Cytonn H1’2018 Markets Review

G. Real Estate

H1’2018 performance of the real estate sector in Kenya improved, with sectors such as office and retail registering a marginal increase in yields of 0.1% points to 9.3% and 9.7% from 9.2% and 9.6%, respectively. The performance has been bolstered by (i) continued demand for investment property from multinational individuals and the growing middle class, (ii) Kenyan Government efforts towards enabling the environment for developers through key statutory reforms such as National Land Use Policy, and initiatives such as the National Housing Development Fund set to fund public-private partnerships in delivery of affordable homes, and for end users such as the proposed stamp duty exemption for first time home buyers, (iii) the expanding middle class, and (iv) continued infrastructural improvements.

The key challenges that continue to face developers and end users include: (i) Strict access to financing with private sector credit growth coming in at 2.1% as at April 2018 compared to a five-year average of 14.0% for the period 2013 to 2018, (ii) high land costs, especially in Nairobi and its metropolis (per Cytonn’s Nairobi Metropolitan Land Report 2018); land prices appreciated by a 6-year CAGR of 17.0% for the period 2011-2017, and (iii) oversupply in selected sectors such as office, per KNBS data; the aggregate value of building approvals came in at Kshs 60.1 bn for the period January to March 2018, which is 2.1% lower than the value of approvals for the same period in 2017 which was Kshs 61.7 bn.

Residential:

The residential sector has had a build-up of development activities in H1’2018, as seen through the launch of several new projects. According to Kenya National Bureau of Statistics data, the value of approved residential buildings in Nairobi between January and March 2018 came in at Kshs 36.9 bn, 58.5% higher than non-residential approvals which came in at Kshs 23.3 bn, and 8.8% higher than the Kshs 33.9 bn registered during the same period in 2017. The sector has mainly been bolstered by (i) improving macroeconomic environment, with the World Bank projecting a GDP growth of 5.5% in 2018 compared to 4.7% in 2017, (ii) renewed investor appetite particularly after last year’s heated political climate, and (iii) the Kenyan Government’s inclusion of affordable housing as part of its Big 4 agenda, which has led to launching of sizeable projects across the country, such as:

- The County Government of Kiambu has plans of putting up a total of 19,500 housing units in a rent-to-own scheme that will target urban residents of Kiambu on 50-acres of public land, in areas such as Ruiru, Juja, Thika, Kikuyu, Limuru and old Kiambu. For more information see the Cytonn Weekly #24/2018,
- Nairobi County’s plans to have old low-rise units located in prime areas such as Starehe, Muguga Green, Shauri Moyo and Makongeni demolished to pave way for its own tenant purchase scheme that will see the development of 36,840 units. For more information see the Cytonn Weekly #24/2018,
- United Bank of Africa (UBA) announced that it had set aside Kshs 3.0 bn to be used in construction of over 1,000 affordable housing units in Kakamega County in partnership with the National Housing Corporation (NHC). For more information see the Cytonn Weekly #20/2018,

and,

- Rendeavour, the developer of Tatu City, a master planned project in Ruiru, announced plans to include a 300-acre affordable housing project within the masterplan that will see the development of 10,000 affordable housing units priced between Kshs 1.5 mn to 5.0 mn. For more information see the Cytonn Weekly #17/2018.

Thus far, the Kenyan Government has rolled out various plans aimed at actualizing the affordable housing initiative, including:

i. Plans to amend the revised Employment Act of 2012 to have employees to contribute 0.5% of their gross salary to the proposed National Housing Development Fund (NHDF), with employers matching the employee's contribution by the same amount. The fund will be tasked with offering alternative financing solutions for low cost housing, as well as the required social infrastructure to Kenyans contributing towards the fund. For more analysis, please see the Cytonn Weekly #25/2018,
ii. A 400.0% increase in Budgetary Allocation for the Housing Sector for the financial year 2018/19 totaling Kshs 6.0 bn, compared to Kshs 1.5 bn in last year's budget. Out of this, Kshs 3.0 bn was allocated for construction of affordable housing units, Kshs 1.5 bn for housing Kenya Prison officers, and Kshs 1.5 bn for the Civil Servants Housing Scheme Fund,
iii. The setting up a Mortgage Liquidity Facility (MLF) i.e. The Kenyan Mortgage Refinancing Company (KMRC), which is expected to enable mortgage affordability in Kenya and give access to long-term loans at attractive market rates in the country, by creating liquidity for primary lenders. For more analysis, please see the Cytonn Weekly #14/2018, and,
iv. Plans to allocate land to developers out of which 70% will be for affordable housing, while the remaining 30% will be high-end units, thus allowing the developers to recoup their costs. This initiative will be rolled out for the first lot comprising of 36,840 housing units in Starehe, Muguga Green, Shauri Moyo, Makongeni all in Nairobi County, and Mavoko, in Machakos County.

The plans are a testament to the government's commitment to address the 2.0 mn housing shortage. However, the initiatives are also likely to face challenges such as (i) delays due to government bureaucracy and lack of absolute transparency in government activities, (ii) opposition from key stakeholders (especially the Employment Act Amendment), and (iii) insufficiency of the budgeted funds considering that the affordable housing initiative is estimated to cost Kshs 2.3 tn against a budget of Kshs 6.0 bn. Thus, we expect to see the government introduce other alternative financing strategies especially towards construction, and more reforms towards encouraging private sector involvement such as (i) clear mechanism on transferring public land to SPVs to facilitate access to private capital by using the land as capital, (ii) reduction of unnecessary red tapes such as the slow approval processes, and (iii) fast tracking of the development process as public projects time-frames tend to lag on for more than 5 years whereas private developers prefer to exit within 3-5 years .

In the mid to high-end market segment, various private developers also launched residential developments during the period driven by (i) attractive developer returns that have averaged over 20.0% in the last five years, which is higher than traditional asset classes with an average of 13.2%, (ii) improved infrastructure in selected areas, and (iii) an expanding middle class who are increasingly demanding quality and lifestyle products.

Some of the developers who launched projects during H1'2018 include;

- Cytonn Real Estate, the development affiliate of Cytonn Investments, who broke ground on a Kshs 15.0 bn, 100-acre master planned project with residential units, in Ruiru, Kiambu County, and,
- Other developers and their developments included:

Private Developments Launched in H1'2018

Developer	Location	Acreage	No. of Units
Krishna Estates Limited	Thindigua	2.0	224
Cool Breeze Limited	Mombasa Road	2.3	524
Erdemann Developers Ltd	Ngara Estate	5.7	1,632
CIC Group	Ruiru – Kamiti Road	90.0 out of 200.0	417
Lordship Africa	Upperhill	0.8	239

Source: Online Sources

The continued investment in the residential sector underlines the sectors potential, which is mainly driven by the constant demand for housing, especially with the improving economic environment.

In terms of performance, apartments in Kilimani and Ngong Road had the highest returns to investors with annual returns of 14.4% and 11.8%, respectively, while for detached units, Ruiru and Lower Kabete areas recorded the best annual returns at 11.7% and 10.7%, respectively. Overall, apartments performed better, with the top five having the highest annual uptake at 27.5%, 5.2% points higher than the top 5 detached, which recorded an average of 22.3%.

All values in Kshs unless sated otherwise

Table A: Nairobi Metropolis Residential Sector Performance Summary H1'2018

Typology	Average Price Per SQM H1'2018	Average Rent Per SQM H1'2018	Average Annual Sales H1'2018	Average Rental Yield H1'2018	Y/Y Average Price Appreciation H1'2018	Total Annual Returns H1'2018
Apartments	97,617	478	25.2%	6.1%	3.3%	9.4%
Detached	137,710	564	22.2%	4.9%	1.9%	6.8%
Average	**117,664**	**521**	**23.7%**	**5.5%**	**2.6%**	**8.2%**

- ***Apartments registered higher returns to investors of 9.4%, 1.2% points higher than the market average of 8.2%. This is attributable to high demand for high rise units, due to (i) their affordability; apartments are 29.1% cheaper compared to detached units, and (ii) apartments allow for intensive land use especially given the high land costs in Nairobi and areas close to CBD.***

Source: Cytonn Research

All values in Kshs unless sated otherwise

Table B: Apartments Performance: Top 5 Areas in Nairobi Metropolis H1'2018

Location	Average of Price Per SQM H1' 2018	Average of Rent per SQM H1' 2018	Average of Annual Sales H1' 2018(%)	Average of Rental Yield H1' 2018	Y/Y Average of Price Appreciation H1' 2018	Average of Total Return H1' 2018
Kilimani	123,433.2	692.5	31.8%	7.1%	7.4%	14.4%
Ngong Road	96,203.8	592.6	26.7%	7.1%	4.7%	11.8%

Table B: Apartments Performance: Top 5 Areas in Nairobi Metropolis H1'2018

Location	Average of Price Per SQM H1' 2018	Average of Rent per SQM H1' 2018	Average of Annual Sales H1' 2018(%)	Average of Rental Yield H1' 2018	Y/Y Average of Price Appreciation H1' 2018	Average of Total Return H1' 2018
Thindigua	90,845.5	457.0	28.8%	6.0%	5.3%	11.3%
Spring Valley	144,169.0	664.8	24.1%	6.3%	3.1%	9.4%
Imara Daima	74,232.1	380.9	26.2%	6.2%	3.0%	9.3%
Average	**105,776.7**	**557.5**	**27.5%**	**6.5%**	**4.7%**	**11.2%**

· ***Kilimani and other estates along Ngong Road such as Race Course, had the highest annual returns to investors, with 14.4% and 11.8%, respectively. The market is driven by increased demand from the expanding middle class, good infrastructure and social amenities as well as proximity to key business districts, that is, Upperhill and the CBD.***

Source: Cytonn Research

All values in Kshs unless stated otherwise

Table C: Detached Performance: Top 5 Areas in Nairobi Metropolis H1 2018

Location	Average of Price per SM H1' 2018	Average of Rent per SQM H1' 2018	Average of Annual Sales (%) H1' 2018	Average of Rental Yield H1' 2018	Y/Y Average of Price Appreciation H1' 2018	Average of Total Return H1' 2018
Ruiru	91,591.0	331.8	23.6%	5.1%	6.6%	11.7%
Lower Kabete	174,963.1	470.7	21.4%	3.2%	7.5%	10.7%
Kitisuru	250,982.7	1,006.7	20.6%	4.7%	5.4%	10.1%
Langata	129,107.0	448.5	21.6%	4.3%	4.7%	9.1%
Runda Mumwe	144,345.7	687.0	24.3%	5.8%	2.8%	8.7%
Average	**158,198.9**	**589.9**	**22.3%**	**4.6%**	**5.4%**	**10.0%**

· ***Ruiru recorded the best returns in the detached sector with returns of 11.7%, attributable to relatively attractive rental yields. The area's location along the Thika Superhighway, serenity, easy availability of development land that is also affordable, has continued to attract investors***

Source: Cytonn Research

We expect to continue witnessing increased activities in the residential sector in the year boosted by (i) government initiatives, such as the focus on affordable housing, (ii) an available market given the shortage of housing units that stand at 2.0mn units with an effective annual shortfall of 200,000 units, and (iii) positive demographic trends driven by a rapid population growth of 2.6% p.a higher than global averages of 1.2%, and rapid urbanization rates of 4.4% p.a compared to global average of 2.1% thereby creating demand for housing units in the country.

Commercial Office:

During the first half of the year, the commercial office sector performance in Nairobi improved marginally, with the rents, rental yields, and occupancy rates increasing by 2.8%, 0.1% points, and 1.4% points, respectively. The marginal increase in returns was as a result of:

i. Conclusion of the electioneering period and thus an increase in economic activities,
ii. Continued positioning of Nairobi as a regional hub and thus increased entrance of multinationals such as French Based Pharmaceutical firm Sanofi that opened its regional office in Nairobi, AA Japan, a Japanese used vehicle auto dealer that set up its first office in the city in Q1'2018, and Nippon Express, a Japanese logistics firms that opened its first African office in Nairobi in Q1'2018, thus increasing demand for office space.

The table below highlights the performance of the commercial office sector in Nairobi in H1'2018:

All values in Kshs unless otherwise stated

Nairobi Commercial Office Performance Summary Over Time					
Year	**FY'2015**	**FY'2016**	**FY'2017**	**H1' 2018**	**H/H Δ 2018**
Occupancy (%)	89.0%	88.0%	83.2%	84.6%	**1.4% points**
Asking Rents (Kshs/SQFT)	97	97	99	102	**2.8%**
Average Prices (Kshs/SQFT)	12,776	12,031	12,595	12,527	**(0.5%)**
Average Rental Yields (%)	9.3%	9.3%	9.2%	9.3%	**0.1% points**

- ***Occupancy rates in H1'2018 grew by 1.4% points from 83.2% to 84.6% in FY 2017. The growth can be attributed to an increase in demand for office space following the return of calm after the end of the protracted electioneering period thus boosting investor confidence to set up shop or expand***
- ***Asking rents rose by 2.8% from Kshs 99.0 per SQFT to Kshs 102.0 per SQFT leading to an increase in rental yields by 0.1% points from 9.2% in FY' 2017 to 9.3% in H1'2018***
- ***We remain cautiously optimistic on the performance of commercial office space in Nairobi, this is as despite the marginal increase in returns, and occupancy, the sector has an oversupply of 4.7mn SQFT, and thus investors are likely to face challenges on exit, both when selling and renting***

Source: Cytonn Research

In terms of Nairobi submarket performance for H1'2018, Karen, Parklands and Westlands were the best performing nodes recording average rental yields of 10.2%, 9.8%, and 9.7%, respectively. The high yields for the 3 locations are attributable to prime locations and high-quality office space, mostly Grade A and high-quality Grade B offices, which enabled developers to charge a premium on rent. Nairobi CBD, Thika Road and Mombasa Road were the worst performing nodes, with average rental yields of 8.7% for Thika Road and the Nairobi CBD, and 8.6% for Mombasa Road. The low yields are as a result of low quality office spaces (mostly low-quality Grade B and Grade C offices), and congestion by both vehicular and human traffic making the nodes unattractive as office locations. The low demand then constrained the rents which are on average 16.7% lower than the market average of Kshs 102 per SQFT.

The table below summarizes the commercial office performance by nodes in H1'2018 for Nairobi:

(All values in Kshs unless otherwise stated)

Nairobi Commercial Office Performance by Nodes H1'2018											
Location	**Price Kshs / SQFT H1'2018**	**Rent Kshs/SQFT H1'2018**	**Occupancy (%) H1' 2018**	**Rental Yield (%) H1' 2018**	**Price Kshs/ SQFT FY 2017**	**Rent Kshs/ SQFT FY 2017**	**Occupancy FY 2017(%)**	**Rental Yield (%) FY 2017**	**Δ in Rent (%)**	**Δ in Yield (%) Points**	**Δ in Occupancy (%) Points**
Karen	13,776	118	87.2%	**10.2%**	13,167	113	89.2%	9.5%	4.0%	**0.7%**	**(2.0%)**
Parklands	12,433	103	85.6%	**9.8%**	12,729	103	85.7%	9.7%	0.0%	**0.1%**	**(0.1%)**
Westlands	12,567	109	84.7%	**9.7%**	12,872	103	88.5%	9.4%	5.8%	**0.3%**	**(3.8%)**
Kilimani	12,694	101	85.4%	**9.4%**	12,901	101	84.5%	9.5%	0.4%	**(0.1%)**	**0.9%**
UpperHill	12,708	101	85.7%	**9.0%**	12,995	99	82.0%	9.0%	1.6%	**0.0%**	**3.7%**
Nairobi CBD	11,750	87	92.1%	**8.7%**	12,286	88	84.1%	8.7%	(0.9%)	**0.0%**	**8.0%**

Nairobi Commercial Office Performance by Nodes H1’2018											
Location	**Price Kshs / SQFT H1’2018**	**Rent Kshs/SQFT H1’2018**	**Occupancy (%) H1’ 2018**	**Rental Yield (%) H1’ 2018**	**Price Kshs/ SQFT FY 2017**	**Rent Kshs/ SQFT FY 2017**	**Occupancy FY 2017(%)**	**Rental Yield (%) FY 2017**	**∆ in Rent (%)**	**∆ in Yield (%) Points**	**∆ in Occupancy (%) Points**
Thika Road	11,500	85	80.0%	**8.7%**	11,500	82	73.6%	8.5%	3.7%	**0.2%**	**6.4%**
Msa Road	11,770	83	68.0%	**8.6%**	11,641	82	74.2%	8.5%	0.6%	**0.1%**	**(6.2%)**
Grand Total	**12,527**	**102**	**84.6%**	**9.3%**	**12,679**	**99**	**83.9%**	**9.2%**	**2.8%**	**0.1%**	**0.7%**
· Karen, Parklands and Westlands recorded the highest yields of on average 10.2%, 9.8%, and 9.7%, respectively and occupancy rates of on average 87.2%, 85.6%, and 84.7%, respectively. This is as the nodes are able to attract higher rents due to prime locations and high-quality office space · Nairobi CBD, Thika Road and Mombasa Road were the worst performing nodes with average rental yields of 8.6% for Mombasa Rd and 8.7% for both Nairobi CBD and Thika Rd. The low yields for the areas are as a result of the low quality office space (mostly Grade B and Grade C) prevalent in the nodes, and congestion by both vehicular and human traffic making the nodes undesirable, for instance, Mombasa Road had an average occupancy of 68.0% over the first half of 2018, compared to a market average of 84.6%, over the same period											

Source: Cytonn Research

The main highlights in the commercial office sector during the first half of the year included:

i. Federation of Kenya Employers (FKE), an entity established under the Trade Unions Act Cap 233 to represent the interest of employers, announced of its plan to construct an 8-storey office building in Upper Hill. The building is expected to cost Kshs. 620mn exclusive of land cost and will be funded through internal reserves. On completion, the building will house the federation’s headquarters, conference facilities, and staff offices. For more analysis, please see the Cytonn Weekly #20, and,
ii. Zamara Umbrella Solutions, a retirement and benefit fund, formerly known as Alexander Forbes announced of plans to build a twin tower in Westlands, comprising 16 and 30 floors. The Mixed-Use Development (MUD) will feature both commercial office space as well as retail space. The building will be located at the junction of General Mathenge Rd and Peponi Rd. For more analysis, please see the Cytonn Monthly February 2018.

Despite the marginal increase in rents in the first half of the year, we retain a negative outlook for the commercial office sector in Nairobi. This is as the sector has an oversupply of 4.7mn SQFT and new buildings are struggling to achieve market average occupancies. The pockets of value in the sector remain to be; (i) Grade A offices which are in short supply accounting for just 24.0% of the office space supply in the market and have attractive returns with average rental yields of 9.8%, compared to a market average of 9.3%, (ii) Serviced offices which have low supply with a market share of just 0.35% and high returns with average rental yields of 13.4% compared to a market average of 9.3%.

Retail Sector:

In H1’2018, we witnessed an increase in activities in the retail sector in Nairobi with a number of retailers, both local and international expanding, as shown below:

H1'2018 Retailers Expansion Activities and Plans

Retailer	**Country of Origin**	**Nature of Store/ Business**	**No of Store being Opened/ planed for opening in 2018**	**Mall/ Location**
Carrefour	French	Supermarket	2 opened, 2-planned	Junction Mall, Sarit Centre, Village Market, Galleria Mall
Shoprite	South African	Supermarket	7 outlets to be opened	Westgate Mall, Garden City Mall and 5 undisclosed

H1'2018 Retailers Expansion Activities and Plans

Retailer	Country of Origin	Nature of Store/ Business	No of Store being Opened/ planed for opening in 2018	Mall/ Location
Choppies	Botswana	Supermarket	1 opened, 1-planned	Southfield mall along Airport North Road
Miniso	Japan	Household and consumer goods	1 opened, 2-planned	Village Market, The Hub Karen
Java Group	Kenya	Restaurant Chain	2 planned for opening	Nairobi and Mombasa
Decathlon	Dubai	Sports retail shop	1 planned for opening	The Hub Karen
Yves Rocher	French	Cosmetics group	1 opened	The Hub Mall in Karen

- ***The aggressive expansion by the retailers is being driven by; i) the increased prudent marketing methods employed by main stream retailers to attract clientele and enhance footfall, and ii) increased preference for international brands by the consumers***

Source: Cytonn Research

The positive outlook, and hence continued expansion by the retailers being driven by (i) high economic growth rates with the GDP growth rate averaging at more than 5.0% p.a over the last 5 years thus boosting disposable incomes, and increasing purchasing power, (ii) Kenya’s growing position as a regional and continental hub hence witnessing an increase in multinationals operating in the country, (iii) huge opportunity, with Kenya having a formal retail penetration of 35% according to Oxford Business Group, compared to markets like South Africa with a penetration of 60%, and (iv) the rise of e-commerce, as seen through the increased digitization of cash systems and a rise in mobile penetration at 90.4%, according to Jumia Mobile Report 2018, hence increased market coverage.

In H1’2018, the retail sector performance improved slightly, with occupancy rates increasing by 0.9% points from 80.3% in FY 2017 to 81.2% in H1’2018. The rents increased by 2.9% points from Kshs 185 per SQFT in FY 2017 to Kshs 190 per SQFT in H1’2018, resulting in a 0.1%-point increase in rental yields from 9.6% in FY’2017 to 9.7% in H1’2018. The improved performance is attributable to prudent methods employed by developers to attract clientele in malls and enhance footfall, including providing a wide variety of products from both local and international retailers. For instance, malls vacated by Nakumatt within Nairobi such as Garden City, Thika Road Mall, Galleria Mall and the Junction have already let out space to alternate anchor tenants such as Carrefour, Shoprite and Game.

The retail sector’s performance during the first half of the year is as shown below;

All figures in Kshs unless stated otherwise

Summary of Retail Market Performance in Nairobi Over Time

Item	**H1’2017**	**FY 2017**	**H1’2018**	**∆ H1’2018**
Asking Rents (Kshs/SQFT)	190	185	**190**	**2.9%**
Occupancy (%)	83.1%	80.3%	**81.2%**	**0.9%**
Average Rental Yields	10.2%	9.6%	**9.7%**	**0.1%**

- ***The retail sector performance improved, recording an average rental yields of 9.7%, a 0.1%-point increase from 9.6% in FY'2017. The occupancy rates as well increased by 0.9% points, while the rental charges increased by 2.9% in H1'2018***
- ***The increase in occupancy rates is attributable to prudent methods employed by developers to attract clientele and enhance footfall***
- ***The increase in rental charges are driven by the recovery of the market from the tough economic environment and the prolonged electioneering period in Q3’ and Q4 2017***

Source: Cytonn Research

In terms of Nairobi submarket performance for H1’2018, Westlands, Kilimani and Karen recorded the best performance with average rental yields of 12.4%, 11.9% and 10.4%, respectively. The high rental yields in these locations are as a result of high rents charged due to a premium added for the high-quality malls and prime locations. Eastlands and Satellite Towns are the worst performing nodes, with average rental yields of 7.0% and 7.3%, respectively. The low yields are as a result of competition from informal retail space hence decreased rental charges to attract tenants.

The table below shows the retail sector performance by nodes;

All figures in Kshs unless stated otherwise

Nairobi Retail Sector Performance by Nodes H1'2018

Location	**Rent H1’2018**	**Occupancy H1’2018**	**Rental Yield H1’2018**	**Rent FY’2017**	**Occupancy FY’2017**	**Rental Yield FY’2017**	**H1’2018 ∆ in Rent (%)**	**H1’2018 ∆ in Cccupancy (%)**	**H1’2018 ∆ in Yield (%)**
Westlands	231.0	90.8%	12.4%	235	91.0%	13.5%	(1.6%)	(0.2%)	(1.1%)
Kilimani	202.9	97.3%	11.9%	181	87.0%	10.3%	12.1%	10.3%	1.5%
Karen	209.5	95.0%	10.4%	206	96.3%	11.2%	1.6%	(1.3%)	(0.8%)
Ngong Road	187.9	93.7%	10.2%	171	81.8%	8.7%	10.1%	11.9%	1.5%
Thika road	204.3	76.5%	9.8%	199	75.3%	8.7%	2.5%	1.3%	1.1%

All figures in Kshs unless stated otherwise

Nairobi Retail Sector Performance by Nodes H1'2018

Location	**Rent H1'2018**	**Occupancy H1'2018**	**Rental Yield H1'2018**	**Rent FY'2017**	**Occupancy FY'2017**	**Rental Yield FY'2017**	**H1'2018 Δ in Rent (%)**	**H1'2018 Δ in Cccupancy (%)**	**H1'2018 Δ in Yield (%)**
Kiambu Road	219.9	67.0%	9.5%	216	78.2%	10.6%	1.8%	(11.2%)	(1.1%)
Mombasa Road	171.8	74.4%	8.6%	180	68.8%	8.3%	(4.7%)	5.7%	0.3%
Satellite Towns	122.0	89.7%	7.3%	130	82.5%	7.7%	(6.2%)	7.2%	(0.4%)
Eastlands	164.0	68.2%	7.0%	149	61.8%	6.1%	10.1%	6.5%	1.0%
Average	**190.4**	**81.2%**	**9.7%**	**185**	**80.3%**	**9.6%**	**2.8%**	**3.3%**	**0.2%**

- ***Westlands, Kilimani and Karen recorded the best performance with average rental yields of 12.4%, 11.9% and 10.4%, respectively at occupancy rates of 90.8%, 97.3%, and 95.0% respectively. The high performance is as a result of high rents charged due to a premium added for the high-quality malls and prime locations***
- ***The worst performing nodes are the Eastlands and Satellite Towns attributable to low rental charges and competition from informal retail space***
- ***The retail sector recorded 0.2% points increase in rental yield, attributable to increase in occupancy rates. The increase in occupancy rates is attributable to the international retailers such as shoprite and Carrefour taking up spaces left in 2017 by struggling retailers such as Nakumatt and Uchumi supermarket.***

Source: Cytonn Research

We retain a positive outlook for the retail sector on the back of continued expansion by some local supermarkets and the entry of foreign brands, positive demographics and recovery of the market from the tough economic environment and the prolonged electioneering period in Q3' and Q4 2017.

Industrial Sector:

Similar to the commercial office and retail sectors, the industrial sector recorded improved performance in 2018 with rental yields increasing by 0.7% points from 5.4% as at H1'2017 to 6.1% in H1'2018. The increase in yields was as a result of an 11.8% increase in occupancy levels driven by an increase in demand attributable to;

i. The renewal of investor confidence following the conclusion of the prolonged electioneering period, and,
ii. Increased focus by the government on manufacturing, with the sector being included among the governments Big Four Agendas of focus for the next four-years.

As a result of the above, we have witnessed an increase in foreign investments with firms such as Warsteiner and Hapag Lloyd from Germany, Isuzu and Volkswagen setting up assembly and manufacturing plants in the country this year.

In terms of performance by submarkets, Syokimau/Mlolongo and Baba Dogo were the best performing submarkets with average rental yields of 7.0% in both markets, against a market average rental yield of 6.1%. The better performance is attributable to the nodes' proximity to the airport, and relatively affordable land prices for the Syokimau and Mlolongo Area, and for Baba Dogo, the key pull factor is ease of access with the area being in close proximity to the Thika Superhighway and the Eastern Bypass, making it an ideal location for storage and distribution developments such as warehouses.

The worst performing node in H1’2018 was Industrial Area which had average rental yields of 5.8%, the relatively low yields are attributable to low quality of warehouses in the node, most of which are owner occupied.

The table below summarizes the performance of the industrial sector performance by nodes in Nairobi:

Nairobi Industrial Sector Performance by Nodes H1’ 2018

Area	Price Kshs / SQFT H1’ 2018	Rent Kshs/SQFT H1’ 2018	Occupancy (%) H1’ 2018	Rental Yield (%) H1’ 2018	Price Kshs/ SQFT H1’ 2017	Rent Kshs/SQFT H1’ 2017	Occupancy H1’ 2017(%)	Rental Yield (%) H1’ 2017	Δ in Rent (%)	Δ in Yield (%) Points	Δ in Occupancy (%) Points
Syokimau/Mlolongo	5,725	38	87.7%	7.0%	4,516	31	79.0%	6.5%	22.6%	0.5%	8.7%
Baba Dogo	6,217	41	87.6%	7.0%	7,206	44	93.0%	6.8%	(6.6%)	0.1%	(5.4%)
Athi River	4,250	27	83.8%	6.4%	3,242	25	73.0%	6.8%	8.0%	(0.4%)	10.8%
Mombasa Road	5,998	35	89.6%	6.3%	7,389	36	74.0%	4.3%	(2.9%)	1.9%	15.6%
Industrial Area	6,588	34	94.0%	5.8%	7,581	38	85.0%	5.1%	(11.0%)	0.7%	9.0%
Average	**5,612**	**32**	**89.1%**	**6.1%**	**6,071**	**33**	**77.3%**	**5.4%**	**(2.0%)**	**0.7%**	**11.8%**

· ***Rental yields in the industrial market in Nairobi grew by 0.7% in H1’ 2018 as compared to the same period in 2017 attributable to return of calm that has led to increased investment activities as seen through higher occupancy rates of 89.1% in H1’2018 compared to 77.3% in H1’ 2017***
· ***Syokimau/Mlolongo and Baba Dogo were the best performing nodes, recording average rental yields of 7.0% as a result of ease of access via Mombasa Road and Thika Road, respectively***
· ***Industrial Area recorded the lowest yields of 5.8%, despite the high occupancy rates of 94.0%. The low yields are attributable to the low quality retail space in the area, most of which are owner occupied***

Source: Cytonn Research

Other highlights in the industrial sector in H1’ 2018 include:

1. The Chief Executive Officer of Tilisi, a Limuru based 400-acre master planned development comprising of residential, education, logistics, medical, hospitality, recreational, commercial and retail centre, Mr Kavit Shah, announced plans to reduce the minimum land sizes it offers for sale in the industrial precinct by 80.0% from 5-acres to 10 acres, in a bid to boost uptake in the development that is currently 47.4% sold. For more analysis, please see the Cytonn Weekly # 25, and
2. The County Government of Homabay announced plans to construct a Kshs 1.0 bn contemporary industrial park. The plan is expected to be executed in line with the National Government’s plan to develop at least one Export Processing Zone (EPZ) in each county. This is part of the government’s plan to increase the manufacturing sector’s contribution to GDP to at least 15.0% going forward from the 8.4% recorded in 2017. For more analysis, please see the Cytonn Weekly # 20.

We have a positive outlook for the industrial sector in Nairobi. We expect the sector to continue growing supported by; i) return of calm following the end of the protracted electioneering period that has led to a better operating environment thus increased industrial activities, ii) low supply that indicates an existence of a market niche that requires to be filled, iii) improved infrastructure that has opened up areas such as Ruiru and Athi River as well as counties for development of industrial parks, and iv) government support, given that the government has included manufacturing among the Big Four Pillars of focus for the next four- years.

Hospitality:

The hospitality sector in Kenya has continued recording increased investment driven by demand from both local and international guests, with the total room nights growing at a 6-year CAGR of

4.6% from 1.5 mn room nights in 2011 to 1.9 mn room nights in 2017 according to Kenya Bureau of Statistics Economic Survey 2018. In addition, according to the survey and following a 5-year slump between 2011 and 2015 that was as a result of insecurity and terrorism, the number of international arrivals have been growing by 16.7% from 1.2 mn in 2015 to 1.4 mn in 2017 as a result of marketing efforts by the government and improved security. As a result, in H1'2018, the sector recorded significant hotel openings and acquisitions including;

i. The opening of Hilton Garden Inn along Mombasa Road in February this year. The 4-star hotel, brought to the market 171-rooms,
ii. DoubleTree, a brand by Global chain Hilton Group, rebranded and reopened a 109-room 4-star Hotel along Ngong' Road, previously known as Amber Hotel. This marked the brand's third hotel chain in Nairobi, with the others being Hilton Hotel in the CBD and Hilton Garden Inn along Mombasa Road,
iii. The entry of Swiss hotelier, Movenpick Hotels & Resorts, through the opening of a 5-star hotel in Westlands, owned by the Kampala based Golf Course Hotel in April 2018. The hotel features 128 guest rooms; 54-1 and 2-bed residential apartments, 94-suites, and 4,000 SQM of conference space,
iv. Sarova Group of Hotels announced plans to take over the management of Spirit of the Mara Lodge in a 15-year partnership agreement. The hotel located in Siana Conservancy overlooking the Mara, has 10-suites each having a lounge and sleeping area,
v. Nairobi Institute of Business Studies (NIBS) announced plans to set up a 5-star hotel in Kileleshwa, Nairobi by 2019. The 72-key hotel is expected to serve commercial clients and offer practical knowledge and internship to the institute's hospitality students.

The activities above are a clear indication of the attractiveness of the sector and will result in i) better accommodation and service standards, as hotels rebrand or improve their facilities which have depreciated over time, so as to remain competitive in the wake of stiff competition from global brands such as Radisson Blu, Mariott and now Movenpick, and ii) increased room capacity to meet the growing demand for accommodation as seen in the increase in tourist arrivals to 1.4 mn in 2017 compared to 1.3 mn in 2016, according to the Kenya National Bureau of Statistics Economic Survey Report 2018.

In addition to the increased investment in the sector, other factors likely to boost the sector include increased flight operations, which increase the convenience of travelling to and within Kenya such as;

i. The launch of direct flights to the US from Kenya where Kenya Airways will be operating daily flights to and from New York and Nairobi, and will see the trip time reduce by about 8-hours, to 15-hours from the previous 23-hours,
ii. Kenya Airways operations between Kenya and Mauritius offering four weekly flights as from June this year, complementing Air Mauritius' existing operations,
iii. Jambojet increased the frequency of its local flights per week to 39 up from 22, while Kisumu-Nairobi flights increased to 14 from the previous 8, attributed to increased demand,
iv. Kenya Airways and KLM Royal Dutch Airlines expanded their sales cooperation agreement to cover more European-Eastern Africa routes, unlike the previous deal, which limited their alliance on the London and Amsterdam routes into Nairobi, with the aim of creating more value for their customers, and,
v. Ethiopian Airline was granted a second frequency flight to Mombasa, meaning the airline will now fly twice a day to Mombasa. This is expected to result in increased tourist arrivals in the general coastal region which is the main tourist destination in Kenya.

On serviced apartments, Executive Residency by Best Western Nairobi received the Best Property 21 to 70 Units Award, at the Serviced Apartments Worldwide Awards 2018, held at Grange Hotel Tower Bridge in London. The serviced apartment development, which is situated along Riverside Drive, came into the market in November 2016 and is currently the only internationally branded serviced apartment development in Kenya, showing the opportunity in the provision of international-grade serviced apartment facilities.

We project further growth in the hospitality sector as a result of; i) restoration of political calm, ii) the revision of negative travel advisories, warning international citizens, e.g. from the United States against visiting Kenya, iii) positive reviews from travel advisories such as Trip Advisor who ranked Nairobi as the 3rd best place to visit in 2018, only behind Ishigaki Island in Japan and Kapaa in Hawaii, and The Travel Corporation who ranked travel to Kenya as one of the top 10 transformative travel experiences in the world, iv) improved hotel standards with the entry of global hotel brands while existing hotels refurbish their developments, v) classification of hotels into their respective hotel star ratings as a way to improve visibility and credibility of local hotel brands and, vi) improved flight operations and systems which will make it easier and more convenient for travelers.

Infrastructure:

Infrastructural development has continued to boost growth in, not only real estate, but also other sectors in Kenya and has a significant impact on the country's macro-economic variables such as: i) the Gross Domestic Product (GDP) through revenue generation, ii) employment, and iii) ease of doing business. To boost economic growth in Kenya, both the National and County governments, through their respective designated departments have continued to undertake expansionary infrastructural initiatives. During H1'18, the state released its fiscal plan for the 2018/19 financial year and highlighted that infrastructure will be among the key enablers to its Big 4 –plan for the next 5 years. The main take-outs related to infrastructural development were:

i. The State will allocate Kshs 250.0 bn towards infrastructure development which marks an increase of 22.4% from last year's Kshs 204.3 bn allocated in the 2017/18 fiscal year,
ii. Ongoing road construction projects and the ongoing construction of phase 2A of the SGR will take up 46.4% and 29.9% of the Kshs 250.0 bn and
iii. Affordable electricity will take up 15.1%, Kshs 37.8 bn of the infrastructure budget allocation while affordable energy comprising exploration of geothermal, solar, wind and oil energy will consume 7.0%, Kshs 17.5 bn of the allocation.

The move by State to invest in infrastructure will improve transport, aid in penetration of electricity with 60.0% of households currently able to access electricity fuel economic growth and result the attainment of Kenya's projected GDP growth which is projected to grow by 5.5% in 2018, a marginal increase of 0.6% from 4.9% according to the World Bank. The Real Estate sector is bound to benefit from economies of scale due to reduced costs as a result of accessibility as well as savings on servicing costs. Additionally, investment in infrastructure is crucial in the attainment of affordable housing one of State's key 4-pillars of focus for the period between 2017-2022 through creation of a better operating environment for investors.

During H1 2018 we saw the launch and completion of various infrastructural projects across the country, including:

Infrastructural Project in Kenya as at H1'2018

	Name of project	**Type**	**Length (Kms)**	**County**	**Project Value**	**Progress**
1.	Ngong Road Expansion (Phase 1) – dualling of road from the Kenya National Library to the junction at Kilimani Ring Road	Road	2.57 km	Nairobi	Kshs 2.3 bn	Completed in Q1'2018
2.	Dongo-Kundu Bypass – Phase 1	Road	11 km	Mombasa	Kshs 11 bn	Complete and Opened in June 2018

Infrastructural Project in Kenya as at H1'2018

	Name of project	Type	Length (Kms)	County	Project Value	Progress
3.	Eldoret Southern Bypass	Road	20.0 km	Uasin Gishu	Kshs 6.0 bn	Commenced in January 2018
4.	Four link roads that is set to connect the Garissa Highway to the upcoming Thika Bypass	Road	2 km, 3 km, 3 km and 8 km	Kiambu	Kshs 1.5bn	Commenced in February 2018
5.	Construction of phase 2A of the Standard Gauge Railway (SGR) traversing through the Nairobi National Park	Railway	120 km	Nairobi, Kajiado, Nakuru, Kiambu, Naivasha and Narok,	Kshs 150.0 bn	Commenced in March 2018
6.	Ngong Road Expansion (Phase 2)	Road	2.4 km	Nairobi	Kshs 2.2 bn	Commissioned in March 2018
7.	Dongo-Kundu Bypass – Phase 2 & 3	Road	8.9 km	Mombasa	Kshs 30 bn	Commissioned in May 2018 to commence in August 2018
8.	Superhighway linking Jomo Kenyatta International Airport to Rironi area in Limuru along the Nakuru- Nairobi highway	Road	43.5 km	Kiambu	Kshs 59.0 bn	Designs commenced February 2018, project to commence in Q1'2019
9.	Dualling of the Salgaa-Mau summit highway	Road	22.0 km	Nakuru	Kshs 748.0 mn	Tender award and project set to commence in June 2018
10.	Upgrade of Kimbimbi-Karoti – Kajiji roads, Pi – Mumbi roads	Road	217 km	Kirinyaga	Not Disclosed	Launched in June 2018

Other key highlights in infrastructure in H1'2018 were:

i. Kajiado county launched a 162-commuter train that will ease operations and transport between Kajiado Town and the Konza Technocity. With a 2-trip a day schedule and operations in 5 days a week, the train will be expected to cover a 42km radius between the 2-towns,
ii. Nairobi Governor Mr. Mike Mbuvi Sonko is spearheading the construction of a new sewer line in Kariobangi. The new sewer line is set to replace the 150 mm diameter sewer line that is inadequate for multiple dwelling developments and
iii. The County Government of Kirinyaga embarked on a Kshs 1.6 bn water and sewer project covering Kutus and Kerugoya town. The project which will be funded by grants from the National Government and the African Development Bank (AfDB) is set to benefit 200 households in Sagana and Baricho area.

The increased investment in infrastructure is an indication that the government is committed to its developmental agenda and guarantees overall growth of the Kenyan economy. If successfully completed and implemented, State's infrastructural initiatives would have a positive effect on the Real Estate sector in Kenya, since infrastructure helps open up more areas for Real Estate Development increasing accessibility and access to essential services such as water, electricity and a sewerage system. This will make more investors venture into the sector given sustained demand as seen through: i) the housing deficit that currently stands at 2.0 mn units according to the National Housing Corporation (NHC) and positive demographics such as a high population growth rate of 2.6%. 1.4% point higher than global averages of 1.2% and high urbanization rates of 4.4% as compared to world averages of 2.1%; this implies sustained demand.

We expect further investment in infrastructural development as State intensifies efforts in a bid to attain expected average GDP rates of between 5.3% - 5.5% for 2018, which would imply a rebound from a low of 4.9% in 2017, the increased investment in infrastructure is thus expected to open up new towns for real estate development and also lead to a reduction in developmental costs

Statutory Reviews:

During the H'1 2018, there were several statutory reviews made or proposed, all in line to promote efficiency and reduce cost on both develop and the end-user in the real estate sector.

The following are the key reviews;

i. The Kenyan Parliament extended the period for consideration of land regulations for a further 90-days from 14th February. The regulations, published in November 2017, were set to facilitate the implementation of the new land laws which among other items outlines the mandates of the various parties, including the Ministry of Lands, the National Land Commission and the County Governments.

These regulations included;

a. The Land (Extension and Renewal of Leases) Rules, 2017;
b. The Land (Conversion of Land) Rules, 2017;
c. The Land (Assessment of Just Compensation) Rules, 2017;
d. The Land (Allocation of Public Land) Regulation, 2017;
e. The Land Registration (General) Regulations, 2017;
f. The Land Registration (Registration Units) Order, 2017;
g. The Land Regulations, 2017;
h. The Community Land Regulations, 2017; and
i. The National Land Commission (Investigation of Historical Injustices) Regulations, 2017.

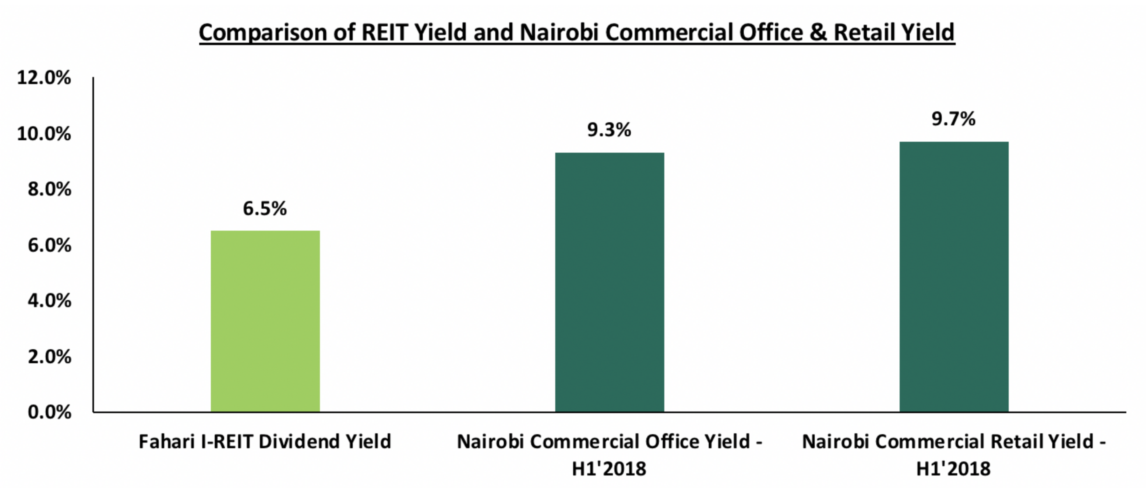
ii. Last month, the Cabinet Secretary of the Ministry of Lands and the Law Society of Kenya (LSK) agreed to form a 15-person task force to look into the issues raised by the LSK on the inadequacies of the Land Information Management System (LIMS). The task force is tasked to recommend guidelines on how the implementation of the electronic registration and conveyancing system will be undertaken, in compliance with Regulation 90 of the Land Registration(General Regulations, 2017), Cytonn Monthly- May 2018,
iii. The National Assembly majority leader, Aden Duale, tabled a bill in Parliament in April this year, seeking to amend the Stamp Duty Act to exempt first time home buyers from paying stamp duty. Stamp duty tax is paid on the market value of a property at the rate of 4.0% for urban areas and 2.0% for rural areas and is payable within 30-days of signing of the sale agreement. In our opinion, if the bill is passed, it will be a move in the right direction, as despite the minimal effect on the total house price, it will reduce the first-time home buyers' financial burden,
iv. The Lands Ministry launched the Sessional Paper No. 1 of 2017 National Land Use Policy (NLUP), aimed at curbing land grabbing and poor land management. The policy is a prerequisite to the National Spatial Plan, County Spatial Planning Guidelines and the Physical Planning Act. In our view, this will especially aid in the delivery of the affordable housing units in the Big 4 Agenda, where availability of land has been a key challenge and will also enhance the efforts to improve the mortgage market, which has been laden with difficulties with property registration and titling,
v. In a bid to increase home affordability, the government, proposed the following legal amendments; i) the NSSF Act to raise member's contribution from current rates of Kshs 400.0 to Kshs 1,080.0, and ii) the Income Tax Act that proposes to raise tax rebates to Kshs 8,000 under the Home Ownership Savings Plan, to employees who save with mortgage institutions from the current Kshs 4,000,
vi. The Energy Regulatory Commission (ERC) kicked off vetting of both existing buildings and those under construction to ensure that they have complied with solar heating rules, and,
vii. The National Construction Authority (NCA) announced on 22nd May 2018, that it was drafting a construction industry policy that will streamline operations in the construction and real estate sectors in the country. In our opinion, this policy will result in reduced use of substandard material and ensure buildings meet set standards thus reduced number of collapsing buildings.

Listed Real Estate:

Stanlib Fahari I-REIT acquired the Kshs. 850.0 mn, 67 Gitanga Road office block in Lavington, Nairobi, in compliance with the Capital Markets Authority's (CMA) requirement for listed REITs to invest a minimum of 75.0% of assets in income-generating real estate. The acquisition of 67 Gitanga Road Office block thus raised the real estate assets share in the fund to 90.0% from 68.0% invested in Greenspan Mall, Signature International Limited, and Bay Holdings Ltd.

The newly acquired property is set to increase the REIT's quality of earnings with a target net income of Kshs. 73.8 mn p.a., translating to 8.7% rental yield, higher than the yield from the other properties in the REIT, which collectively have a rental yield of 7.0%. In our view, this acquisition, is a step in the right direction as the REIT is acquiring higher quality office spaces with good returns and it is likely to increase REITs total return.

On performance, Stanlib Fahari I-REIT released their FY'2017 earnings, registering a 61.0% growth in earnings to Kshs 0.95 per unit from Kshs 0.59 per unit in FY'2016, attributable to a 24.8% decline in fund management expenses to Kshs 135.6 mn from Kshs 180.4 mn in FY'2016 and a 12.4% increase in rental income to Kshs 279.4 mn from Kshs 248.6 mn in FY'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 while the increase in revenues was a result of the additional income from 2 of the properties that were acquired mid-2016. In addition, the I-REIT had no debt in FY'2017, thus no financing costs compared to the previous period, in which it had Kshs 23.4 mn in financing costs. The I-REIT recorded a dividend yield of 6.5%, based on market price as at 29th March 2018, up from 4.3% dividend yield in FY'2016. Despite the increase, the yield is still relatively low compared to brick and mortar assets with commercial retail and office achieving rates of 9.7% and 9.3% in H1'2018, respectively as shown below;

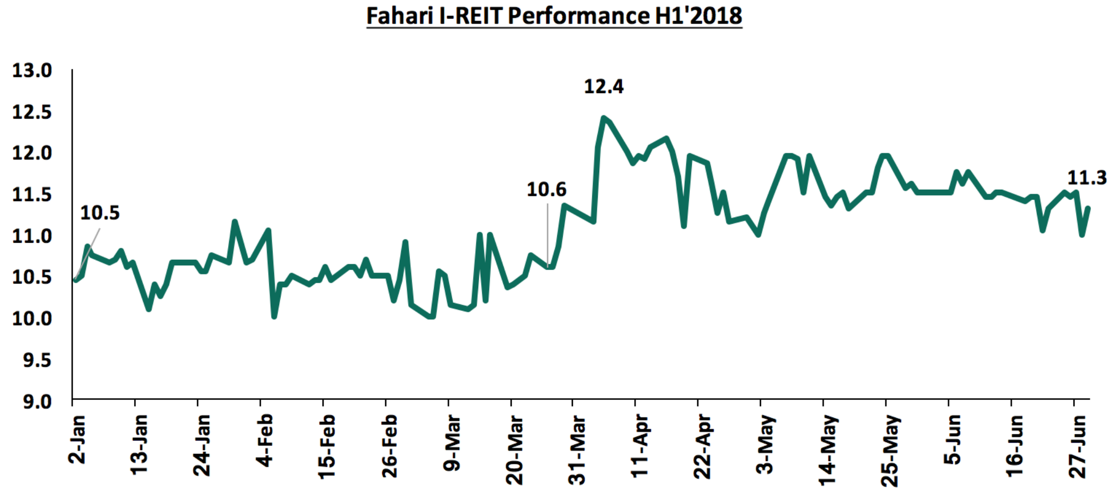


Source: Cytonn Research 2018

For a more comprehensive analysis on the REIT FY'2017 performance, see our Stanlib Fahari I-REIT Earnings Note.

During H1'2018, Stanlib's Fahari I-REIT price rose by 8.1%, closing at Kshs 11.3 per share from Kshs 10.5 per share at the beginning of the year, and shedding 45.7% from its listing price of Kshs 20.8 in November 2015. In addition, Fahari I-REIT is trading at a discount of 47.6% to its Net Asset Value per share, which currently stands at Kshs 16.7 as per FY'2017 reporting. The prices for the instrument have remained low averaging at Kshs 11.1 in H1'2018 largely due to: i) opacity of the exact returns from the underlying assets, ii) the negative sentiments currently engulfing the sector given the poor performance of Fahari and Fusion REIT (FRED), iii) inadequate investor knowledge, and iv) lack of institutional support for REITs. We expect the REIT to continue trading at low prices and in low volumes.

The graph below shows the REIT's performance in H1'2018;



We retain a negative outlook for the listed real estate sector mainly due to market structures and poor market sentiment, however, attempts by key real estate industry players in the region such as East Africa Forum for Structured products to improve the market sentiment on REITs and other alternative investments and need for capital by developers is expected to drive uptake of the REIT.

We remain optimistic about the positive performance of the real estate sector driven by: positive demographic trends such as: rapid urbanization that currently stands at 4.4% against a global average of 2.1%, rapid population growth rates of 2.6% against a global average of 1.2%, sustained infrastructural development, with the government set to build 10,000 kms of road networks in the next 5-years which will open up areas for real estate development and a better operating environment due to political calm after the end of the extended electioneering period, as well as sustained investor appetite.