Nairobi Metropolitan Area Residential Report 2023, & Cytonn Weekly #18/2023

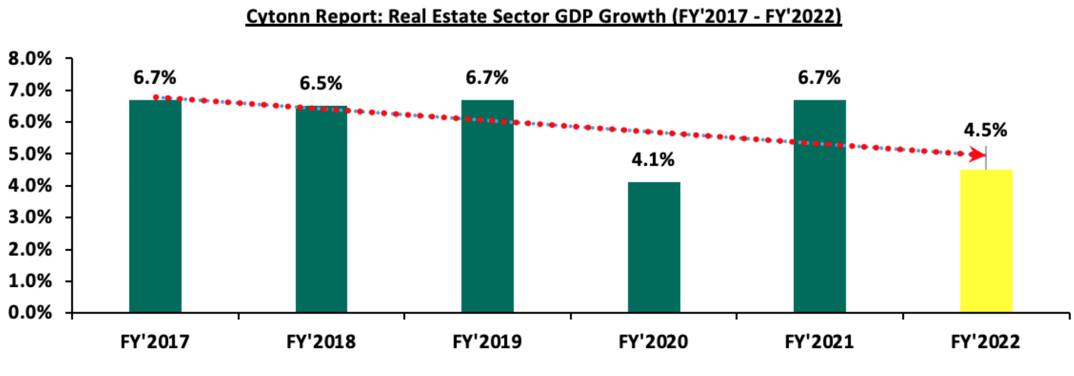
Real Estate

I. **Industry Reports**

a. **Economic Survey 2023 Report**

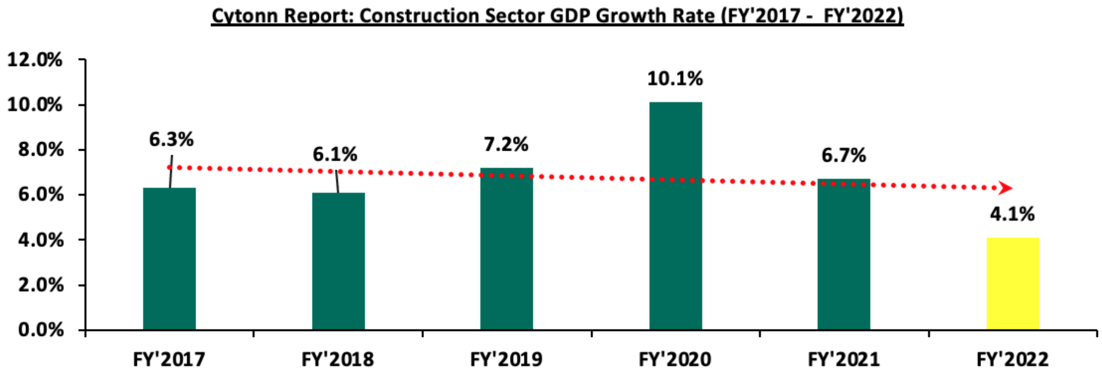
During the week, the Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2023, and below are the key take outs related to the Real Estate sector:

i. **Declined Growth in the Real Estate Sector** – According to the report, the Real Estate Sector grew by 4.5% in FY'2022. This was however 2.2% points lower than the 6.7% growth recorded in FY'2021. The decline in performance was mainly attributed to increased cost of construction materials which hampered optimum investments, and reduced investor confidence as most investors, for the most part of the year adopted a 'wait-and-see' approach in anticipation of the August 2022 general elections. The graph below shows Real Estate sector growth rates from FY'2017 to FY'2022;



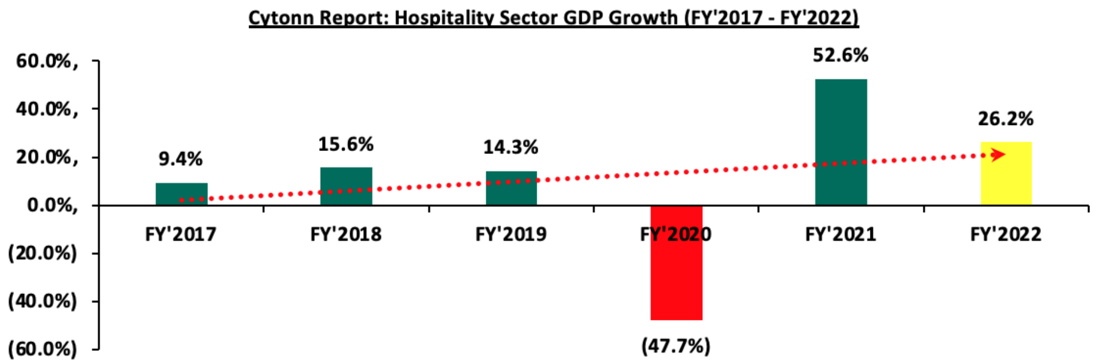
Source: Kenya National Bureau of Statistics (KNBS)

ii. **Slower Growth in the Construction Sector** - The construction sector grew by 4.1% in FY'2022, 2.6% point lower than the 6.7% growth recorded in FY'2021. The decline was driven by: i) rising cost of construction materials averaging at Kshs 5,210 per SQFT in 2022, a 5.0% increase from Kshs 4,960 per SQFT recorded in 2021, hence hindering several construction projects, ii) the completion of major development projects in the country such as the Nairobi Expressway, Eastern Bypass, and, iii) the government's decision to cut back on infrastructure expenditure, subsequently reducing the FY'2022/23 budgetary allocation towards infrastructure projects, for the year ending June 2023, by Kshs 47.3 bn. This represented a 21.4% reduction in expected spending to Kshs 174.0 bn, from the Kshs 221.3 bn previously allocated, with an aim of prioritizing completion of stalled projects, and avoiding new capital intensive projects. The graph below shows the construction sector growth rate from FY'2017 to FY'2022;



Source: Kenya National Bureau of Statistics (KNBS)

iii. **Sustained Recovery in Accommodation and Food Service Sector** - The Accommodation and Restaurant services grew by 26.2% in FY'2022, from the 52.6% growth recorded in FY'2021 demonstrating sustained recovery of the sector toward pre-COVID levels. However, the performance was 26.4% points decline from the 52.6% recorded in FY'2021, which was mainly attributed to the sector rebounding from a contraction occasioned by the COVID-19 pandemic, that saw countries impose lockdowns and travel restrictions. The sector's growth in FY'2022 was slowed down by the elevated global and local inflationary pressures resulting from supply chain bottlenecks and persistent drought that negatively affected food production. Notably, the sector's performance continues to be cushioned by the rising tourism activities with the number of visitors arriving into the country coming in at 1,145,133 visitors in FY'2022, from 692,938 visitors in FY'2021. The graph below shows the accommodation and restaurant sector growth rate from FY'2017 to FY'2022;



Source: Kenya National Bureau of Statistics (KNBS)

Kenya's Real Estate sector is expected to experience a surge in growth supported by; i) the peaceful post-election period, which bolstered investors' confidence, ii) the continuous recovery of the hospitality sector, aided by the Ministry of Tourism's vigorous marketing campaigns on platforms such as Magical Kenya, and iii) more development activities, particularly in the residential sector, with an emphasis on affordable housing. However, the impacts of the elevated inflationary pressures in the hospitality and construction sectors, coupled with a 4.4% reduction in government's allocation for Infrastructure, Energy, and Information and Technology (ICT) for the FY'2023/24 to Kshs 398.2 bn, from Kshs 416.4 bn, are expected to weigh down on the optimum performance of the Real Estate sector.

b. **Hass House and Land Price Index Q1'2023 Report by Hass Consult**

During the week, Hass Consult, a consulting and Real Estate development firm based in Kenya, published its House Price Index Q1'2023 Report. The report highlights the performance of the residential Real Estate sector in the Nairobi Metropolitan Area (NMA). The following are the main findings of the report:

i. The average q/q selling prices for residential houses registered a 0.02% increase in Q1’2023, compared to a 2.2% decline in Q4’2022. The performance was mainly driven by 0.8% and 0.7% increase in apartment prices and detached houses prices respectively. However, the performance was weighed down by a 2.4% decline in the selling prices of semi-detached houses. On a y/y basis, the average selling prices for residential houses appreciated by 2.0%, compared to a 6.8% increase that was recorded in Q1’2022. The slow increase in property prices is attributable to inflationary pressures which have impended consumer demand, and saw developers be less aggressive in pricing their properties,
ii. In the Nairobi Suburbs detached and semi-detached houses, Lang’ata was the best performing node having recorded a y/y capital appreciation of 17.5% for its detached units, indicating increased demand for detached and townhouses in the area, fuelled by; i) its affordability compared to neighbouring nodes such as Karen, ii) good infrastructure network including the Southern-Bypass, and Lang’ata road enhancing accessibility and, iii) its close proximity to the Central Business District (CBD). Conversely, house prices in Runda recorded a significant y/y price decline of 6.5% primarily attributed to a decrease in demand for townhouses in the area due to house price affordability in neighbouring neighbourhoods such as Ridgeways and Nyari Estate that offer buyers the same lifestyle and quality of living as compared to Runda,
iii. In the Nairobi Suburbs apartments, Lang’ata remained to be the best performing region recording a y/y capital appreciation of 16.4% due to: i) its close proximity to the CBD and prime neighbourhoods such as Karen, ii) convenient access to social amenities such as shopping centres including Galleria, the Hub, Waterfront, and recreational facilities such as the Nairobi National Park, and iii) a well-established infrastructure network enhancing seamless accessibility through Lang'ata Road, Ngong Road, Mombasa Road, the Southern Bypass, and Wilson Airport for air travel. On the other hand, Upperhill realized the highest y/y price correction of 11.8% attributed to city residents opting for quieter neighbourhoods away from the noise pollution and traffic congestion prevalent in the area, and its transformation into a business district leading to a shift in demand from residential to commercial properties,
iv. In the satellite towns, houses in Ngong’ recorded the highest y/y price appreciation at 16.7% driven by increased demand resulting from; i) improved infrastructure development such as the Ngong’ Road thus enhancing accessibility, ii) growing middle income population in the area supporting demand, iii) proximity to social amenities and recreational facilities such as Milele Mall, Waterfront Karen, and The Hub, and iv) its affordability in terms of selling and rental prices compared to neighbouring areas such as Karen. Conversely, houses in Limuru realized the highest y/y price correction of 9.4% attributed to reduced demand owing to the region’s location which is far from Nairobi CBD and other major urban business nodes, and main transportation hubs like the Jomo Kenyatta International Airport (JKIA), Standard Gauge Railway (SGR), among others,
v. In satellite towns’ apartments, Thika recorded the highest y/y price appreciation of 3.3% attributed to increased demand for apartments in the region facilitated by: i) the availability of affordable apartments in terms of selling and rental prices thus increasing demand ii) a growing student population from Mount Kenya University (MKU), Zetech University , Jomo Kenyatta University of Agriculture and Technology (JKUAT) and many more Technical And Vocational Institutes (TVETs) creating demand for affordable apartments in the area, and, iii) good infrastructural development mainly on the back of the Thika Superhighway which has reduced commute time from the CBD, thereby benefitting home buyers seeking to reside away from the city and the near-to-completion dualling of Kenol - Marua Road connecting the town centre to Murang’a and other counties in the Mt.Kenya region and the Northern Eastern frontier. On the other hand, Kitengela realized the highest y/y price correction of 11.1% attributed to stiff competition faced from neighbourhoods such as Athi River, Mlolongo, and Syokimau, which are strategically located along the Mombasa-Nairobi Highway enhancing accessibility and demand by buyers as well as its close proximity to amenities such as Crystal Rivers and Signature malls, and the Nairobi CBD,

vi. The overall asking rents of housing units in the NMA slightly declined by 0.5% q/q resulting to a 1.2% y/y decline, compared to a 1.5% q/q decline recorded in Q4’2022 and 0.3% y/y growth recorded in 2022, attributed to slow growth in the general demand for rental units post pandemic, and landlords still offering rent incentives to attract customers. Apartments recorded the highest y/y increase in asking rents of 3.2% with detached and semi-detached units realizing price corrections of 2.5% and 3.2% respectively, supported by the progressive expansion of the middle class preferring to renting apartments due to their affordability,
vii. In the Nairobi suburbs, houses in Loresho realized the highest y/y rent appreciation of 8.6%. This was attributed to; i) presence of sufficient amenities and infrastructure enhancing investments, ii) serene environment appealing to the upper-middle class hence creating demand, and iii) strategic and ambient location which is in part of Westlands. On the other hand, houses in Kileleshwa realized the highest y/y rental rates decline of 7.7% attributed to reduced demand for detached and semi-detached houses owing to new tenants shifting preference to renting apartments in areas that are more affordable,
viii. In the Nairobi Suburbs apartments, Lang’ata remained to be the best performing region recording a y/y rent appreciation of 12.8%, attributed to increased demand for the units in the region due to better amenities and the accessibility it offers. On the other hand, Parklands continued to realize the highest y/y rent correction of 11.3% attributable to reduced demand for residential properties by city dwellers and the region attracting more commercial office investments as compared to residential,
ix. In the satellite towns, houses in Ngong’ recorded the highest y/y rent appreciation at 17.4%, driven by increased demand resulting from; i) improved infrastructure development such as the Ngong’ Road thus enhancing accessibility, ii) growing middle income population in the area supporting demand, iii) proximity to social amenities and recreational facilities such as Milele Mall, Waterfront Karen and The Hub, and iv) its affordability in terms of selling and rental prices compared to neighbouring areas such as Karen. Conversely, houses in Juja realized the highest y/y rent correction of 3.1% attributed to reduced demand for detached and semi-detached houses owing to increased demand for apartments units facilitated by the student population from JKUAT and several colleges and TVETs in the region, and,
x. For the satellite towns’ apartments, Rongai realized the highest y/y rental rate increase by 22.8% mainly due to better accessibility facilitated by improved infrastructure development and its affordability to the middle class that predominantly resides in the area. On the contrary, only apartments in Athi River recorded a y/y rental rates decline of 0.9% due to reduced demand on the back of competition from neighbouring nodes such as Mlolongo and Syokimau which are strategically located along Mombasa road are close to major transportation hubs such as Jomo Kenyatta International Airport (JKIA) and the Standard Gauge Railway (SGR) via the Nairobi Expressway which have significantly improved accessibility to the regions.

The findings of the report are in line with our Cytonn Q1’2023 Markets Review, highlighting that the residential market in NMA recorded a y/y improvement in performance with the average total returns to investors coming at 6.1%, 0.4% points increase from 5.7% recorded in Q1’2022. The improvement in performance was primarily fuelled by implementation of major infrastructural projects such as the Nairobi Expressway, Eastern, Northern and Western Bypasses, which have significantly improved accessibility to areas along the development, leading to increased demand of residential units, and the gradual recovery of the economy from the COVID-19 pandemic.

Hass Consult also released the Land Price Index Q1’2023 Report which highlights the performance of Real Estate land sector in the Nairobi Metropolitan Area (NMA). The following were the key take outs from the report:

i. The average q/q selling prices for land in the Nairobi suburbs slightly increased by 0.3% compared to a 0.1% gain realized in Q1’2022. On a y/y basis, the performance represented a 1.4% increase, compared to a 1.1% growth recorded in Q4’2021. Consequently, q/q and y/y land prices in satellite towns of Nairobi increased 1.3% and 8.1% respectively, compared to a 2.2% and 7.4% respectively in Q1’2022. The sustained improvement in performance continues to demonstrate the sector’s resilience even during times of economic uncertainty characterised by inflationary pressures,

ii. Spring Valley was the best performing node in the Nairobi suburbs with a y/y price appreciation of 18.8%. This was attributed to increase in demand for land in the region owing to; i) adequate infrastructure, ii) adequate amenities such as Sarit Centre, and Westgate Shopping Malls, and, iii) proximity to the CBD and other prime and rising urban nodes such as Westlands. On the other hand, land in Kileleshwa recorded the highest y/y price correction of 2.9%. This was due to continuous decline in demand for development land attributed a general shift in trend by developers to satellite towns due to scarcity of affordable land for development in Nairobi, and,
iii. For satellite towns, Ngong was the best performing node with a y/y capital appreciation of 18.6%, followed by Athi River which recorded a y/y capital appreciation of 18.3%. The improvement in performance in Ngong was driven by i) infrastructural development, ii) increased demand for land due to its affordability, and, iii) its close proximity to the city centre and major urban nodes. On the other hand, land prices in Athi River continued to soar on the back of the Standard Gauge Railway (SGR) extension speculation. Conversely, Ongata Rongai was the worst performing node with a y/y price correction of 8.0% driven by low demand for land in the area, resulting from relatively farther distance from Nairobi CBD and other business nodes.

The findings of the report are also in line with our Cytonn Q1’2023 Markets Review, which highlighted that the overall average selling prices for land in the NMA appreciated by 5.7% to Kshs 130.4 mn per acre in Q1’2023, from Kshs 129.6 mn per acre recorded in Q1’2022. This was mainly attributed to; i) positive demographics driving demand for land facilitated by high population and urbanization growth rates significantly above the global averages, ii) improved development of infrastructure such as roads, railways, water and sewer lines which has improved and opened up areas for investment, ultimately increasing property prices, iii) increased construction activities particularly in the residential sector driven by the government’s affordable housing agenda thus boosting demand for land, iv) limited supply of land especially in urban areas which has contributed to rising land prices, and, v) a rising middle income class population with more disposable income to invest.

II. **Commercial Office Sector**

During the week, the United Nations (UN) announced plans to relocate the United Nations Office for Project Services (UNOPS) Africa regional office to Nairobi, Kenya. Previously, the UNOPS Africa regional headquarters had its base in Denmark, while maintaining country offices in Liberia, Tunisia, Sudan, South Sudan, Kenya, the Democratic Republic of Congo (DRC), Nigeria, Ethiopia, Cote d'Ivoire, and Tunisia. The aim of the move was to bolster the agency's capability to aid its African member nations by improving its agility in addressing the continent's needs related to development, humanitarianism, peace, and security. Following the announcement, Kenya is set to host yet another United Nations agency including the United Nations Office at Nairobi (UNON), United Nations Environment Programme (UNEP), and, United Nations Human Settlements Programme (UN-Habitat) all of which are headquartered in Nairobi, alongside other country offices such as United Nations Development Programme (UNDP), and United Nations Children’s Fund (UNICEF) among others. The relocation is planned to be completed by the end of 2023.

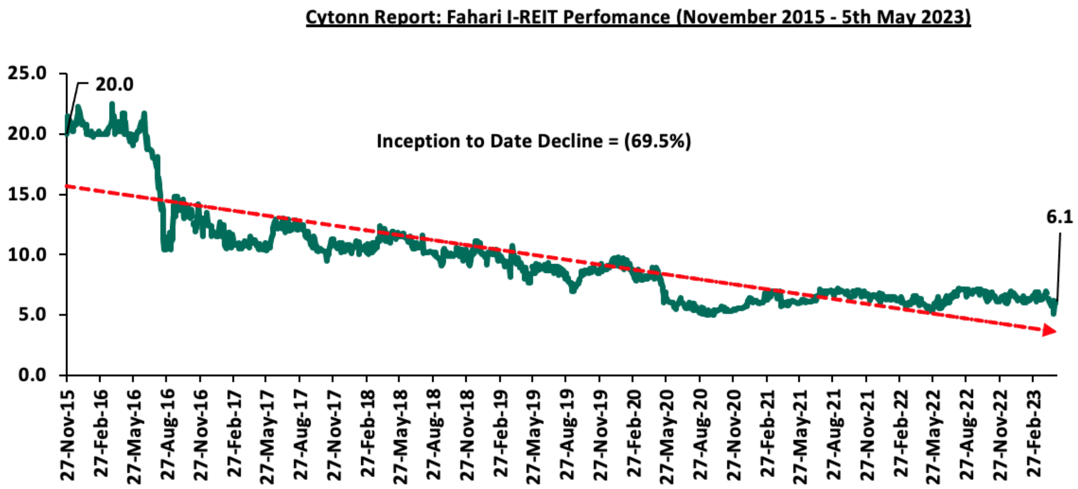
Upon completion of the regional relocation by the agencies, we expect continued improvement in performance supported by; i) Kenya’s recognition as a peaceful, politically stable regional hub for businesses and diplomacy in the Eastern and Central Africa hence attracting more global organizations and agencies to the Kenyan commercial market, ii) increasing popularity of co-working spaces that cater to freelancers, small businesses, and clients with specific needs or shared interests, and, iii) full resumption of operations by most local firms and businesses resulting from the post-

COVID-19 and peaceful post-electioneering periods thereby improve the economy. However, despite these positive developments, the sector's overall occupancy rates and yields may still be subdued due to the existing oversupply of office spaces, which is estimated at approximately 5.8 mn SQFT in the Nairobi Metropolitan Area (NMA) as at 2022.

III. Regulated Real Estate Funds

a. Real Estate Investment Trusts (REITs)

In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.10 per share. The performance represented a 0.2% gain from Kshs 6.09 per share recorded the previous week, taking it to a 10.0% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3 January 2023. In addition, the performance represented a 69.5% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 10.7%. The graph below shows Fahari I-REIT's performance from November 2015 to 5th May 2023;

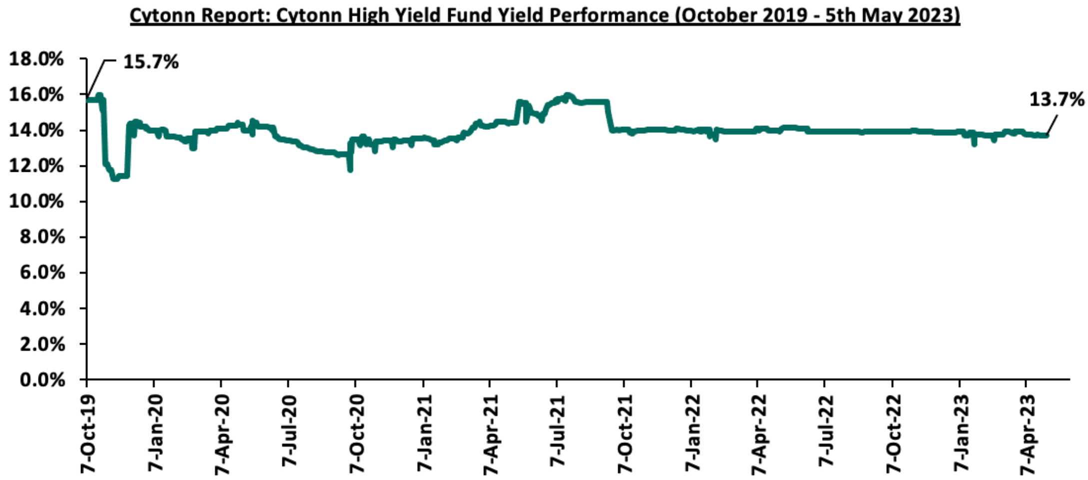


In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 23.9 and Kshs 20.9 per unit, respectively, as at 28th April 2023. The performance represented a 19.4% and 4.4% gain for the D-REIT and IREIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 12.3 mn and 29.6 mn shares, respectively, with a turnover of Kshs 239.0 mn and Kshs 603.2 mn, respectively, since inception in February 2021.

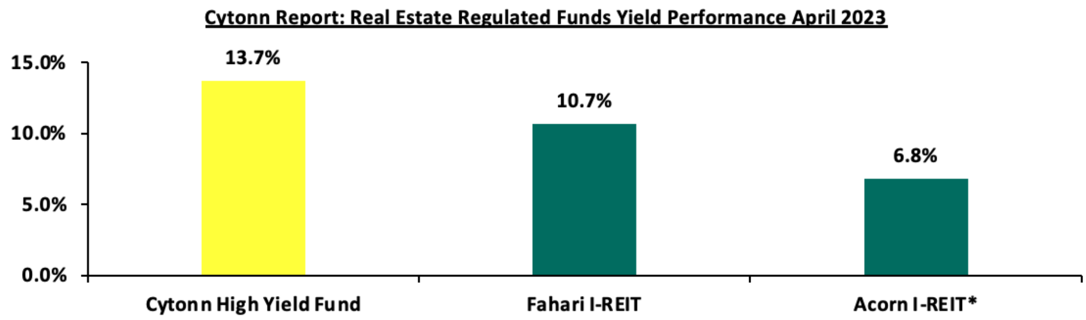
REITs provide numerous advantages, including; access to more capital pools, consistent and prolonged profits, tax exemptions, diversified portfolios, transparency, liquidity and flexibility as an asset class. Despite these benefits, the performance of the Kenyan REITs market remains limited by several factors such as; i) insufficient investor understanding of the investment instrument, ii) time-consuming approval procedures for REIT creation, iii) high minimum capital requirements of Kshs 100.0 mn for trustees, and, iv) high minimum investment amounts set at Kshs 5.0 mn discouraging investments.

b. Cytonn High Yield Fund (CHYF)

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 13.7% remaining relatively unchanged from what was recorded the previous week. The performance also represented a 0.2% points Year-to-Date (YTD) decline from 13.9% yield recorded on 1 January 2023, and 2.0% points Inception-to-Date (ITD) loss from the 15.7% yield. The graph below shows Cytonn High Yield Fund's performance from November 2015 to 5th May 2023;



Notably, the CHYF has outperformed other regulated Real Estate funds with an annualized yield of 13.7%, as compared to Fahari I-REIT and Acorn I-REIT with yields of 10.7%, and 6.8% respectively. As such, the higher yields offered by CHYF makes the fund one of the best alternative investment resource in the Real Estate sector. The graph below shows the yield performance of the Regulated Real Estate Funds;



**FY'2022*

Source: Cytonn Research

We expect Kenya's Real Estate sector performance to continue on an upward trajectory propelled by various factors, including increased activities in the industrial sector, emphasis on affordable housing projects and the entry of international organizations into the commercial office sector that will assist curb the existing oversupply standing at 5.8 mn SQFT as at 2022. However, factors such as rising costs of construction due to inflationary pressures, a surplus of physical space in select sectors, and low investor appetite for REITs are expected to continue subduing the optimal performance of the general Real Estate.