Nairobi Metropolitan Area Residential Report 2017/2018 & Cytonn Weekly #26/2018

Focus of the Week

In September 2017, we released the Nairobi Metropolitan Area Residential Report 2017, which showed that residential sector performance softened in 2017, with the total returns coming in at 9.4% from 12.6% in 2016. The average rental yield was 5.6%, 0.4% points higher than the 5.2% recorded in 2016. However, average price appreciation was 3.8%, 3.6% points lower than the 7.4% recorded in 2016. The low performance was attributable to:

i. A tough operating environment characterized by low credit supply, as a result of the implementation of the Banking (Amendment) Act 2015, which resulted in declining private sector credit growth from 25.8% in June 2014 to 1.7% as at September 2017, and,
ii. The wait and see attitude adopted by investors as a result of the prolonged electioneering period. This resulted in reduced transaction volumes and development activity with Nairobi building approvals for the period January to July 2017 declining by 18.4% in 2017 to Kshs 149.5 bn from building approvals worth Kshs 183.2 bn approved during a similar period in 2016.

This year, we update the findings of that report by looking at the residential market performance in 2017/2018. We consider the same 35 submarkets covered in 2017. We will start with an introduction to the real estate market in Kenya, an overview of the residential sector, where we will cover the factors affecting residential supply and demand; then we will cover the performance of the residential sector for the period 2017/2018, identify the investment opportunity, before concluding, as outlined below:

A. Introduction to the Real Estate Sector in Kenya
B. Factors Affecting Residential Demand
C. Factors Affecting Residential Supply
D. Market Performance
E. Investment Opportunity
F. Conclusion

A. **Introduction to the Real Estate Sector in Kenya**

The real estate sector in Kenya remains an attractive asset class as a result of (i) relatively high returns that have averaged at 24.3% over the last five years, compared to an average of 13.2% for traditional asset classes, (ii) continued growth, with the real estate sector contribution to Kenya's GDP increasing to 6.8% in Q1'2018, from the 6.1% recorded in Q1'2017, according to Kenya National Bureau of Statistics (KNBS), and (iii) low supply in some themes such as residential, which has a housing deficit of 2.0 mn units. Of key interest in the real estate sector is the residential theme, which driven by the aforementioned deficit continues to grow and has attracted government focus, with H.E. President Uhuru Kenyatta including it among the Kenyan Government Big Four Pillars of focus for 2018-2022, the others being manufacturing, universal health care and food security. As a result of the inclusion, the Kenyan Government, with the support of other key stakeholders such as the World Bank, have rolled out new initiatives aimed at driving the affordable housing initiative, key among them being:

a. The Kenya Mortgage Refinancing Company; which we wrote about in our focus dated April 8, 2018. See the focus here
b. The National Housing Development Fund; which we wrote about in our focus dated June 24, 2018. See the focus here
c. Corporate tax rebates/cuts,
d. Scrapping of NEMA and NCA levies,
e. Launch of the PPP portal to enhance Public-Private Partnerships.

B. **Factors Affecting the Residential Demand**

The residential demand in Kenya area is estimated to be 2.0 mn units, growing annually by 200,000 units, as per National Housing Corporation (NHC), World Bank, and other research institutions, against limited supply from both the government and private sector's estimated annual delivery of 50,000 units. Thus, the sector has continued to attract interest with the main factors affecting the level of demand, as shown below:

Factors Positively Affecting Demand:

i. **Household Incomes:** With a relatively stable economy, household incomes continue to increase further boosted by the fact that most households, especially in the middle-income class have both partners working and earning a steady income. As per the KNBS Economic Survey 2018, the number of recorded employed persons came in at 16.8 mn people in 2017, a 5.6% increase from 15.9 mn persons recorded in 2016, while average monthly wage came in at Kshs 57,008 per person in 2017, a 6.1% increase from Kshs 53,733 reported in 2016. This has resulted in increased disposable income resulting in higher demand for formal housing, and,
ii. **Demographics:** Kenya's population has been growing at 2.6% p.a. over the last 5-years compared to a global average of 1.2%, creating demand for dwelling units. Additionally, the urbanization rate in Kenya is relatively high at 4.4%, compared to the global average of 2.1%, necessitating the need for adequate housing units in the urban areas.

Factors Negatively Affecting Demand:

1. **Access to Credit:** Before the enactment of the Banking (Amendment) Act 2015, the average interest rate on a mortgage in 2015 stood at 18.7%, ranging between 11.9%-23.0%. This however dropped to an average of 13.5%, as at 2016, ranging between 10.5%-18.0% (CBK Bank Supervision Report 2016), due to the interest rates cap law. Despite this, the number of active mortgages dropped by 1.5% y/y in December 2016 to 24,085 from 24,458 in 2015, attributed to tight credit standards employed by banks as they prefer the less risky government securities, and thus reduced lending to the private sector, including real estate.

Of the three factors that affect demand, one is negative, that is, access to credit. However, two are positive, that is, household income and positive demographic dividend, and thus our outlook on sustained demand for residential property is positive.

C. **Factors Affecting Residential Supply**

Development activity within the residential sector has continued on an upward trend in 2018 bolstered by increased investor appetite and the huge housing deficit. According to KNBS, the value of approved residential buildings in Nairobi between January and March 2018 came in at Kshs 36.9 bn, 8.8% higher than the Kshs 33.9 bn registered during the same period in 2017. The key factors affecting supply are below:

Factors Positively Affecting Supply:

i. **Government Initiatives:** Owing to the huge housing deficit of 2.0 mn units, growing by 200,000 units p.a. according to NHC, the Kenyan government has put in place initiatives aimed at promoting the private sector to aid in addressing the shortage. These initiatives include the urban regeneration plan for various parts of Nairobi, and tenant purchase schemes in other counties, a 50.0% corporate tax reduction for developers of at least 100 low-cost housing units annually, and the proposal to avail public land to private developers for development under the Public-Private Partnership (PPP) structure, and,
ii. **Infrastructural Developments:** Improved infrastructural developments following the dualling of major roads such as Outer Ring Road and Ngong Road, the construction of the Standard Gauge Railway (SGR), bypasses, and electrification, have opened up new areas such as Kikuyu, Ruiru, Ruaka, and metropolitan areas such as Machakos to real estate development. This is due to ease of access. Challenges such as insufficient sewer systems, water supply and access roads in some areas, especially in satellite towns, still persist hampering supply of housing and thus necessitating the need for local government support in the real estate industry.

Factors Neutral for Supply:

i. **Statutory Approvals:** The statutory requirements and approval procedures have been a key challenge for most developers especially due to the elongated processes and also the many fees required which ultimately add onto developer costs. However, even though inadequate, the Kenyan Government has introduced a number of measures aimed at reforming the industry such as the recently launched Sessional Paper No. 1 of 2017 National Land Use Policy (NLUP), digitization of the lands ministry and the scrapping of land title search fees, all aimed at curbing the lack of transparency and efficiency, as well as curbing poor land management.

Factors Negatively Affecting Supply:

i. **Land Regime**: The multiple land tenure land system in Kenya and the fact that 64.0% of the land in Kenya is estimated to be communal has led to opacity in land registrations and transfers, which affects development processes,
ii. **Access to Credit:** Lack of proper funding for real estate developments has resulted in excessive debt financing, resulting in increased financing costs, especially where there are extended project time frames. The Banking (Amendment) Act 2015, which capped interest rates at 4.0% above the CBK rate, which currently stands at 9.5%, continues to impact negatively on development activity as financial institutions deprive the private sector of credit, in favor of the risk-free government securities. For instance, private sector credit growth came in at 2.1% as at April 2018, compared to a 5-year average growth of 14.0% (2013-2018), and,
iii. **Availability and Cost of Development Class Land:** Land prices in Nairobi are relatively high with an average price per acre of Kshs 222.6 mn, that is for high rise, low rise and commercial areas, compared to an average of Kshs 6.1 mn in other towns such as Kisumu and Eldoret. In satellite towns where land is relatively affordable, with an average price per acre of Kshs 17.0 mn, there is inadequate trunk infrastructure, and the developer has to provide, this ultimately leads to increased construction costs for developers amidst waning private sector credit growth.

Of the factors that affect supply, two are positive, that is government initiatives and infrastructural development, one is neutral, that is, statutory approvals, while three, that is, land regimes, access to credit and cost of development class land, are negative. Thus, our sentiments towards supply are negative due to the tough operating environment.

D. **Market Performance:**

In 2018, we conducted market research in 35 sub-markets in Nairobi Metropolitan area to determine returns, measured by rental yields and price appreciation.

In our submarket analysis, we classified the various suburbs and satellite towns in the Nairobi Metropolitan Area into three segments:

A. **High-End Segment** – Consists of prime suburbs in Nairobi, such as Karen, Runda and Kitisuru. Most of these areas have been zones for low rise residential developments only, and are characterized by palatial villas and bungalows on half-acre land parcels,
B. **Upper Middle-Income Segment –** Consists of suburbs such as Kilimani, Lavington, Kileleshwa, Loresho and Ridgeways, among others. The population in these zones are middle class but with higher incomes than the average characterization of middle class. They are zones for both high rise and low-density houses, and,
C. **Lower Middle-Income Segment –** Consists of suburbs in Nairobi habited by middle class such as Donholm, Komarock and Imara Daima as well as Satellite Towns such as Ngong, Rongai and Juja.

To note:

i. **Detached** units refer to stand-alone houses such as townhouses, maisonettes and bungalows,
ii. **Apartments** refer to a self-contained housing unit occupying part of a building, also called flats.

In terms of overall market performance, for the period 2017/2018, the residential sector recorded total returns of 8.2%, a 1.2% points decline from the 9.4% total returns recorded in 2017; the average price appreciation was 2.8%, with an average rental yield of 5.4%. The performance is attributable to a decline in price appreciation, which dropped by 1.0% points y/y due to a sluggish growth with selected markets such as the lower middle market for detached units and upper middle markets for apartments recording big decline in price appreciation of 4.1% and 1.5%, respectively. In some sub-markets however, where there is the good infrastructure, easy access to main business nodes such as Kilimani, double-digit returns of up to 13.9% were recorded, as they continue to attract interest from investors.

The sector's returns summary is as shown below:

Change in Residential Sector Performance - 2017/2018

Metric	2018	2017	Y/Y Change
Annual Uptake	23.3%	23.6%	**(0.3% points)**
Capital Appreciation	2.8%	3.8%	**(1.0% points)**
Rental Yield	5.4%	5.6%	**(0.2% points)**
Total Returns	8.2%	9.4%	**(1.2% points)**

· The sector recorded subdued performance, with total returns dropping by 1.2% points to 8.2% in 2018 from 9.4% in 2017 mainly due to a decline in price appreciation, attributable to various markets softening such as the lower middle market for detached units and upper middle markets for apartments. This is as the markets receive increased supply against reduced uptake as a result of a reduction in private sector credit supply, following the implementation of the Banking Amendment Act, 2015.
· Rental yields remained fairly stable declining by a marginal 0.2% points to 5.4% in 2018 from 5.6% in 2017, attributable to developers having to stabilize rents against in a bid to retain occupants

Performance by Typology

Apartments recorded the high average annual returns of 8.7%, compared to detached with 7.6% returns. This is attributable to increased demand for apartments due to a rapidly increasing population and also their affordability with apartments being 49.1% cheaper on average compared to detached units.

The performance of the residential sector for the 2017/2018 period is as summarized below:

(All Values in Kshs Unless Stated Otherwise)

Nairobi Metropolitan Area Residential Sector Performance by Typologies 2017/2018

Typology	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales	Average Rental Yield	Y/Y Average Price Appreciation	Total Annual Returns 2017/18
Apartments	99,052	463	24.0%	5.8%	2.9%	**8.7%**
Detached	140,601	577	22.6%	4.9%	2.7%	**7.6%**
Average	**119,826.7**	**519.9**	**23.3%**	**5.4%**	**2.8%**	**8.2%**

· ***Apartments registered higher returns to investors of on average 8.7%, 0.5% points higher than the market average of 8.2%. This is attributable to high demand for high rise units, mainly due to their affordability; on average apartments are 49.1% cheaper compared to detached units***

Performance by Class

The upper middle and lower middle suburb markets for apartments recorded the highest average annual returns with 8.8%, driven by demand for apartments in these markets especially by the expanding middle-class. The lower middle market for detached posted the deepest decline in year-on-year price appreciation, by 4.1%, mainly due to increased supply in these market and also focus on affordability which has hindered price appreciation.

(All Values in Kshs Unless Stated Otherwise)

Nairobi Metropolitan Area Residential Performance by Class 2017/2018

Segment	Average Rental Yield (2018)	Average Price Appreciation (2018)	Total Returns (2018)	Average Rental Yield (2017)	Average Price Appreciation (2017)	Total Returns (2017)	Y/Y Change in Appreciation	Y/Y Change in Rental Yield	Y/Y Change in Total Returns
Detached									
High-End	4.7%	3.5%	8.3%	5.6%	3.9%	9.5%	(0.4%)	(0.9%)	**(1.2%)**
Upper Middle	5.1%	2.4%	7.5%	4.9%	2.6%	7.5%	(0.2%)	0.2%	**0.0%**
Lower Middle	5.0%	2.0%	7.0%	5.0%	6.1%	11.1%	(4.1%)	0.0%	**(4.1%)**
Average	4.9%	2.7%	7.6%	5.0%	3.9%	8.9%	(1.5%)	(0.1%)	**(1.8%)**
Apartments									
Upper Middle	6.0%	2.9%	8.9%	6.2%	4.3%	10.5%	(1.4%)	(0.2%)	**(1.6%)**

(All Values in Kshs Unless Stated Otherwise)

Nairobi Metropolitan Area Residential Performance by Class 2017/2018

Segment	**Average Rental Yield (2018)**	**Average Price Appreciation (2018)**	**Total Returns (2018)**	**Average Rental Yield (2017)**	**Average Price Appreciation (2017)**	**Total Returns (2017)**	**Y/Y Change in Appreciation**	**Y/Y Change in Rental Yield**	**Y/Y Change in Total Returns**
Lower Middle Suburbs	5.6%	3.2%	8.8%	5.3%	3.5%	9.2%	(0.3%)	0.3%	**(0.4%)**
Lower Middle Satellites	5.9%	2.7%	8.6%	6.5%	2.6%	9.1%	0.1%	(0.6%)	**(0.5%)**
Average	5.8%	2.9%	8.7%	6.0%	3.5%	9.5%	(0.6%)	(0.2%)	**(0.9%)**
Grand Average	**5.4%**	**2.8%**	**8.2%**	**5.6%**	**3.8%**	**9.4%**	**(1.1%)**	**(0.2%)**	**(1.3%)**

· In 2018 prices increased by 2.8% on average, 1.0% points slower compared to the 3.8% recorded in 2017. This is attributable to short-term effects of last year's electioneering period and tight access to credit which has restricted affordability for buyers and thus, asking prices have softened as developers compete to attract buyers,
· The biggest decline in prices was 4.1%%, recorded in the lower middle-end sector for detached units; This is attributable sellers' competition as investors selling old stock have had to reduce their asking prices to compete with the new affordable stock,
· Lower Middle satellite towns recorded a positive change on y/y appreciation with a marginal increase of 0.1% points to 2.7%. This is as areas in these segments have a low supply of investment grade high rise properties but towns like Ruaka and Thindigua are increasingly attracting developers due to good infrastructure and high demand from young populations,
· Rental yields in 2018 declined marginally by 0.2% points to 5.4%. This is attributable to increasing housing stock in the market and thus developers have had to stabilize rents in order to preserve clientele,
· Upper middle market for apartments had the highest yields of 6.0% attributable to attractive rents that specific sub-markets such as Kilimani, Riverside, Westlands among others attract; while the high-end market for detached recorded the least rental yields at 4.7%, attributable to stabilized rents against high prices.

Source: Cytonn Research

a. Detached Units Performance

Detached units recorded subdued returns in 2018 with average total returns of 7.6%, 0.6% points lower compared to the market average of 8.2%. This is attributable to a drop in price appreciation, which declined by 1.5% points with markets such as the lower middle dropping by 4.1% points, attributable competition in the market as investors selling old stock have had to reduce their asking prices to compete with the new affordable stock; rental yields remained fairly stable dropping by 0.1% as developers stabilize their rents in order to retain occupants. The best performing sub-market was Ruiru with average returns of 11.7%, on account of i) good infrastructure, for instance, it is accessible through both the Thika Superhighway and the Eastern Bypass, and ii) relative affordability compared to other satellite towns such as Juja and Redhill.

i. High-End

The high-end market comprises suburbs such as Runda, Kitisuru, Lower Kabete, Karen, and Rosslyn. In 2018, this market recorded average returns of 8.3%. The best performing market was Lower Kabete, attributable to its exclusivity, which is bound to attract more interest as more traditionally low-rise areas become densified. Rosslyn was the worst performing market recording a decline in asking prices by 1.9% on average, owing to limited options for potential investors in terms of product compared to neighbouring estates like Runda and Kitisuru, which have more new supply. However, high-end areas recorded the highest average annual uptake in the detached category with 23.1% p.a., against the detached market's average of 22.5%, attributable to increased demand for luxury properties especially from high net-worth individuals and multinationals.

The performance of detached units in high suburbs is as summarized below;

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Detached Units Performance 2017/2018 – High-End Suburbs

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales(%)	Average Rental Yield(%)	Average Price Appreciation(%)	Average Total Returns(%)
Lower Kabete	174,963	491	21.4%	3.4%	7.5%	**10.8%**
Kitisuru	250,983	1,007	22.6%	4.7%	5.4%	**10.1%**
Karen	194,341	799	27.7%	4.7%	4.0%	**8.8%**
Runda	188,098	772	23.2%	5.0%	2.7%	**7.7%**
Roselyn	164,125	808	20.8%	5.9%	(1.9%)	**3.9%**
Average	**194,502**	**776**	**23.1%**	**4.7%**	**3.5%**	**8.3%**

· Lower Kabete and Kitisuru areas registered the highest returns of 10.8% and 10.1%, respectively in the high-end market. This is attributable to the exclusivity both areas offer and high land prices which leads to developers having to increase their prices in order to recoup returns
· Rosslyn recorded the least returns, owing to a depreciation of asking prices by 1.9%. This is attributable to the market's limitation in terms of what it offers investors due to inadequate land for development, and thus most investment grade stock is aged

Source: Cytonn Research

ii. **Upper Mid-End**

The upper mid-end area comprises of areas such as Spring Valley, Lavington, Loresho, among others. The market recorded a relatively low average annual uptake of 21.7% compared to high-end areas and lower middle markets which recorded 23.1% and 22.9%, respectively. This is attributable to the continued development of high rise buildings in the upper mid-end areas which reduces the attractiveness of detached units in these markets as the suburbs no longer offer exclusivity. The area recorded average total returns of 7.5%, with Langata being the best performing node, with average total returns of 9.1%, attributable to its proximity to key business districts such as Upperhill and CBD, and a low supply of detached units, and Ridgeways was the worst performing node with total returns of 5.2% due to encroachment of apartments in and around these areas, leading to decline in value for low rise houses as the areas lose their appeal to high end buyers.

The performance is as summarized below;

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Detached Units Performance 2017/2018 - Upper Mid-End Suburbs

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales(%)	Average Rental Yield(%)	Average Price Appreciation(%)	Average Total Returns(%)
Langata	129,107	448	21.6%	4.3%	4.7%	**9.1%**
Runda Mumwe	144,346	687	24.3%	5.8%	2.8%	**8.7%**
South B/C	131,394	582	22.3%	4.5%	3.5%	**8.0%**
Spring Valley	167,940	504	21.2%	4.3%	3.5%	**7.7%**
Lavington	180,498	658	16.7%	4.4%	3.1%	**7.5%**
Loresho	150,499	827	25.0%	6.6%	(0.6%)	**6.0%**
Ridgeways	150,422	822	20.8%	5.5%	(0.3%)	**5.2%**
Average	**150,601**	**647**	**21.7%**	**5.1%**	**2.4%**	**7.5%**

· ***Langata had the highest returns in the upper mid end sector of 9.1% compared to the market's average of 7.5%, and also recording the highest price appreciation in the category with 4.7%. This is attributable to its proximity to key business districts such as Upperhill, and CBD and a low supply of detached units***

· ***Ridgeways and Loresho registered a slight decline in prices by 0.3% and 0.6%, respectively. This is attributable to the encroachment of apartments in and around these areas, leading to a decline in value for low rise houses as the areas lose their appeal to high end buyers***

Source: Cytonn Research

iii. **Lower Mid-End**

Lower mid-end areas mainly comprise of areas in Nairobi's periphery such as Athi River, Juja, and Ngong and lower mid-end suburbs such as Donholm, Komarock and Imara Daima. They recorded the lowest returns in the detached units' category with 7.0%. This is due to selected sub-markets that have softened recording a price stagnation such as Ruai, Syokimau, and Mlolongo, amidst relatively low uptake rates at 18.8% and 20.0%, respectively, compared to the market average of 22.9%. The best performing sub-market was Ruiru with average returns of 11.7%, attributable to good infrastructure that offers easy access to areas such as CBD, and Mombasa Road, among other business nodes.

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Detached Units Performance 2017/2018 - Lower Mid-End Suburbs

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales (%)	Average Rental Yield (%)	Average Price Appreciation (%)	Average Total Returns(%)
Ruiru	91,591	332	23.6%	5.1%	6.6%	**11.7%**
Kitengela	70,558	309	22.6%	4.8%	6.2%	**11.0%**
Ruai	49,407	265	18.8%	6.6%	0.0%	**6.6%**
Donholm & Komarock	86,198	367	22.8%	5.2%	1.1%	**6.3%**
Rongai	80,145	305	23.8%	4.6%	4.1%	**8.7%**
Juja	81,844	277	23.3%	5.1%	1.1%	**6.1%**
Redhill	89,979	327	19.2%	4.2%	1.6%	**5.8%**
Syokimau/Mlolongo	73,333	340	20.0%	5.7%	0.0%	**5.7%**
Athi River	91,948	295	22.6%	3.7%	2.4%	**6.2%**
Thika	67,875	326	22.3%	4.7%	0.3%	**5.1%**
Ngong	65,125	247	23.4%	4.5%	2.1%	**6.6%**
Imara Daima	72,417	318	26.9%	5.1%	(1.0%)	**4.2%**
Average	**76,702**	**309**	**22.9%**	**5.0%**	**2.0%**	**7.0%**

· Ruiru had the highest returns at 11.7%. The area has been performing well as a result of i) good infrastructure, for instance, it is accessible through both the Thika Superhighway and the Eastern bypass, ii) relative affordability – absolute prices are cheaper in Ruiru with an average of Kshs 16.4 mn for a typical detached unit compared to areas like Juja and Redhill where the same would go for an average of Kshs 17.1 mn and Kshs 18.6 mn, respectively
· Imara Daima registered the least returns of 4.2%, compared to a market average of 7.0%, attributable to the outdated status of detached properties in the area which is predominantly a high rise area

Source: Cytonn Research

b. **Apartment Performance**

Apartments recorded relatively high returns with an average of 8.7%, 0.5% points higher compared to the market's average of 8.2%. This is as apartments are more affordable compared to detached units, with 49.1% on average. Upper mid-end and lower middle suburb markets recorded the highest average annual returns at 8.8%, with selected markets such as Kilimani, Upper Kabete, Thindigua, Ruaka and South B/C recording double-digit average returns of 13.9%, 11.9%, 11.2%, 11.1% and 10.1%, respectively. These markets are boosted by good infrastructure, and good locations in relation to places where people work such as CBD, Upperhill, Westlands, thus attracting demand.

i. **Upper Mid-End**

The upper mid-end market comprises of areas such as Kilimani, Westlands, Spring Valley and Riverside. The market recorded relatively high annual uptake at 24.2%, driven by continued demand from the expanding middle class. The best performing sub-market was Kilimani with average total returns of 13.9%. This is as the area benefits from its location in proximity to key business districts such as CBD, and Upperhill as well as easy access to other key nodes such as Westlands, and also its vast supply of amenities, which has continued to create demand from investors, and especially from the growing middle-income class. Parklands recorded the lowest returns with 5.9% compared to the market average of 8.9%, attributable to the growing supply of apartments in the area thus creating competition among developers in a bid to attract buyers, hence the negative price appreciation of 1.3%.

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Apartments Performance 2017/2018 - Upper Mid-End Performance

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales (%)	Average Rental Yield(%)	Average Price Appreciation(%)	Average Total Returns(%)
Kilimani	131,594	621	25.6%	6.1%	7.8%	**13.9%**
Riverside	121,295	508	21.7%	5.4%	3.8%	**9.3%**
Spring Valley	144,169	647	24.1%	5.9%	3.1%	**9.0%**
Loresho	109,426	558	23.2%	6.0%	2.7%	**8.7%**
Upperhill	141,905	593	23.7%	5.2%	3.4%	**8.6%**
Westlands	132,128	636	26.1%	6.0%	2.3%	**8.3%**
Kileleshwa	124,549	629	23.6%	6.0%	1.0%	**7.0%**
Parklands	113,908	641	25.8%	7.3%	(1.3%)	**5.9%**
Average	**127,372**	**604**	**24.2%**	**6.0%**	**2.9%**	**8.9%**

· Kilimani area has the highest returns at 13.9% owing to its proximity to key business districts and nodes such as CBD, Upperhill, and Westlands, and also its vast supply of social amenities such as neighborhood malls and good infrastructure and incoming infrastructure such as the upgrade of Ngong Road,
· Parklands had the lowest returns averaging at 5.9% compared to a market average of 8.8%, due to a decline in asking prices by 1.3%. This is attributable to an increase in supply of apartments as investors move out of Westlands which is increasingly being commercialized

Source: Cytonn Research

ii. **Lower Mid-End Suburbs**

The lower mid-end suburbs comprise of areas such as South C, estates along Ngong Road such as Race Course, Thome, and Langata, among others. This market has relatively high annual uptake at 24.1%, with areas such as Upper Kabete recording 27.4% average annual uptake, especially due to the fact that most of the estates are located along major routes such as Waiyaki Way, Ngong Road and Thika Superhighway, hence demand from young people and the working population in general. The best performing sub-market was Upper Kabete, driven by its location along Waiyaki Way, and low supply of investment grade apartments against increased demand from emerging middle-income earners, and also its proximity to the upscale neighbourhoods such as Riverside, Loresho, and Westlands. The sub-market with least returns was Langata with 5.6%, compared to the market average of 8.8%, attributable to a low price appreciation which came in at 0.3% on average, compared to the market average of 3.2%, attributable to competition from areas such as South B and C.

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Apartments Performance 2017/2018 - Lower Mid-End Suburbs

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales(%)	Average Rental Yield(%)	Average Price Appreciation(%)	Average Total Returns(%)
Upper Kabete	86,344	429	27.4%	6.3%	5.6%	**11.9%**
South B & C	107,819	510	26.5%	5.7%	4.4%	**10.1%**
Donholm & Komarock	75,072	374	20.3%	6.0%	3.9%	**9.9%**
Ngong Road	99,630	453	25.6%	5.9%	4.0%	**9.9%**
Imara Daima	74,232	381	26.2%	6.3%	3.0%	**9.4%**
Kahawa West	82,166	416	22.9%	6.2%	1.8%	**8.1%**
Dagoretti	98,038	482	22.5%	6.2%	1.7%	**7.8%**
Thome	124,554	297	22.3%	2.8%	3.9%	**6.7%**
Langata	107,374	462	23.2%	5.3%	0.3%	**5.6%**
Average	**95,025**	**423**	**24.1%**	**5.6%**	**3.2%**	**8.8%**

· Upper Kabete recorded the best returns in the lower middle-end sector for suburbs with 11.9%. This is due to its proximity to Waiyaki Way which offers good access to business nodes such as Westlands, and the CBD, thus, attracting demand especially from the young and working populations
· Langata has the lowest returns with total returns of on average 5.6% due to a slow y/y price appreciation indicating low demand from investors due to competition from areas such as South B and C

Source: Cytonn Research

iii. **Lower Mid-End Satellite Towns**

The lower mid-end satellite towns comprise of areas located in counties bordering Nairobi and within a 40-km radius of Nairobi's CBD; they include Juja, Athi River, Rongai, Ruiru, and Kikuyu. The market recorded relatively high annual uptake of 23.7%, albeit a relatively subdued average annual price appreciation of 2.7%, compared to other high rise markets. Total returns came in at 8.6% with Thindigua and Ruaka recording the highest average returns of 11.2% and 11.1%, respectively. The areas benefit from close proximity to high-end neighbourhoods such as Runda and Rosslyn, as well as close proximity to amenities such as Two Rivers. Juja recorded the lowest returns with 6.1%, attributable to a stagnation of prices as apartments in the area are mostly attractive to students thus buyers in that market prefer detached units.

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Apartments Performance 2017/2018- Lower Mid-End Satellite Towns

Location	Average of Price Per SQM	Average of Rent per SQM	Average of Annual Sales 2018(%)	Average of Rental Yield 2018(%)	Average of Price Appreciation 2018(%)	Average of Total Return 2018(%)

(All figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Apartments Performance 2017/2018- Lower Mid-End Satellite Towns

Location	Average of Price Per SQM	Average of Rent per SQM	Average of Annual Sales 2018(%)	Average of Rental Yield 2018(%)	Average of Price Appreciation 2018(%)	Average of Total Return 2018(%)
Thindigua	92,603	454	28.2%	5.9%	5.3%	**11.2%**
Ruaka	101,163	440	25.6%	5.3%	5.8%	**11.1%**
Ruiru	89,918	469	20.6%	6.3%	3.7%	**9.9%**
Athi River	63,395	351	25.4%	6.3%	2.4%	**8.7%**
Rongai	70,983	338	23.7%	5.9%	2.8%	**8.7%**
Lower Kabete	86,026	415	24.3%	5.8%	2.6%	**8.4%**
Kitengela	67,018	327	19.4%	6.4%	1.8%	**8.2%**
Kikuyu	76,046	336	22.3%	5.3%	2.7%	**8.1%**
Syokimau/Mlolongo	75,313	299	22.0%	5.0%	1.8%	**6.8%**
Thika	49,155	284	25.0%	6.1%	0.3%	**6.4%**
Juja	50,728	259	23.7%	6.1%	0.0%	**6.1%**
Average	**74,759**	**361**	**23.7%**	**5.9%**	**2.7%**	**8.6%**

· Thindigua and Ruaka recorded the best returns driven by relatively high y/y price appreciation of 5.3% and 5.8%, respectively, compared to the market average of 2.7%. Both areas benefit from proximity to high-end neighborhoods such as Runda and Rosslyn, thus attracting investors,
· Apartments in Juja recorded the lowest returns, with total returns of 6.1% on average. This is due to the high student population in the area who take up the apartment, thus buyers in the area are more attracted to detached units

Source: Cytonn Research

E. **Investment Opportunity**

To gauge the investment opportunity, we look at key metrics that are considered when investing in real estate as follows:

i. **Weighted Annual Uptake:** Refers to how fast developments sell on average, the higher/ faster the sales rate, the higher the points allotted. This was derived by getting the difference between 2018 and 2017 absolute uptake,
ii. **Average Returns:** This is the sum of the rental yield and price appreciation for each suburb. The higher the return the more points allotted,
iii. **Amenities:** Areas with a regional mall among other social amenities such as recreational and entertainment amenities, healthcare and education facilities among others, scored higher points while areas that lacked these amenities scored low,
iv. **Distance from Main Business Nodes:** This is to establish the commute distance for the majority of the working population, where we assumed Nairobi Central Business District as the common node. Using the farthest town as our guide, areas in close proximity to Nairobi CBD/ a radius of 14 km, scored high,
v. **State of Infrastructure:** Here we looked at elements of infrastructure that affect real estate heavily, that is, roads and sewer systems. For the purpose of the ranking, the following factors have been used to rank the state of the infrastructure in the various areas;

- **Good**-Access mainly through tarmac Roads and main sewer,
- **Average**- Access mainly through tarmac roads but not main sewer,
- **Poor**- Access mainly through earth roads and not main sewer.

We allotted the highest weighting to uptake, and average returns at 30.0% and 35.0%, respectively.

This is because for the investors these are the most important factors to consider when investing in an area. The lowest weighting was allotted to distance from main business node and amenities at 5.0%. This is as these factors are catered for in the pricing while for infrastructure (incoming and existing), we allocated 15.0% as it is what attracts both developers and buyers;

The points are allocated as shown below, with 3 being the highest for each metric and 1 being the lowest:

Residential Market Opportunity

Weighted Annual Uptake (WAU)	**<0.2%**	**0.2%-0.4%**	**>0.4%**
Points	1	2	3
Average Returns	**<5%**	**5-10%**	**>10%**
Points	1	2	3
Availability of Amenities	**Low (supermarket)**	**Average (Neighbourhood Community + Social Amenities)**	**High (Regional Mall, Social Amenities)**
Points	1	2	3
Infrastructure	**Poor**	**Average**	**Good**
Points	1	2	3
Distance from Main Business Nodes	**>28 km**	**15km-28km**	**Within 14km radius of NRB CBD**
Points	1	2	3

Based on the above, the best places to invest in for apartment units are Kilimani and Westlands driven by the presence of amenities and good status of existing and incoming infrastructure such as revamping of Ngong Road and Waiyaki Way.

Nairobi Metropolitan Area Investment Opportunity -Top 5 Areas to Invest for Apartments

Location	Distance from Main Business Node	Amenities	Infrastructure	Weighted Annual Uptake	Returns	Availability of Development Land	Total Points	Rank
Kilimani	3.0	3.5	3.5	2.0	3.0	2.0	2.7	**1**
Westlands	3.0	3.5	3.5	3.0	2.0	1.0	2.6	**2**
Thindigua	3.0	2.0	2.0	2.0	3.0	2.0	2.4	**3**
Ruaka	2.0	2.0	2.0	2.0	3.0	2.0	2.4	**4**
Upper Kabete	3.0	2.0	2.0	2.0	3.0	1.0	2.3	**5**
South B & C	3.0	2.0	2.0	2.0	3.0	1.0	2.3	**5**

· Kilimani and Westlands are the best areas to invest in due to their location in proximity to the CBD, the areas also have good infrastructure in terms of status of roads and connection to sewer main, and a vast supply of amenities and hence are attractive to home buyers. However, land for development is scarce in these areas which imply land prices are high, thus costly for developers to invest in them

Source: Cytonn Research

For detached units, the best areas to invest in are Karen and Runda Mumwe driven by the high rate of uptake at 27.7% and 24.3%, respectively, and availability of development land, making it affordable for developers to invest in these areas.

Nairobi Metropolitan Area Investment Opportunity- Top 5 Areas to Invest for Detached Units

Location	Distance from main Business Node	Amenities	Infrastructure	Weighted Annual Uptake	Average Returns	Availability of Development Land	Total Points	Rank
Karen	3.0	3.0	2.0	3.0	2.0	3.0	2.6	**1**
Runda Mumwe	3.0	2.0	1.5	2.0	2.0	3.0	2.2	**2**
Ruiru	1.0	2.0	2.0	2.0	2.0	3.0	2.1	**3**
South B/C	3.0	1.0	1.0	3.0	2.0	1.0	2.1	**4**
Kitisuru	3.0	1.0	2.0	1.0	3.0	2.0	2.1	**4**

· Karen and Runda Mumwe are the best areas to invest in for detached. Their viability is boosted by (i) the availability of development land, and (ii) location in close proximity to the CBD. However, the areas lack in good quality infrastructure with most served by earth roads, which is costly for developers to cater for

Source: Cytonn Research

F. Conclusion

We expect the fundamental factors supporting the residential sector such as (i) constant demand for residential report driven by a deficit of affordable homes for the growing population and luxury properties for the growing number of wealthy individuals in Kenya and incoming multinationals, (ii) a stable macroeconomic environment that has averaged at 5.3% over the last 5 years, and (iii) continued infrastructural improvements, to remain strong thus sustaining the performance of the sector. However, the key challenges remain the high land costs, high construction and infrastructural costs, and access to financing hindering provision of affordable housing.The table below shows a summary of the residential performance:

Residential Report 2017/2018 Conclusion

Measure	2017 Sentiment	2018 Sentiment	2017 Outlook	2018 Outlook
Demand	• The housing deficit was estimated to be 1.9 mn units according to Cytonn Research with the demand being highest in the lower middle income segment of the market at 70.7%	• The Housing deficit in the Nairobi Metropolitan area continues to widen driven by rapid population growth at an average of 3.3%, compared to the national average of 2.6%, with 97.1% being lower middle-income and low end income earners, creating demand for affordable homes • Furthermore, the number of wealthy Kenyans has been on the rise and is expected to grow by 60.5% by 2022, creating demand for luxury homes	**Positive**	**Positive**
Credit	• There was a tough operating environment characterized by low credit supply, as a result of the implementation of the Banking (Amendment) Act 2015, which resulted in declining private sector credit growth from 25.8% in June 2014 to 1.7% as at September 2017	• The private sector credit growth has been on a continuous downward trend following the Banking (Amendment) Act 2015, coming in at 2.1% as at April 2018 compared to a 5-year average of 14.0% between 2013 and 2018 • However, the introduction of innovative financial credit solutions such as the Kenya Mortgage Refinancing Company an National Housing Development Fund is expected to create a better credit financing environment for developers and end buyers	**Negative**	**Neutral**

Residential Report 2017/2018 Conclusion

Measure	2017 Sentiment	2018 Sentiment	2017 Outlook	2018 Outlook
Infrastructure	• Improved infrastructural developments such as improved roads, the SGR, electrification, and ICT led to opening up of new development areas in areas such as Athi River, Mlolongo and Ruaka	• We have witnessed a continued provision of infrastructure in the recent years, as well as revamping of old roads. This has opened up new areas for investment and helped reduce development costs for developers	**Positive**	**Positive**
Performance	• The residential sector performance softened in 2017, with the total returns coming in 9.4% from 12.6% in 2016. The average rental yield was 5.6%, 0.4% points higher than the 5.2% recorded in 2016, however average price appreciation was 3.8%, 3.6% points lower than the 7.4% recorded in 2016 • We expected there to be price stagnation in selected markets with surplus supply	• The average return in the residential sector is 8.2%, a 1.2% decline from 2017 returns. The best-performing markets have returns of up to 13.9% which is high compared to returns from other asset classes such as the 10-Year Treasury Bond with a 13.2% yield	**Neutral**	**Neutral**

For the key metrics that have been used to determine the performance of the sector, two are positive, that is, demand and infrastructure; and two are neutral, that is, access to developer and end buyer credit, as well as the performance of the sector in terms of total returns, thus we have a positive outlook for the sector. Theresidential sector's returns have been subdued over the last one year, partly attributable to the tightened access to end buyer financing against an increasing cost of living and the short to medium term effect of the protracted electioneering period. However, we remain bullish on the performance of the sector driven by (i) Increased demand for residential property, (ii) continued interest from global investors, (iii) government initiatives, and (iv) innovative financing solutions aimed at enhancing off take and developer financing challenges.

See the full report.

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