Cytonn Annual Markets Review - 2017

Real Estate

In 2017, the real estate sector experienced a slow-down due to political uncertainty brought about by the extended electioneering period, oversupply in some segments such as the commercial office, and credit constrains due to the interest rate cap that led to reduced lending to the private sector, which resulted to slower credit to private sector growth of 2.4% as at October 2017 from a five year CAGR of 14.4%. This was evident with the KNBS Leading Economic Indicators October issue noting that the value of building approvals in Nairobi between January and July 2017 declined by 18.4% to Kshs 149.5 bn from Kshs 183.2 bn during the same period in 2016. Looking at performance, the sector recorded rental yields of 9.2% in commercial office, 9.6% in retail and 5.2% in residential sector, resulting to an average rental yield for the real estate market of 8.0%, compared to 7.8% in 2016. Capital appreciation came in at 6.5% in 2017 from 18.0% in 2016, the real estate sector therefore recorded a total returns of 14.5% in 2017 compared to returns of 25.8% in 2016, showing a slow-down in real estate operators' returns. Development returns however, still remain high at on average more than 25.0%, given that real estate is a long term investment with a capital appreciation of 17.4% over the last 6 years

Annual Real Estate Returns Summary Table			
	2016	**2017**	**Change**
Average Rental Yield	7.8%	8.0%	0.2%
Average Capital Appreciation	18.0%	6.5%	(11.5%)
Total	**25.8%**	**14.5%**	**(11.3%)**
· ***The slowdown in performance was a result of a steep decline in capital appreciation brought about by stagnated land prices in areas like Upperhill, Westlands, Kilimani among others, where prices are capping out*** · ***Development returns in the sector however remain high at on average more than 25.0% p.a driven by price appreciations of the units under development, profit margins and as real estate is a long term investment with a capital appreciation of 17.4% over the last 6 years***			

Residential: The residential sector recorded lower returns to investors with total returns of 10.3% in 2017, 2.6% points lower than the 12.9% total returns recorded in 2016. This was as a result of a 2.8% points decline in capital appreciation as rental yield increased by 0.3% points to 5.2% in 2017 from 4.9% indicating that the demand was for rentals as investors and home buyers in general adopted a wait and see approach during the electioneering period.

Commercial Sector (Office and Retail): The performance of commercial real estate softened in both office and retail with commercial office in recording 0.2% points and 2.0%, declines in occupancy rates, yields, respectively attributable to the slowdown in economic activities as a result of the elections and increased supply of commercial office space in the city which has an oversupply of 3.2mn SQFT of office space. The retail sector also as a result of increased supply, which grew by 41.0% y/y softened with rental yields in Nairobi averaging at 9.6% from 10.0% in 2016.

Hospitality: The hospitality sector depicted signs of recovery following the slump between 2011 and 2015 that was caused by insecurity and terrorist attacks. The recovery has been driven by improved security, aggressive marketing by the government among other government measures aimed at

reviving the sector. However, the sector recorded a decline in performance with average daily rate coming in at 11,789 from 12,270 in 2016, a 3.9% decline. This was due to the political headwinds witnessed this year which saw the hotels' occupancy rates decline as well by 4.6% points to 50.7% from 55.3% in 2016.

Land: The land sector continued to record a positive performance across various locations despite the political uncertainty with the Nairobi Metropolitan area recording a growth of 6.5% in 2017 resulting to a 6-years CAGR of 17.4%. However, areas like Muthaiga, Riverside and Ruai recorded a decline in appreciation attributed to a price correction, resulting in slower y/y capital appreciation of 6.5% in 2017 from 18.0% in 2016

Below is a detailed analysis of different real estate themes that we cover;

A. Residential Sector

The residential sector recorded mixed performance with increased activity in the mid and low end markets, and a decline in activity and performance in the high end segment. The sector was heavily affected by the heated political landscape exacerbated by a tough economic environment especially from the interest rates cap law. This is evidenced by the decline in not only transaction volumes, but also in development activity over the year. As a result, the performance of the sector also slowed down with investor total returns dropping by 2.6% points to an average of 10.3% from last year's 12.9%, attributable to the decline in transaction volumes, which resulted to lower capital appreciation.

The performance summary is as shown below:

Performance Summary Table - Residential (2016/2017)			
	2016	**2017**	**Y/Y Change**
Uptake	84.3%	86.7%	+2.4%
Occupancy	83.2%	84.0%	+0.8%
Rental Yield	4.9%	5.2%	+0.3%
Price Appreciation	7.9%	5.1%	(2.8%)
Total Returns	12.9%	10.3%	(2.6%)
· ***Rental yields increased marginally y/y, attributable to the increase in average occupancy rates showing sustained demand for rental properties*** · ***Uptake increased this year to 86.7%, a 2.4% points increase simply attributable to the increased sales recorded for projects completed before this year*** · ***The total returns to investors however declined by 2.6% points from last year's average of 12.9%, attributable to slow price appreciation rates this year as a result of the electioneering period and a slightly shaky macroeconomic environment which resulted in reduced demand***			

Source: Cytonn Research December 2017

In the sub-markets, the upper middle end segment recorded the highest returns to investors of 11.3%, followed by the lower end segment with 9.6%, and the high end market had the lowest performance with total returns to investors of 8.0%.

A: Lower Mid End
Performance Summary for Lower Mid End

Location	Uptake (sales)	Occupancy Rate	Rental Yield	Capital Appreciation	Total Returns
Komarock	96.0%	95.8%	6.6%	6.6%	**13.2%**
Donholm	88.2%	88.4%	4.7%	6.7%	**11.4%**
Athi River	67.2%	66.9%	4.6%	4.2%	**8.1%**
Kitengela	69.4%	73.8%	3.6%	10.9%	**8.0%**
Imara Daima	83.4%	81.0%	5.2%	4.5%	**7.4%**
Average	**80.8%**	**81.2%**	**4.9%**	**6.6%**	**9.6%**
· ***Donholm and Komarock were the best performing areas with average total returns of 11.4% and 13.2%, respectively due to high uptake and occupancy rates a result of affordability brought about by spatial arbitrage as well as the ongoing infrastructural development such as Outer Ring road*** · ***Kitengela however had the highest capital appreciation at 10.9%. in terms of uptake, Komarock and Imara Daima had the highest with 96.0% and 83.4%, respectively, attributable to an increased investor appetite for satellite towns***					

Source: Cytonn Research December 2017

B: Upper Mid End					
Performance Summary for Upper Mid End					
Location	**Uptake (sales)**	**Occupancy Rate**	**Rental Yield**	**Capital Appreciation**	**Total Returns**
Kileleshwa	91.3%	96.1%	10.7%	7.7%	**18.3%**
Riverside	82.4%	91.2%	5.9%	5.1%	**10.9%**
Lavington	96.3%	90.2%	5.5%	5.2%	**10.7%**
Parklands	92.8%	83.2%	5.7%	4.3%	**9.8%**
Kilimani	84.1%	70.7%	5.1%	5.3%	**10.4%**
Spring Valley	87.1%	87.8%	4.3%	3.2%	**7.5%**
Average	**89.0%**	**86.5%**	**6.2%**	**5.1%**	11.3%
· ***Kileleshwa and Riverside had the best returns to investors at 10.9% and 18.3%, respectively, attributable to high capital appreciation rates, as a result of their close proximity to CBD creating sustainable rental demand***					

Source: Cytonn Research December 2017

C: High End					
Performance Summary for High End					
Location	**Uptake (sales)**	**Occupancy Rate**	**Rental Yield**	**Capital Appreciation**	**Total Returns**
Karen	94.0%	71.0%	4.7%	8.5%	**12.7%**
Runda	84.0%	79.4%	5.2%	3.7%	**8.9%**
Kitisuru	89.5%	87.0%	4.4%	2.0%	**6.4%**
Loresho	84.8%		4.3%	1.6%	**5.9%**
Lower Kabete	94.6%	87.6%	3.3%	2.5%	**5.8%**
Average	**89.4%**	**81.3%**	**4.4%**	**3.7%**	**8.0%**
· ***Karen was the best performing market in the high end segment with 12.7% returns a high capital appreciation as it has relatively lower land price compared to the other high end areas with an acre in Karen selling for Kshs 52mn on average against an average of Kshs 70-100mn an acre in other high end areas*** · ***Generally the high end segment recorded low capital appreciation rates compared to other areas with an average of 3.7%, a factor attributable to the increased surplus in the high end market which has led to price stagnation and also high costs of land in these areas***					

Source: Cytonn Research December 2017

Investors continued to cash in on the sector with some of major projects launched this year including Cytonn Investments' 'The Ridge', a 10-acre luxurious development comprising of residential and serviced apartments in Ridgeways, 'RiverRun', a master planned community seated on a 100 acres in Ruiru, 'Cytonn Towers', a comprehensive mixed-use project in Kilimani ,Uriithi Housing Cooperative's Osten Terrace and Panorama Gardens in Kangundo Road and Thika, respectively, and Tatu Waters by Tatu City's developers, Reandeavor in Ruiru. On the statutory front, the government

introduced a tax incentive whereby developers constructing more than 100 houses annually will receive a 15.0% tax reduction and we thus expect an increase in development of affordable housing in the country.

Generally, we expect the residential market to pick up in 2018 with (i) better performance continuing to be recorded in the mid and low mid end segments as investor appetite for the same continues in a bid to curtail the housing deficit , while also (ii) gaining impetus further from the expected government's affordable housing initiative and (iii) Probable increase in credit to the private sector, if the interest rates cap law is revised, which is set to encourage more activity from the developers' side. We expect a drastic turn around for the high end market especially with the proposed review of zoning regulations for some of the exclusive Nairobi suburbs such as Spring Valley, Kyuna, Loresho, Lavington and Dagoretti, to make them high density areas, a factor that is bound to lead to the said regions experiencing increased development and thus, immediate land price hikes.

B. **Commercial Sector**

In 2017, the performance of commercial real estate was affected by the tough economic and operating environment characterized by reduced credit supply and an extended electioneering period as well as an oversupply in the commercial office theme in the Nairobi Metropolitan region. Below is a summary of commercial office and retail themes:

i. **Commercial Office**

In 2017, the performance of commercial office theme in Nairobi softened with rental yields, and occupancy rates declining by 0.2% points and 3.4% points, respectively. The low performance can be attributed to:

- An oversupply in the sector with Nairobi having an oversupply of 3.2mn SQFT which is expected to increase by 21.9% in 2018 to 3.9mn SQFT,
- the reduced economic activities as a result of the extended electioneering period

Asking rents declined by 2.0% to Kshs 101 from Kshs 103 per sqft y/y as a result of the increase in supply decreasing occupancy rates by 3.4%y/y.

Summary of Commercial Office Returns in Nairobi Over Time												
Year	**FY'15**	**FY'16**	**Q1'17**	**H1'17**	**Q3'17**	**Δ Q4 (2017)**	**FY'17**	**Δ Q1 (2017)**	**Δ H1 (2017)**	**Δ Q3 (2017)**	**Δ Q4 (2017)**	**Δ Y/Y 2016/17**
Occupancy (%)	89%	88%	86%	86%	84%	82.4%	**84.6%**	(1.8%)	(0.4%)	(1.9%)	(1.6%)	**(3.4%)**
Asking Rents (Kshs/Sqft)	97	103	102	100	101	101	**101**	(0.6%)	(2.3%)	1.0%	0.0%	**(2.0%)**
Average Prices (Kshs/Sqft)	12,776	13,003	13,211	13,103	13,055	12,864	**13,058**	1.6%	(0.8%)	(0.4%)	(1.5%)	**0.4%**
Average Rental Yields (%)	9.3%	9.4%	9.0%	9.2%	9.1%	9.3%	**9.2%**	(4.8%)	2.8%	(0.1%)	0.2%	**(0.2%)**
Commercial office market softened y/y between 2016 and 2017 with occupancy rates and yields declining by 3.4% points, 0.2% points, respectively attributable to the slowdown in economic activities as a result of the elections and increased supply of commercial office space in the city which increased by a 6-year CAGR of 34.0%												

Source: Cytonn Research

In terms of submarket analysis in Nairobi, Karen, Parklands and Westlands were the best performers in 2017 as a result of their superior locations, enabling them to charge premium on rentals. The areas attracted yields of 10.3%, 9.8% and 9.5%, respectively. Nairobi CBD and Mombasa Road had

the lowest returns recording average rental yields of 8.4% and 8.5%, respectively. This is attributable to poor quality offices, which are mostly Grade C's, and poor location with the CBD being characterized by congestion and insufficient parking spaces and Mombasa Road being affected by traffic jams.

(All Prices in Kshs unless stated otherwise)										
Nairobi Commercial Office Submarket Performance 2016 -2017										
Area	**Price/SQ FT 2017**	**Rent/SQ FT 2016**	**Rent/SQ FT 2017**	**Occupancy (%) 2016**	**Occupancy (%) 2017**	**Rental Yields (%) 2016**	**Rental Yields (%) 2017**	**Δ Rent Y/Y**	**Δ Occupancy Y/Y**	**Δ Rental Yields Y/Y**
Karen	14,583	107	125	90.0%	**91.1%**	**9.7%**	**10.3%**	16.5%	1.1%	**0.6%**
Parklands	12,571	102	104	80.0%	**84.8%**	**10.0%**	**9.8%**	2.0%	4.8%	**(0.2%)**
Westlands	12,861	102	106	92.1%	**86.4%**	**9.2%**	**9.5%**	3.6%	(5.7%)	**0.3%**
Kilimani	13,017	99	101	90.5%	**85.4%**	**9.3%**	**9.4%**	1.7%	(5.1%)	**0.1%**
UpperHill	12,733	102	98	89.8%	**79.8%**	**9.0%**	**8.9%**	(3.9%)	(10.0%)	**(0.1%)**
Msa Road	11,646	80	81	86.1%	**75.0%**	**8.5%**	**8.5%**	0.9%	(11.1%)	**0.0%**
Nairobi CBD	12,250	92	90	92.7%	**77.3%**	**9.0%**	**8.4%**	(2.7%)	(15.4%)	**(0.6%)**
Average	**12,809**	**98**	**100**	**88.7%**	**82.8%**	**9.2%**	**9.3%**	**2.6%**	**(5.9%)**	**0.0%**
· Karen, Parklands and Westlands were the best performing offices markets recording average rental yields of 10.3%, 9.8% and 9.5%, respectively due to superior locations. ***· Nairobi CBD and Mombasa Road were the worst performing markets due to poor quality offices and congestion. Notably the CBD recorded a 15.4% decline in occupancy rates from 92.7% to 77.3% due to exit of corporates such as Ecobank to more prime business districts in Westlands***										

Source: Cytonn Research

Highlights for the office sector in 2017 include the opening of a grade-A 54,000 sqft green building in Milimani dubbed 'Vienna Court' and the 25-storey FCB Mirhab in Kilimani. The supply of office space is expected to continue increasing in the next 5-years with the launching of developments such as Pinnacle Towers in Upperhill and Cytonn Towers in Kilimani and Kasarani Investment Holdings Ltd development expected to begin construction of a business park comprising of 600,000 sqft of office space, a hospital, hotel and a residential village adjacent to the Garden City Mall along Thika Road, in November 2017.

We expect the slowdown in performance to continue in the short to medium term mainly as a result of the oversupply of office space which was 3.2mn sqft in 2017 and expected to grow by 21.0% to 3.9mn sqft in 2018. The is an opportunity in Grade A office space which are undersupplied accounting for only 10.0% of office space in Nairobi. In terms of returns grade A offices and serviced offices still have high returns with rental yields of 10.0% and 13.4%, respectively compared to 9.2% for conventional office space.

ii. **Retail Sector**

Like the office market, the retail market softened in 2017, recording average rental yields of 8.3% from 8.7% in 2016 and average occupancy rates of 80.6% from 82.9% in 2016.in Key urban centres such as Nairobi, Kisumu, Eldoret and Mombasa. In Nairobi, the returns also softened with rental yields declining by 0.4% points from 10.0% in 2016 to 9.6% in 2017, with occupancy rates declining by 9.0% points from 89.3% in 2016 to 80.3% in 2017 in Nairobi. The constrained performance was attributed to:

i. a tough operating environment characterized by reduced credit supply from 8.6% in 2016 to a 10-month average of 1.6% in 2017,
ii. the wait and see attitude adopted by investors due to the 2017 general elections,

iii. internal challenges facing retailers on supply chain management and financing specifically Uchumi and Nakumatt, and
iv. increased supply of mall space, that increased by 41.6% y/y in Nairobi alone to 5.6mn SQFT in 2017 from 3.9mn SQFT in 2016 through the opening of malls like Southfield Mall in Embakasi.

Kenya's Retail Sector Performance 2016-2017			
Item	**FY' 2016**	**FY' 2017**	**Δ Y/Y**
Asking Rents (Kshs/SQFT)	154.9	141.0	**(9.0%)**
Occupancy (%)	82.9%	80.2%	**(2.7%)**
Average Rental Yields (%)	8.7%	8.3%	**(0.4%)**
The average rental yields declined by 0.4% points, from 8.7% last year while occupancy rates reduced by 2.7% points to 80.2% from 82.9% in 2016, attributable to increased supply in some submarkets like Nairobi which recorded a 41.6% increase in supply and a tough economic environment lowering retailers returns hence a reduction in expansion measures by retailers			

Nairobi submarkets performance softened across all nodes in 2017, rental yields declined by 0.4% y/y to 9.6% from 10.0% as a result of decreased occupancy rates that fell to an average of 80.3% from an average 89.3% in 2016, that was occasioned by increased supply. Westlands and Karen were the best performing submarkets. High rental yields for Westlands are as a result of proximity to the CBD and high rental rates, while Karen posted high yields due to its prime rents, affluent population and lower competition. The worst performing node was the Nairobi Eastlands, with yields of 6.1% and highest decline in occupancy rates by 23.3% points from 85.0% to 61.8% due to increased retail space with Southfield Mall adding 220,000sqft of lettable space.

Summary of Nairobi's Retail Market Performance 2016-2017								
Location	**Rent Kshs/SQFT 2017**	**Occupancy 2017**	**Rental Yield 2017**	**Occupancy 2016**	**Rental Yield 2016**	**% Change in Occupancy Y/Y**	**% Change in Yield Y/Y**	**Reason for Negative/Positive Change in Yield/Occupancy**
Westlands	234.7	91.0%	**13.5%**	92.0%	12.3%	**(1.0%)**	**1.2%**	**10.4% increase in rental rates y/y**
Karen	206.2	96.3%	**11.2%**	96.3%	12.5%	**0.0%**	**(1.2%)**	**9.8% decline in rental rates y/y**
Kiambu & Limuru Road	216.1	78.2%	**10.6%**	90.0%	10.1%	**(11.8%)**	**0.4%**	**277.4% increase in supply hence decline in occupancy rates**
Kilimani, Kileleshwa & Lavington	181.0	87.0%	**10.3%**	86.0%	10.6%	**1.0%**	**(0.3%)**	**Relative change in occupancy for some malls**
Thika Road	199.2	75.3%	**8.7%**	89.3%	10.0%	**(14.0%)**	**(1.3%)**	**16.5% increase in supply hence decline in occupancy rates**
Ngong Road	170.7	81.8%	**8.7%**	93.3%	9.7%	**(11.6%)**	**(0.9%)**	**Decline in occupancy due to competition from Karen and Kilimani**
Mombasa Road	180.4	68.8%	**8.3%**	83.3%	8.2%	**(14.6%)**	**0.1%**	**188.5% increase in supply**
Satellite Towns	130.1	82.5%	**7.7%**	88.3%	9.3%	**(5.8%)**	**(1.6%)**	**Drastic decline in occupancy rates due to a 29.1% increase in supply**

Summary of Nairobi's Retail Market Performance 2016-2017								
Location	**Rent Kshs/SQFT 2017**	**Occupancy 2017**	**Rental Yield 2017**	**Occupancy 2016**	**Rental Yield 2016**	**% Change in Occupancy Y/Y**	**% Change in Yield Y/Y**	**Reason for Negative/Positive Change in Yield/Occupancy**
Nairobi Eastlands	148.9	61.8%	**6.1%**	85.0%	7.5%	**(23.3%)**	**(1.4%)**	**Decline in occupancy rates due to a 45.2% increase in supply**
Average	**185.2**	**80.3%**	**9.6%**	**89.3%**	**10.0%**	**(9.0%)**	**(0.4%)**	
· ***Performance softened across all nodes with yields declining by 0.4% points y/y as a result of increased supply which increased by 41.6% y/y leading a 9.0% points decline in occupancy levels y/y*** · ***Westlands and Karen were the best performing submarkets, with a yields of 13.5% and 11.2%, respectively, with Karen having the highest average occupancy rates of 96.3%. This is due to the fact that they are high end neighborhoods hosting most of Nairobi's middle end and high end populations***								

Source: Cytonn Research

Regional Retail Performance

Similar to Nairobi, performance across select key urban cities in Kenya softened with Mt. Kenya Region having the highest declines with occupancy and rental yields declining by 10.0% and 1.0%, respectively. Mombasa recorded a slight increase in occupancy rates of 6.1% resulting in a 0.1% points increase in yields to 7.3% from 7.2% in 2016. Eldoret's performance remained largely unchanged though it was still the worst performing node with average rental yields of 6.6% mainly due to low rental rates as shown below:

Summary of Retail Market Performance in Key Urban Cities in Kenya 2016-2017							
Location	**Rent Kshs/SQFT 2017**	**Occupancy 2017**	**Rental Yield 2017**	**Occupancy 2016**	**Yield 2016**	**Change in Occupancy Y/Y**	**Change in Yield Y/Y**
Nairobi	185.2	80.3%	**9.6%**	89.3%	10.0%	**(9.0%)**	**(0.4%)**
Kisumu	150.2	75.0%	**9.1%**	75.0%	9.4%	**(0.0%)**	**(0.3%)**
Mt Kenya	136.0	80.0%	**9.1%**	90.0%	10.1%	**(10.0%)**	**(1.0%)**
Mombasa	130.3	82.8%	**7.3%**	76.7%	7.2%	**6.1%**	**0.1%**
Eldoret	96.0	83.3%	**6.6%**	83.3%	6.6%	**0.0%**	**0.0%**
Average	**140.7**	**80.2%**	**8.3%**	82.9%	**8.7%**	(2.7%)	(0.4%)
· ***Despite the decline in performance, Nairobi was still the best performing region, with average yields of 9.6% and occupancy rates of 80.2% on average, this is attributable to higher rents charged by malls in the City due to higher quality of retail spaces supplied*** · ***Eldoret had the lowest yield of 6.6%, which is due to the low rental rates charged within that market of on average Kshs 96 per SQFT , 44.2% lower than the market average of Kshs 172 per SQFT, this is however likely to change in the future following the development of high quality malls in the Town such as the newly opened Rupa Mall and the upcoming Highway Mall***							

Source: Cytonn Research

The main highlights for the retail sector for 2017 include the adoption of expansion strategies by both local and international retailers that included LC Waikiki and Woolworths opening stores at the Hub, Karen, plans by Java House to take up 2,800 sqft of space at Crystal rivers mall, Athi River with operations scheduled to kick off in early 2018 and Carrefour the French based retailer that is scheduled to open a fourth outlet in January 2018 at the Junction Mall, where the retailer will cover 5,000 SQM of prime retail space. Paradigm shifts in the retail sector were witnessed with the closure of several Nakumatt branches due to insolvency and cash-flow challenges leading to increased foothold of international retailers such as Carrefour and Souk Bazaar taking up space previously occupied by the former leading retailer. In terms of expansion, Rosslyn Riviera Mall, Two Rivers Mall and the newly expanded Village Market formally opened their doors, with the malls

adding 116,00 SQFT 700,000 SQFT and 230,000 SQFT of space to the sector, respectively. However, in a bid to effect operational efficiency, renowned retail store Tuskys shut down its operations in one of its CBD stores, Tuskys Beba Beba, following a recent closure of its Sheikh Karume Branch.

We expect reduced development activity of malls in 2018 due to the current large supply. However, our outlook for the sector in 2018 is positive as the sector continues to attract both local and international retailers driven by i) a conducive macro-economic environment, with an average GDP growth of above 5.0% over the last 5-years, ii) a low retail penetration rate of 35.0% that serves as an incentive for formal retailers compared to a formal retail penetration of 60.0% in South Africa , and iii) closure of spaces occupied by underperforming retail chains such as Uchumi and Nakumatt, hence opening up an opportunity for other retailers in the Kenyan market.

C. **Hospitality Sector**

In 2017, the hospitality sector depicted signs of recovery following the slump between 2011 and 2015 that was caused by insecurity and terrorist attacks. The recovery has been driven by:

i. improved security,
ii. aggressive marketing, which has helped restore confidence among key international markets such as Europe and USA,
iii. international conferences held in Nairobi during the year such as the Africa Renewable Energy Leaders' Summit, and Aid and Development Africa Summit Expo, and
iv. government incentives such as the introduction of liberal entry for all African visitors into Kenya, removal of VAT charges on national park fees and the scrapping of visa fees for children under the age of 16-years.

However, during the year, the sector struggled due to:

i. concerns over security during the elections period and the recent political impasse over the presidential elections, which led to either cancelled or postponement of visits by tourists into the country, and
ii. increased supply of hotel rooms and serviced apartments, which has resulted in a large bed capacity and thus reducing growth in room occupancy.

Despite the challenges, we have seen growth of hotels and serviced apartments in Nairobi with the opening and breaking ground of facilities during the year, an indication of attractive investment opportunities in the sector.

Below are tables showing some of the hotels opened and launched during the year;

Opened in 2017		
Hotel	**Location**	**No. of Rooms**
The Lazizi Premiere	Mombasa Road, JKIA	144
Park Inn by Radisson	Westlands	140
Four Points by Sheraton, JKIA	Mombasa Road, JKIA	172
Total		**456**

Launched in 2017			
Hotel	**Location**	**Opening Date**	**No. of Rooms**
Nairobi Serena(Expansion)	Nairobi	2018	40
Ole Sereni(Expansion)	Mombasa Road	2018	154
Cytonn Towers	Kilimani	2020	180
Pinnacle	Lavington	2020	255
Total			**629**

According to the KNBS Leading Economic Indicators October Issue, the number of tourist arrivals during the period between January and September 2017 at Jomo Kenyatta International Airport and Moi International Airport increased by 10.0% to 720,376 persons from 655,058 during the same period, compared to a 17.8% increase from 2015 to 2016, indicating slow demand for hotel services.

Below is a summary of the performance of the hotels by rating;

Hotel Performance									
	ADR 2016(Ksh)	ADR 2017(Ksh)	%Δ	RevPAR 2016(Ksh)	RevPAR 2017(Ksh)	%Δ	Occupancy 2016	Occupancy 2017	%Δ
3star	7,574	7,672	1.3%	4,149	3,793	(8.6%)	54.8%	49.4%	(5.4%)
4star	13,418	12,164	(9.3%)	8,260	6,872	16.8%	61.3%	56.5%	(4.8%)
5star	15,818	15,530	(1.8%)	7,863	7,148	(9.1%)	49.7%	46.0%	(3.7%)
Average	**12,270**	**11,789**	(3.9%)	**6,757**	**5,938**	(12.1%)	**55.3%**	**50.7%**	**(4.6%)**
· ***Occupancy in both 2016 and 2017 was highest in 4 star hotels at 61.3% and 56.5%, respectively, indicating the growing demand for accommodation in 4-star hotels compared to the 3 and 5-star, which have lower occupancy levels*** · ***The average occupancy decreased from 55.3% in 2016 to 50.7% in 2017, and this we attribute to 2017 being an electioneering year hence putting off guests for fear of political disturbance***									

Source: Cytonn Research, STR

In the serviced apartments segment, Westlands/Parklands was the best performing area with yields of 7.3% compared to the market average of 5.8% as it charges the highest rates per square metre and had high occupancy at 77.8% in 2017 as shown in the table below;

Serviced Offices Performance in Nairobi						
Node	Market Share	Monthly Charge per SM	Devt Cost per SM	Occupancy 2016	Occupancy 2017	Rental Yield
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 Rd	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 Rd	5.8%	1,367	200,757		64.0%	3.1%
Thika rd (Muthaiga North)	3.1%	910	200,757	78.5%	69.0%	2.6%
Average		**1,949**	**210,300**	**81.8%**	**72.1%**	**5.8%**

Source: Cytonn Research

We expect the serviced apartments market to grow with the launch of a number of developments such the Britam Serviced Apartments in Kilimani, Cytonn Serviced Apartments in Westlands, Cytonn Towers in Kilimani, The Ridge in Ridgeways and Pinnacle Towers in Upperhill. The Pinnacle Towers will be operated by the Hilton Group.

The opportunity in the hospitality sector lies 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 the serviced apartments, the opportunity lies in areas such as Upperhill, Lavington and Kileleshwa, where supply is relatively low. For more details on supply and performance in the hospitality sector, see the Cytonn Hospitality Report 2017.

We expect the hospitality sector to recover in 2018 supported by increased international arrivals due to sustained demand for business and tourism travel, increased government incentives, increased marketing efforts by the government & the industry players and a stable macroeconomic environment.

D. **Land**

In the year 2017, land continued to attract developers and investors, informed by the positive

performance recorded across various locations despite the political uncertainty brought about by the extended electioneering period. Nairobi Metropolitan area, recorded an appreciation of 6.5% in 2017 leading to a 6-year CAGR of 17.4%. Satellite Towns such as Utawala, Juja, Athi River, Ongata Rongai and Ruiru recorded the highest capital appreciation of 18.5%. Land prices in Nairobi reported an increase in asking price with only Riverside, Old Muthaiga and Ruai witnessing a land price correction with prices dropping by (0.5%), (7.2%) and (5.8%), respectively, over the same period.

The land performance was positively affected mainly by the relaxation of zoning regulations in areas such as Spring Valley and Kilimani, and improved infrastructure such as sewer lines and road network.

The summary of the performance of the theme in the year 2017 is as outlined below:

All values in Kshs unless stated otherwise

Summary of Price change over 6 years in Nairobi Metropolitan Area						
Location	*Price in 2011	*Price in 2016	*Price in 2017	6-year CAGR	% Price change from 2011	**2017 Annual Capital appreciation**
Satellite Towns - Unserviced Land	9m	21m	22m	**18.5%**	2.88	**7.8%**
Nairobi Suburbs - High Rise Residential Areas	46m	97m	103m	**15.7%**	2.44	**7.6%**
Satellite Towns - Site and service schemes	6m	14m	15m	**18.9%**	3.2	**6.3%**
Nairobi Suburbs - Low Rise Residential Areas	56m	106m	109m	**13.1%**	2.11	**6.0%**
Nairobi Suburbs - Commercial Areas	156m	458m	478m	**20.7%**	3.1	**4.4%**
Average				**17.4%**	**2.75**	**6.5%**
*Asking prices of land are per acre						

Source: Cytonn Research

The key highlights are as follows;

1. Land prices in commercial zones such as Kilimani, Nairobi CBD, Westlands and Upperhill recorded a 6-year CAGR of 20.7%, attributable to the high plot ratios allowing for densification of developments, hence high demand due to attractive returns on investment after development and also due to the increased migration of firms to commercial nodes away from the CBD creating demand in areas such as Westlands, Upperhill and Kilimani,
2. Land prices in high rise residential zones such as Kahawa, Githurai, Kasarani, Embakasi and Dagoretti recorded a 6-year CAGR of 15.7%, also attributable to the premium associated with high plot ratios allowing for land use maximization,
3. Land prices in areas allowed for low rise residential houses such as Karen, Kitisuru and Runda recorded a 6-year CAGR of 13.1%. This is lower than other areas i.e. zoned for high rise residential and commercial zones, which can be associated to limiting plot ratios on land, reducing the return on investment on land,
4. Unserviced land prices in Nairobi satellite towns such as Athi River, Juja, Ngong' and Rongai recorded a 6-year CAGR of 18.5% due to improved infrastructure opening up the areas for development while serviced land in these areas recorded a 6-year CAGR of 18.9%, attributable to the value add attributable to the amenities provided.

Overall, in the Nairobi Metropolitan area, Satellite Towns and areas such as Kilimani, Ridgeways,

Karen, Ongata Rongai and Juja present the best investment opportunity, supported by high capital appreciation, zoning regulations relaxation and increased investment in infrastructure including roads and sewerage.

The land sector continued to record investments in 2017 with various transactions such as Rendeavour, the group behind Tatu City, expanding the master plan by buying an additional 2,500-acres of land adjacent to the master plan. Initially on 2,500-acres, the new master plan will now be 5,000-acres. Uriithi Housing handed over a 1,200-land project in Malindi to its members who bought the land as a joint investment initiative and E-Farm Housing Co-operative Society deepened its investment portfolio with the acquisition of 300-acres of land in Embu as part of its growth and diversification plan targeting investors who want to invest in agribusiness. The society also endeavours to provide 5,000 low-cost houses in Konza, Juja, Nanyuki, with a target price of Kshs 1.0 mn for a one-bedroom unit.

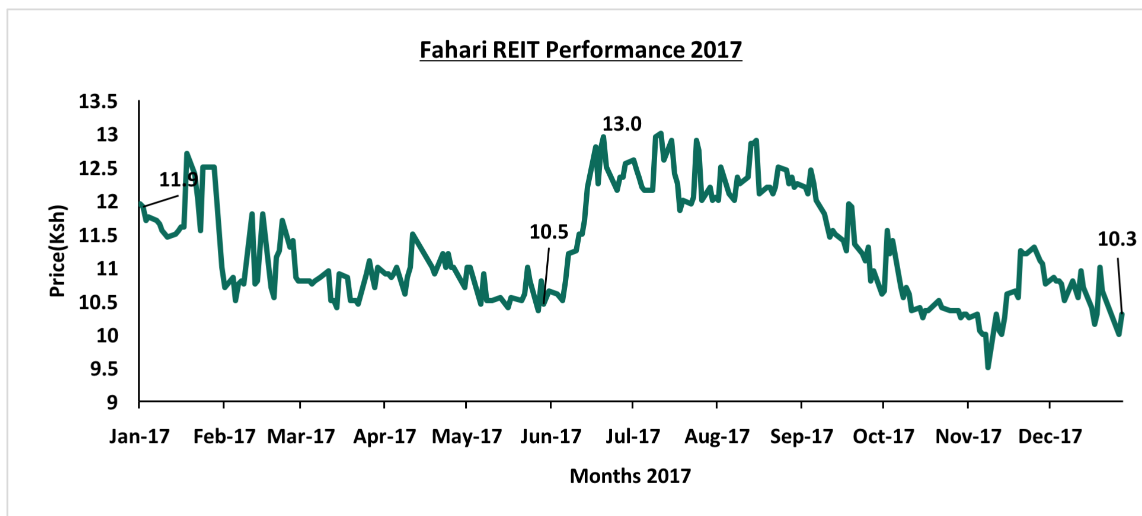
In conclusion, the outlook for the land sector remains positive backed by: i) improved demographics evidenced by the growth of middle income population who have an increasing purchasing power indicating sustained demand, ii) high returns with land prices growing at a 6-year CAGR of 17.4% iii) an enabling macro-economic environment shown by the waiver of land title search fees, iv) improved infrastructure that exposes areas for investment and v) the relaxation of zoning regulations that facilitates optimal land use.

E. **Listed Real Estate Sector**

During the year, Stanlib Fahari I-REIT released their H1'17 earnings, registering a 220.8% growth in earnings per unit to Kshs 0.43 per unit from Kshs 0.13 per unit in H1'2016 attributable to a 30.0% decline in operating expenses to Kshs 112.5 mn from Kshs 160.8 mn in H1'2016 and a 14.2% increase in rental income to Kshs 138.0 mn from Kshs 120.9 mn in H1'2016 from the 3 real estate assets they own; Greenspan Mall, Bay Holdings and Signature International Properties. The decline in expenses was because of the one-off set up and listing costs such as promotional and marketing expenses incurred in H1'2016. In addition, the I-REIT had no debt in H1'2017, thus no financing costs compared to the previous period, which had Kshs 23.0 mn in financing costs. The I-REIT manager did not recommend the distribution of an interim dividend. From our projections, the I-REIT had a 5.9% dividend yield at market price as at 11th August, assuming a 92% pay-out from its distributable earnings, similar to the 2016 dividend pay-out. For a more comprehensive analysis, see our Stanlib Fahari Reit Earnings Note.

On the bourse, Stanlib's Fahari I-REIT price declined by 13.4% year to date closing the market at Kshs 10.3 down from Kshs 11.9 at the beginning of the year and shedding 50.5% from its listing price of Kshs 20.8 in November 2015. In addition, Fahari I-REIT is trading at a discount of 47.8% to its Net Asset Value per share, which currently stands at Kshs 19.75 as per H1'2017 reporting. The prices for the instrument have remained low averaging at Kshs 11.3 in 2017 largely due to:

- opacity of exact returns from the underlying assets,
- poor dividend yield of 5.9% as at 11th August assuming a 92% pay-out ratio from distributable earnings compared to government securities such as T- bills yields which are currently at 8.1%, 10.6% and 11.2% for the 91-day, 182-day and 364-day papers, respectively and market average yields of 2% and 9.6% for office and retail sectors, respectively and
- conservative investors preferring to invest in brick and mortar real estate, equities and other securities on the stock exchange that they are conversant with, which also resulted in undersubscription of Fusion D-REIT in 2016.
- poor market sentiment given this was the first REIT and it has left investors with losses and then the second REIT attempt, Fusion DREIT, failed



To boost the Listed Real Estate sector, the Capital Markets Authority (CMA), in July 2017, backed the exemption of REITs from Value Added Tax (VAT), which accrues to both rent and professional services, in addition to exemption from stamp duty and capital gains tax. The regulator hopes that this incentive will spur interest in the product that opens up the property market to retail investors. In our view, REIT managers also need to align their interests with those of investors to ensure higher earnings, thus boost investor appetite for the product. There is a need for the industry to accept alternative financing to real estate such as REITs and other forms of structured products to reduce reliance on bank funding which currently forms the bulk of real estate finance. Players in the industry have started working towards this with the formation of the East African Forum for Structured Products (EAFSP) by promoters and issuers of structured products with the aim of educating the investment community and developers on structured products and alternative investments thus facilitate uptake of structured products and alternative investments in general.

In 2017, Kenya’s real estate sector was set back by the effects on the elections. We remain cautiously optimistic on its performance going forward. The increased focus by institutional developers in the sector indicates growth but competition is expected to be stiff as clients and investors demand for quality developments.