs in Kenya; they have been discussed for a long time with no demonstrable traction or success.

Regus, the world's largest service office provider with operations in 106 countries, is set to establish its 8th business centre in Nairobi, a decade after setting up shop in the country. The operator has local offices in the Nairobi's Central Business District, Westlands, Kilimani, Riverside, Museum Hill, the Village Market and Upperhill**.** In our opinion, the expansion has been driven by high demand for serviced offices from the growing SME sector, growth in the ICT and professional services provider and high returns average rental yield of 13.4% at 66% occupancy, 4.2% points higher than the conventional office space yield of on average 9.2**%.** Serviced offices are also in low supply in the market accounting for approximately 0.35% of the total office space thus making it a viable investment option. In our opinion, we are likely to witness more investment in the sector as investors seek to satisfy the demand for serviced offices and diversify from the oversupplied commercial office sector in Nairobi.

Other real estate highlights in the week include:

Investors in the hospitality sector in the Western part of Kenya lost Kshs 700 million over the election period as a result of uncertainties linked to the August 8th general elections. According to the chairman of Western Kenya Hospitality Leaders Association, hoteliers made losses as many guests cancelled their bookings in the various facilities located in this region owing to the uncertainty attributable to elections. We expect the sector in the region to pick up after normalcy is restored after the end of the electioneering period. This is contrast to performance of the sector in the Coast and Maasai Mara regions whereby occupancy levels have generally remained high with Maasai Mara region experiencing full occupancy during July August period. The resilience of the Coastal region and Maasai Mara can be attributed to the superior product offering in these markets with Maasai Mara being cushioned by the Wildebeest Migration, currently in its peak season.

Nakumatt announced the closure of its NextGen Mall outlet, 9 months after it started operations. The outlet occupied approximately 12% of the 490,000 sqft of retail space within the complex. The closure is part of the strategy being applied by the retailer to cut costs and in August, the retailer closed its Uganda operations. With increased supply of retail space, and a tough economic environment we expect retailers to be bearish on their expansion plans and malls to witness lower pre lets and pre sales rates with development activity being concentrated in county headquarters and Satellite Towns which have low supply and are witnessing an influx in population.

We expect the hospitality and industrial sectors to continue doing well backed by improved infrastructure and high demand, given the relatively peaceful election period despite the election rerun. For the commercial office and retail sectors, stagnation and even a decrease in price and rental growth rates is expected as a possible oversupply looms.

Nairobi Metropolitan Area Mortgage and Rental Affordability Report 2017

Last year, we released a report, The Nairobi Metropolitan Area Mortgage and Rental Affordability Report 2016, that covered the mortgage and rental affordability of the residential sector. According to the report, most sub-markets were unaffordable to prospective home-owners with an average mortgage affordability index of 66, whereas most markets were affordable to the renters with an average rental affordability index of 132, where index scores of 100 and above indicate affordability. This year, we update the report with research conducted in 35 sub-markets in the Nairobi Metropolitan, to estimate the affordability of mortgages in 2017 and to note any changes in affordability between the two years. We start by explaining the methodology used in constructing the index, then cover the mortgages affordability showing the areas various income groups will be able to purchase houses using mortgages, then concluding with the rental affordability and the areas the various income groups will be able to rent houses.

Mortgage and Rental Affordability

Using market data from the Nairobi Metropolitan area on house and rental prices, we constructed indices to gauge the affordability of mortgages and rents in specific locations. The purpose of the research is to inform households on the areas they will find affordable to purchase mortgages and / or rent houses based on their levels of income and the corresponding house and rental prices in those areas.

Methodology

The Mortgage Affordability Index is a tool used to measure whether the average income earned by a household is enough to enable a household to purchase a house with a mortgage option. The Rental Affordability Index is a tool used to measure whether the average income earned by a household is enough to enable a household rent a house in a given location. In the computation of these indices, the key factors under consideration are household income, house prices, locations in Nairobi and the Metropolis, and monthly payments for mortgages and rent. The index value is obtained by dividing the qualifying income by the median household income.

- The qualifying income is obtained by dividing the monthly mortgage payments by 40%. The assumption being made here is that households spend a maximum of 40% of their income on mortgage payments; and
- An index of 100 or above indicates the most affordable areas, while that of below 100 to 0 indicates the least affordable areas.

From our survey and analysis, of the affordability of mortgages in the Nairobi Metropolitan area, our take outs, were as follows:

(all values in Kshs unless stated otherwise)					
Nairobi Metropolitan Mortgage Affordability Index					
Segment	**House Price per Square Meter****	**Median Monthly Household Income***	**Monthly Mortgage Payment*****	**Qualifying Household Income******	**Mortgage Affordability Index *******
High Income	197,706	1,300,000	1,156,241	2,890,603	45
Upper Middle	129,165	450,000	301,139	752,848	62
Lower Middle	85,745	200,000	138,720	346,800	68
Satellite Towns	66,628	200,000	106,751	266,879	82
Average	**107,455**	**325,000**	**219,930**	**549,824**	**65**
With an average index of 65, mortgages are unaffordable across all segments due to the high prices of houses and cost of debt indicating that the median-income household cannot afford to service a mortgage. The index records a slight decline of 1 point from the 2016 average of 66 mainly as a result of the 3.8% price appreciation recorded year on year					
Median monthly household income - this is the median of the monthly income earned by households in the area under consideration. For one bedroomed houses it is assumed that a household has one breadwinner and for the rest, a household has two breadwinners **House price per square metre - this is the median of the price per square metre of houses in the region under consideration obtained by market research ***Monthly mortgage payment - this is the monthly contribution that a household makes to the mortgage lender to service the loan. It is calculated using the excel PMT function based on the house price, at a 15% interest rate and a 20-year term * Qualifying household income - this is the monthly income that a household needs to earn to be able to afford a mortgage on a house *****Mortgage affordability index - is the quotient of the qualifying income and the median monthly household income***					

Source: Cytonn Research

As such, in order to provide actionable recommendations, the table below summarises where households should take up mortgages depending on their income levels:

Summary and Conclusions -Mortgage Affordability	
Income Bracket (Kshs)	**Towns in which mortgages are affordable to households for the stated income levels**
150,000-300,000	Thindigua, Kiambu, Athi River, Komarock, Dagoretti, Thika Kitengela, Ruaka, Rongai, Donholm
300,000- 1,000,000	Kikuyu, Juja, Ruiru , Ngong , Mountain View, Imara Daima, Kasarani, Langata, Upper Hill, Kilimani, Lavington, Kileleshwa, Westlands, Runda Mumwe, Redhill
Above 1,000,000	Lower Kabete, Loresho, Ridgeways, Riverside, Roselyn , Karen, Runda, Kitisuru
· Satellite Towns such as Thindigua, Kiambu, Athi River and Kitengela are the most affordable mortgage market with a household requiring a median income of between Kshs 150,000 – Kshs 300,000 to purchase a house using a mortgage · Roselyn, Karen, Runda, Muthaiga and Kitusuru are the most unaffordable mortgage markets with households requiring a minimum monthly income of Kshs 1 Million to purchase a house using a mortgage	

Source: Cytonn Research

Given the unaffordability in the mortgage market, we also constructed a Rental Affordability Index to analyse the affordability of rents in the Nairobi Metropolitan area. The results were as follows:

(all values in Kshs unless stated otherwise)					
Nairobi Metropolitan Rental Affordability Index					
Location	**House Rent per Square Metre****	**Median Monthly Household Income***	**Rent 2017**	**Qualifying Household Rental Income*****	**Rental Affordability Index******
Satellite Towns	318	200,000	38,708	129,028	155
Lower Middle	400	200,000	47,063	156,875	127
Upper Middle	629	450,000	127,900	426,332	120
High Income	914	1,300,000	424,375	1,414,583	92
Average	**514**	**325,000**	**87,481**	**291,604**	**124**
With an average index of 124, rents are affordable in most segments apart from the high-income segment apartment from the High income segment where a household needs to earn Kshs 1.4 mn per month to afford the average rent of Kshs 424,375 per month					
****Median monthly household income - this is the median of the monthly income earned by households in the area under consideration. For one bedroomed houses it is assumed that a household has one breadwinner and for the rest, a household has two breadwinners* *** House rent per square metre - this is the rent per square meter paid by households each month. It is obtained by market research* **** Qualifying household rental income - this is the monthly income that a household needs to earn to be able to afford to pay rent* *****Rental Affordability Index - It is the quotient of Qualifying rental income and median monthly household income***					

Source: Cytonn Research

The table below summarises where households should take up rentals depending on their income levels:

Summary and Conclusions on Rental Affordability	
Income Level (Kshs)	**Towns in which rents are affordable to households for the stated income levels**
50,000-150,000	Athi River, Kitengela ,Ruaka, Kiambu, Thindigua ,Rongai Komarock , Juja ,Ngong, Donholm, Thika
150,000-300,000	Dagoretti, Mountain View, Imara Daima , Kasarani , Ruiru Kikuyu, Langata, Upper Hill
300,000-1,000,000	Parklands, Redhill , Westlands, Lower Kabete , Kilimani Runda Mumwe, Kileleshwa, Lavington , Loresho ,Ridgeways, Riverside
>1,000,000	Karen, Roselyn, Runda, Kitisuru
· Athi River, Kitengela, Ruaka and Kiambu are the most affordable middle class residential areas in Nairobi Metropolitan area. A house hold needs to earn a median income of Kshs 50,000-150,000 to live in these estates · The most unaffordable rental markets are Karen, Roselyn, Runda and Kitisuru with a household requiring more than a million Kshs to be able to live in these estates	

Source: Cytonn Research

Conclusion

In conclusion, similar to 2016, no area in the Nairobi Metropolitan Area had an index score of 100 and above for the mortgage market indicating that the market is still a renter's market as opposed to a buyers' market despite the government's efforts to increase the affordability of houses through measure such as (i) Capping the interest rates, (ii) giving developers constructing more than 100 units p.a a tax cut of 15%, and (iii) removing NEMA, NCA and title search fees. The ineffectiveness can be attributed to low incomes levels that cannot service a mortgage, high property prices which keep on rising and low mortgage disbursements by banks following the implementation of the Banking Amendment Act 2015. Consequently, The Nairobi Metropolitan Area still remains largely a rental market. For additional information on how we constructed the index, methodology and our assumptions, including the mortgage and rental affordability indices of the individual towns, refer to

the full report here: Nairobi Metropolitan Area Mortgage and Rental Affordability Report 2017

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Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com
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