Nairobi Hospitality Report 2017, & Cytonn Monthly – November 2017

Focus of the Week

In October 2016, we released Kenya's-Hospitality-Sector-Report dubbed 'Sailing Through The Storm'. According to the report, the hospitality sector recorded a downward trend between 2011 and 2015 with international arrivals, occupancies and Total Revenue per Available Room declining by CAGRs of 10.3%, 7.8% and 5.8%, respectively. The decline was attributed to insecurity brought about by terrorist attacks, which in turn led to issuance of negative travel advisories, thus lowering demand for accommodation and other hotel-related services in Kenya. Despite the decline initially, we have seen growth of hotels and serviced apartments in Nairobi with the opening of facilities such as Golden Tulip and Tune Inn (rebranded to Ibis Styles) and serviced apartments such as Executive Residency in 2016, while more hotels including the Lazizi Premiere and Four Points by Sheraton, JKIA, have been opened in 2017, an indication of the appetite for hospitality investment. The average occupancies for 3-star, 4-star and 5-star hotels in the Nairobi market has been at 56% over the last 5-years. In our view, the main driving factors have been improved security, aggressive government marketing and tourism incentives, which have resulted in increased travel and business tourism. In 2017, the following statistics according to KNBS have been recorded;

i. International arrivals at the Jomo Kenyatta and Moi International Airports increased by 12.6% between January and July 2017 from 482,470 persons in 2016 to 543,146 persons in 2017. In August, however, arrivals declined by 7.4% due to political noise during the electioneering period period. Given the extended electioneering period, we project overall 6.2% growth in international arrivals in 2017, slower that the 13.5% growth recorded in 2016,
ii. The contribution of accommodation and food services to GDP increased by 0.1% points from 1.0% in H1'2016 to 1.1% in H1'2017. For the full year, we project a marginal increase in contribution to GDP from 1.1% in 2016 to 1.2% in 2017.

The above show that the sector was on an upward trend during the first half of the year but has been constrained by the effects of the Kenyan Elections. We therefore conducted research to establish trends and performance of top-rated hotels (3-star, 4-star and 5-star hotels) and serviced apartments in Nairobi and obtained information pertaining to supply, occupancy, average daily rates and revenues and thereafter identified the ideal areas to invest in.

From our survey, we found that the Nairobi Central Business District (CBD) and Westlands have the highest higher end room supply with 25.8% and 19.6% market share, respectively. In the next 5-years, however, Westlands will have the largest market share with 5 hotels under construction and set to deliver approximately 1,097 rooms. For serviced apartments, Westlands and Kilimani areas have the largest market share at 40.3% and 25.8%, respectively. Overall, having collected details of on-going and proposed projects, we project completion of at least 2,945 top-rated hotel rooms and 1,260 serviced apartments in Nairobi in the next 5-years.

In terms of performance the following were the findings;

i. Hotel Average Daily Rate has declined by 18.0% from Kshs 13,909 in 2016 to Kshs 11,789. This is mainly attributable to reduced demand during the electioneering period
ii. Average hotel Occupancy has declined by 2.4% points from 53.0% in 2016 to 50.6% due to political noises that resulted in cancellation and postponement of planned visits
iii. Average hotel RevPAR has declined by 23.1% from Kshs 7,308 to Kshs 5,937 due to the reduced rates and reduced room occupancy

Performance of hotels in Nairobi according to star rating was analysed and the following were the findings;

All figures in Kshs unless stated otherwise

2017	Occupancy	Average Published Rate (Ksh)	Average Daily Rate (Ksh)	Charge Discount (ADR/APR)	Revenue Per Available Room (Ksh)
3-Star	49.4%	14,199	7,672	(46%)	3,793
4-Star	56.5%	16,395	12,164	(26%)	6,872
5-Star	46.0%	24,227	15,530	(36%)	7,148
Average	**50.6%**	**18,274**	**11,789**	**(36%)**	**5,937**

- **3-Star hotels in Nairobi in 2017 charge Kshs 7,672 for every room sold, which is a 46% discount on their average published rates, 4-Star hotels charge Kshs 12,164 for every room sold, and 5-star hotels charge Kshs 15,530 per night on average**
- **4-Star hotels are the best performing with an average occupancy of 56.5% compared to 3-Star hotels at 49.4% and 5-star hotels at 46.0% indicating that 4-stars are better able to fill their rooms at the set prices compared to 3-Star and 5-Star hotels**
- **5-Star hotels are the worst performing with an average occupancy of 46.0% and a RevPAR of Kshs 7,148, indicating they require to charge lower rates to increase occupancy**

Source: Cytonn Research, STR Global

Serviced Apartments Performance

Serviced apartments are a fast-growing sector as they charge lower rates per night than hotels (while a standard 3-star hotel charges Kshs 14,000 per night on average, a 1-bedroom serviced apartment charges Kshs 11,000 per night), provide larger spaces (while the standard hotel room size is 30-50 SQM the average size of a 1-bedroom serviced apartment is 75 SQM) and have a homely feel. For an investor, they are ideal as they have relatively longer tenancy tenures of more than a month thus providing more stable incomes and are easily convertible to other product offerings such as unserviced apartments or furnished apartments, depending on the needs of the clients. In Nairobi, assuming 40% operational costs, Westlands and Kilimani are the best-performing locations with yields of 7.3% and 7.2%, respectively, while Muthaiga North and Garden Estate along Thika road and Mombasa road are the poorest performing locations with yields of 2.6% and 3.1% as shown below:

All figures in Kshs unless stated otherwise

Node	Market Share	Average Monthly Charge per SM	Average Devt Cost per SM	Occupancy 2016	Occupancy 2017 (YTD)	Rental Yield (2017)
Westlands/Parklands	40.4%	2,519	209,092	84.6%	77.8%	7.3%
Kilimani	25.9%	2,592	202,662	78.0%	74.0%	7.2%
Kileleshwa/Lavington	7.3%	2,369	206,132	85.0%	70.0%	7.0%
Upperhill	7.4%	2,333	206,711			6.6%
Limuru Road	1.8%	1,686	231,715	86.7%	80.0%	4.5%
Nairobi CBD	8.3%	1,684	224,571	78.0%	70.0%	4.2%
Mombasa Road	5.8%	1,367	200,757		64.0%	3.1%
Muthaiga N/Garden Estate	3.1%	910	200,757	78.5%	69.0%	2.6%
Average		**1,949**	**210,300**	**81.8%**	**72.1%**	**5.8%**
High		**2,654**	**231,715**	**86.7%**	**80.0%**	**9.2%**
Low		**910**	**200,757**	**78.0%**	**64.0%**	**2.6%**

- **Westlands and Kilimani areas are the best performing as they charge the highest rates per square meter and have retained high occupancy of above 78%. Being prime commercial hubs within the UN blue zone and with social amenities such as schools, shopping centers and hospitals, they are ideal for expatriates who are the main guests**
- **Apartments along Thika Road (Muthaiga North and Garden Estate) and Mombasa Road have the lowest yields attributed to lower rates per square meters and low occupancies of less than 70%. Mombasa Road lacks quality serviced apartments with most service providers being individuals who therefore lack professional management and service provision skills**

Source: Cytonn Research, STR

Investment Opportunity

To establish the most ideal locations to invest in Nairobi, we used various metrics which in our view would be key considerations for investment;

i. **Current Supply -** This refers to the existing hotel rooms stock. The higher the stock, the lesser the points awarded as it indicates potentially more competition
ii. **Incoming Supply -** This refers to hotel rooms under construction. The higher the pipeline, the lesser the points awarded as it indicates potentially more competition
iii. **Presence of a Commercial Hub -** This refers to availability of a commercial catchment area who serve as the main clients for hotels and serviced apartments
iv. **Presence in a UN Blue Zone -** These are areas marked by the United Nations as suitable for stay as they adhere to UN set standards on security, facilities, amenities, access ways, recreational facilities etc. Areas in the UN Blue zone have higher points
v. **Transport Network -** This is to establish the ease of access within the location. Areas with easy accessibility have higher points
vi. **Yields (serviced apartments) -** This is to establish the potential returns in a location. The higher the yields, the higher the points awarded

Based on the above metrics, we allotted points to the areas on a scale of 1 to 5 as shown below with

1 being low and 5 high;

Hospitality Market Opportunity

Supply (% of market share)	**>20%**	**15%-19%**	**10%-14%**	**5%-9%**	**<5%**
Points	1	2	3	4	5
Incoming Supply (% of market share)	**>20%**	**15%-19%**	**10%-14%**	**5%-9%**	**<5%**
Points	1	2	3	4	5
Commercial Hub	**Low-scale**	**Lower-scale**	**Mid-scale**	**Upper-scale**	**High-scale**
Points	1	2	3	4	5
UN Blue Zone	**Area is not in the blue zone**		**Partially in the blue zone**		**Area is in the blue zone**
Points	1		3		5
Transport Network	**Poor**	**Less than Avg**	**Average**	**Good**	**Very Good**
Points	1	2	3	4	5
Yield (serviced apartments)	**<2%**	**2%-4%**	**5%-7%**	**7%-9%**	**10% and above**
Points	1	2	3	4	5

Based on the above criteria, Upperhill emerged as the most suitable for hotel investment as it is a commercial hub with good transport network yet currently only has 8.6% share of the existing hotel room stock.

Hotel Investment Opportunity

Location	Supply	Pipeline	Commercial Hub	UN Blue Zone	Transport Network	Points	Rank
Upperhill	4	3	5	5	5	4.4	1
Kilimani	2	3	4	5	5	3.7	2
Kiambu/Limuru Rd	5	5	2	5	4	4.0	2
Westlands	2	1	5	5	5	3.6	4

Hotel Investment Opportunity

Location	Supply	Pipeline	Commercial Hub	UN Blue Zone	Transport Network	Points	Rank
Thika Rd	5	5	2	3	4	3.6	4
Nairobi CBD	1	5	5	1	5	3.4	6
Karen/Lang'ata	4	3	3	3	5	3.4	6
Mombasa Rd	3	3	3	1	5	2.8	8

- **Upperhill is the most viable for investment as it is a main commercial hub and yet has only 8.6% share of the existing hotel room stock. The main challenge with Upperhill, however, is inadequate social amenities such as shopping centres and thus investors ought to consider mixed use developments that will provide the requisite social amenities;**
- **Mombasa Rd is the least viable area for investment as it is mainly an industrial area and is not within the UN Blue zone**

Source: Cytonn Research, STR

For serviced apartments, Upperhill and Kileleshwa/ Lavington ranked as the most ideal as they have relatively high yields of 6.6% and 7.0%, respectively, and have a low market share of serviced apartments at 7.4% and 7.3%, respectively.

Serviced Apartments Investment Opportunity

Location	Supply	Commercial Hub	UN Blue Zone	Transport Network	Yield	Points	Ranking
Upperhill	4	5	5	5	3	4.3	1
Kileleshwa/Lavington	4	3	5	5	4	4.1	2
Westlands	2	5	5	5	4	4.0	3
Kilimani	2	4	5	5	4	3.8	4
Limuru Rd	5	2	5	4	2	3.6	5
Muthaiga North/Garden Estate	5	2	4	4	1	3.1	6
Nairobi CBD	4	4	1	4	2	2.9	7
Mombasa Rd	3	3	1	5	1	2.3	8

- **Upperhill and Kileleshwa/Lavington area are the most suitable for investment as they have relatively high rental yields of 6.6% and 7.0% respectively and have a relatively low market share of 7.4% and 7.3%, respectively. Both areas are within the UN Blue Zone and have a commercial catchment area**
- **Mombasa Rd and the CBD are the least viable for investment as they are not within the UN Blue zone and have low yields of 3.1% and 4.2%, respectively**

Source: Cytonn Research, STR

The following factors summarize our outlook on the hospitality sector;

Measure	Sentiment	Outlook
Hotels Market Performance	Occupancy rates and earnings increased in 2016 by 1.2% and 17.8% indicating recovery of the sector. In 2017 the market has been affected by political tension but only temporarily. We expect the market to recover in 2018	Positive
Serviced Apartments Performance	Serviced apartments had a high average occupancy of 81.8% in 2016 but has recorded declined occupancy in 2017 due to political tension. The sector is likely to recover with the conclusion of the elections	Positive
Supply	Hotel room supply has been increasing at a 5-year CAGR of 3.6% while serviced apartments have increased by 23.6% while room occupancy during the period has declined by 4.2%. At least 4,675 hotels rooms and 1,260 serviced apartments are set to be complete in the next 5-years, and thus likely to increase competition	Negative
Domestic Tourism	Domestic tourism grew from 46.9% of total bed nights in 2014 to 54.2% of total bed nights in 2016 and is expected to continue due to increased government incentives and marketing efforts by both the government and the industry players	Positive
International Tourism	International arrivals grew by 13.4% in 2016 and is expected to increase by 6.2% in 2017 given improved security and the increased marketing efforts by the government	Positive
MICE Tourism	Local MICE tourism grew by 17.4% in 2016 faster than international MICE tourism at 4.1% during the same period. Growth in the sector is boosted by devolution and increased demand for conference by corporations and groups	Positive
Opportunity	There is an opportunity in 4-star hotels in Nairobi as they are the best performing with occupancy of 56.5% in 2017. On location, Upperhill, Kilimani and Kiambu/Limuru rd are the most viable for hotel investment. For serviced apartments, Upperhill, Lavington and Kileleshwa are the most viable for investment	Positive

Conclusion

In conclusion, given improved security, increased government marketing efforts, growth of MICE and domestic tourism, the hospitality sector is only likely to grow further. In 2017, we project a 6.2% increase in international arrivals, a 4.2% growth in tourism earnings, and a slight increase in contribution to GDP to 1.2% from 1.1% in 2016. While the sector was set back during the electioneering period, in our view it was only a temporary phase and the sector will pick up towards the end of the year and in 2018. The opportunity in the sector lies in serviced apartments and 4-star hotels in undersupplied markets such as Upperhill, Kileleshwa and Lavington. In other locations, given the increasing supply, developments will need to be differentiated through product offering and customer service to retain high occupancy. For the comprehensive report, see Cytonn Hospitality Report.