Cytonn Q3’2018 Markets Review

Real Estate

During Q3’2018, the real estate sector recorded an array of activities across all themes supported 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.

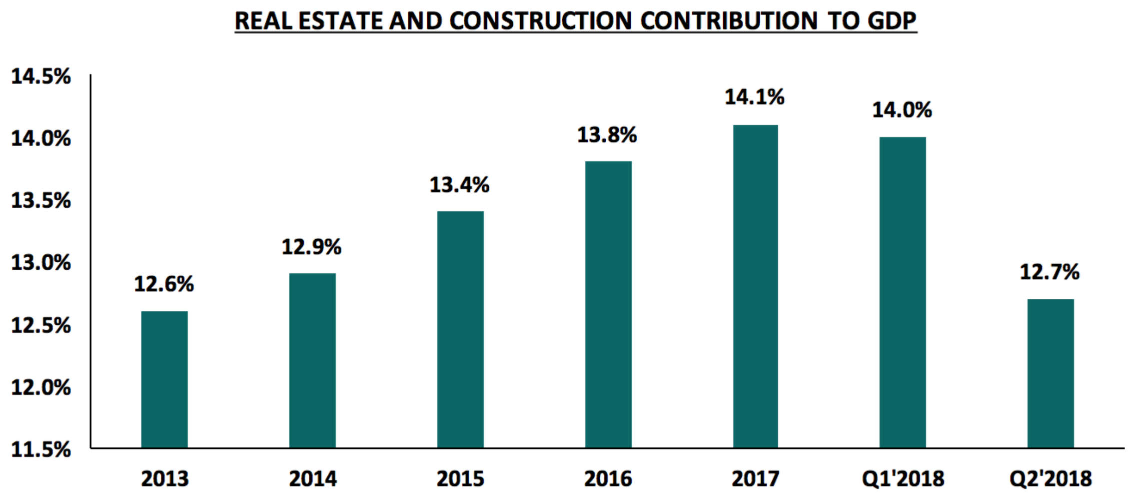
The key challenges that continue to face developers and end users include: (i) Access to financing with private sector credit growth coming in at 4.3% as at June 2018 compared to a five-year average of 14.0% for the period 2013 to 2018, (ii) high land and construction costs, especially in Nairobi and its metropolis, and (iii) oversupply in selected sectors such as office and retail space with an oversupply of 5.7mn SQFT and 2.0mnSQFT, respectively.

I. **Industry Reports:**

The Kenya National Bureau of Statistics (KNBS) released their Gross Domestic Report Q2'2018, where the key take-outs for the real estate sector were:

i. The construction sector recorded slower performance growing by 6.1% in Q2’2018, 1.1% points lower than 7.2% in Q1’2018, and 3.4% points lower than 9.5% growth recorded in Q2’2017 while the consumption of cement dropped by 6.8% in Q2’2018. We attribute the decline to the reduction in development activity particularly in the commercial sector as developers await the absorption of the existing surplus stock of office and retail space with an oversupply of 4.7mn SQFT and 2.0mnSQFT, respectively according to Cytonn Research. Despite the slowed activities, the sector’s growth was supported by the ongoing construction of the second phase of the Standard Gauge Railway (SGR). The KNBS report highlighted a 12.4% increase in credit to the construction industry, a reflection that the sector remained vibrant during the quarter despite being 3.4% points slower than Q2’2017, and,

ii. The real estate sector grew by 6.6% in Q2’2018, 0.2% points lower than 6.8% in Q1’2018, and 0.6% points higher than the 6.0% growth recorded in Q2’2017, and we attribute the growth to renewed investor confidence, and thus investments in real estate following the improved macro-economic environment.



Source: KNBS

According to KNBS, the real estate and construction sectors contribution to GDP declined to 12.7% in Q2'2018 compared to 14.0% during Q1'2018. We attribute the decline mainly to the 3.4% points decline in activities in construction sector. We however expect the trend to reverse driven by; (i) economic recovery with the GDP growing at 6.3% in Q2'2018, higher than the 4.7% recorded in Q2'2017, and (ii) increased focus on affordable housing as part of the Big 4 Agenda with several projects set to be launched in various parts of the country in the coming months.

II. **Residential Sector:**

The residential sector continued to record activity during Q3'2018, as we witnessed new developments especially in regard to the affordable housing initiative as part of the Kenya Government's Big 4 Agenda. To this end, the key highlights included:

- The National Government invited bids from both international and local developers to build 1,500 affordable residential units at Nairobi's Park Road estate situated in Ngara for low–income earners, expected to be delivered within 36-months. The government plans to achieve this through Public-Private Partnerships (PPP's) where the government's role is to provide the land while the developer is tasked with the role of designing, funding and constructing the units. For more information, please see Cytonn Weekly #34/2018,
- Nairobi Lands, Urban Renewal and Housing County Executive, Mr. Charles Kerich, announced that the implementation of the Nairobi Urban Regeneration Plan would start in September 2018 in Pangani Estate, where a developer known as Technofin was expected to break ground. However, of key to note is that this is yet to be actualized due to unclear and unsatisfactory methods of resettling the residents of Pangani. For more information, please see Cytonn Weekly #31/2018, and
- Co-operative Bank announced that it will invest Kshs 200.0 mn worth of share capital in the Kenya Mortgage Refinancing Company (KMRC), in support of the facility, which is aimed at boosting mortgage financing in Kenya by increasing liquidity for primary lenders. The facility is also expected to receive Kshs 15.1 bn seed funding from the World Bank, and Kshs 1.5 bn from the National Treasury. For more information, please see Cytonn Weekly #31/2018.

To support the affordable housing initiative, H.E. President Uhuru Kenyatta signed into law various bills with an aim of supplementing the budgetary needs of the affordable housing initiative and also boosting offtake for first-time home buyers and thus, increasing the rate of home ownership in Kenya (*currently home ownership rate is 26.4% in urban areas and 89.5% in the rural areas, Kenya National Bureau of Standards*). These include;

- The Financial Bill 2018, which includes a clause on employees' contribution to the National Housing Development Fund, as proposed in the National Budget reading for 2018/2019. As per the clause, employees shall be contributing 1.5% of their gross salary to the fund, while employers top this up with a similar amount,

- The amendment of the Income Tax Act that will allow buyers get a 15.0% tax relief up to a maximum of Kshs 108,000 p.a., or Kshs 9,000 p.m., under the newly introduced Affordable Housing Relief section, and,
- The amendment of the Stamp Duty Act, which will now exempt first time home-buyers under the affordable housing scheme from paying the Stamp Duty Tax, normally set at 2.0% - 4.0% of the property value. For more information, please see CytonnWeekly#28/2018.

These advancements are commendable and in our view are a testament to the Kenyan Government's commitment to delivering the promise of affordable homes to Kenyans, and we anticipate the launch of various projects especially in the Nairobi, Kiambu, Mombasa and Kisumu Counties in the coming months. However, we expect the lack of an attractive public-private partnership (PPP) package for private developers to remain as the biggest impediment to the delivery of the projects. This is due to the persistent challenges that hinder the success of PPPs in Kenya such as (i) persistent red tape during government approval processes, (ii) equivocal profit-sharing strategies for the private partners, and (iii) long and extended time-frames that tend to characterize PPP projects, thus making them unattractive to private developers.

In the mid and high-end market segment, investor appetite remains strong as we have continued to see more private developers coming into the market, such as (i) the recently launched Art Stone Valley project by Kenya-based firm, Capitaland, in partnership with Dubai-based investment firms, that is, Abu Dhabi Investments, Emirate Homes Group, Royal Investments Group; (ii) Double Win Company Limited, a real estate firm, which announced plans to put up a residential complex along Argwings Kodhek Road in Kilimani; while, (iii) Centum, an investment firm in Kenya, announced plans to break ground on Riverbank Apartments within their Two Rivers Mixed Use Development based in Runda. The summary of these projects is as below:

Various Private Residential Developments Launched in Q3'2018

Project	Developer	Location	Typology	Total number of Units
Art Stone Valley	Capitaland	Mang'u, Juja	3 BR	960
			2 BR	480
			1 BR	60
-	Double Win Company Limited	Kilimani, along Argwings Kodhek Road	2 & 3 BR	138
River Bank	Centum Investments	Runda, Along Limuru Road	3 BR	60
			2 BR	118
			1 BR	18
Total number of units				1,834

Online Sources

In terms of performance, the sector recorded a 2.0% points decline in annualised total returns to 6.2% in Q3'2018 from 8.2% in Q2'2018. The decline in returns was as a result of slow price appreciation which came in at an average of 0.9% q/q, attributable to credit to the private sector which has been persistently low following the retention of the interest rates cap law. However, rental yields remained fairly flat declining marginally by 0.1% points to an average of 5.3% during the quarter under review from 5.4% in Q2'2018, as developers retain their rental rates in a bid to retain occupants. Apartments performed better compared to detached units with average q/q total returns coming in at 7.1% compared to the overall market's average returns of 6.2%. This is as buyers continue to opt for the high rise units which tend to be more affordable than low rise units due to the realization of economies of scale through densification,

The summary of the sector is as shown below:

Residential Market Performance Summary Q3'2018

Segment	Average Rental Yield Q3'2018	Average Price Appreciation Q3'2018	Average Total Returns Q3'2018	Average Rental Yield Q2'2018	Average Price Appreciation Q2'2018	Average Total Returns Q2'2018 (Annualized)	Q/Q Change in Rental Yield	Q/Q Change in Appreciation	Q/Q Change in Total Returns
Detached									
High End	4.5%	(0.4%)	4.3%	4.7%	3.5%	8.3%	(0.2%)	(3.9%)	(4.0%)
Upper Middle	4.9%	0.5%	5.4%	5.1%	2.4%	7.5%	(0.2%)	(1.9%)	(2.1%)
Lower Middle	5.9%	0.5%	6.3%	5.0%	2.0%	7.0%	0.9%	(1.5%)	(0.7%)
Average	**5.1%**	**0.2%**	**5.3%**	**4.9%**	**2.6%**	**7.6%**	**0.2%**	**(2.4%)**	**(2.3%)**
Apartments									
Lower Middle Satellite	5.7%	2.5%	8.2%	5.9%	2.7%	8.6%	(0.2%)	(0.2%)	(0.4%)
Lower Middle Suburbs	5.3%	1.0%	6.3%	5.6%	3.2%	8.8%	(0.3%)	(2.2%)	(2.5%)
Upper Middle	5.3%	1.5%	6.8%	6.0%	2.9%	8.9%	(0.7%)	(1.4%)	(2.1%)
Average	**5.4%**	**1.6%**	**7.1%**	**5.8%**	**2.9%**	**8.8%**	**(0.4%)**	**(1.3%)**	**(1.7%)**
Grand Market Average Q3'218	**5.3%**	**0.9%**	**6.2%**	**5.4%**	**2.8%**	**8.2%**	**(0.1%)**	**(1.8%)**	**(2.0%)**

- ***Apartments recorded better performance with average total returns to investors of 7.1% in comparison to detached units which recorded average returns to investors of 5.3%. This is as buyers continue to opt for the high-rise units which tend to be more affordable than low rise units due to the realization of economies of scale through densification,***
- ***In addition, as low-rise areas such as Loresho and Ridgeways become more densified, low rise developments are losing their appeal to potential investors thus leading to slow price appreciation, which came in at 0.2% on average during the quarter while apartments recorded an average price appreciation of 1.6%***

Source: Cytonn Research

<u>Detached units</u>

Detached units recorded subdued performance during the quarter, with average returns to investors coming in at 5.3%, 0.9% points lower than market's average of 6.2%, mainly a result of the continued interest in high rise developments in the wake of the huge housing gap for affordable housing. The performance is as shown below:

(All Values in Kshs Unless Stated Otherwise)

Top 5: Detached Market Performance Q3'2018

Location	**Average of Price Per SQM Q3'2018**	**Average of Rent per SQM Q3'2018**	**Average of Uptake Q3'2018**	**Average of Rental Yield Q3'2018**	**Average of Price Appreciation Q3'2018**	**Average of Total Return Q3'2018 (q/q)**	**Average of Total Return Q2'2018 (Annualized)**	**Q/Q Change in Total Returns**
Runda Mumwe	159,855.0	715.3	84.5%	5.7%	1.6%	7.4%	8.70%	(1.3%)
Ridgeways	148,029.5	901.5	75.4%	7.0%	0.0%	7.0%	7.7%	(0.7%)
Runda	211,684.5	846.7	86.4%	5.0%	1.5%	6.5%	5.8%	0.7%
Karen	187,926.2	752.1	88.4%	4.9%	1.6%	6.5%	11.7%	(5.2%)
Lower Kabete	176,137.4	490.7	81.9%	3.8%	2.7%	6.5%	8.70%	(2.2%)
Average	**176,726.5**	**741.3**	**83.3%**	**5.3%**	**1.5%**	**6.8%**	**8.5%**	**(1.8%)**

- ***Runda Mumwe, Ridgeways, Runda, Karen, and Lower Kabete were the best performing markets in the detached market during the quarter, with average total returns to investors of 6.8% compared to the overall detached market average of 5.3%***
- ***Runda Mumwe was the best performing market with average total returns of 7.4% in comparison to the market average of 6.3%. This is attributable to the area's association with the upscale Runda while offering affordable high-end developments thus attracting buyers***
- ***Ridgeways recorded a stagnation of prices, attributable to the area's increased densification and thus losing its appeal to buyers. However, the area's performance is boosted by the premium rental rates it attracts, which against flat prices boosts its rental yields***

Source: Cytonn Research

Apartments

Apartments recorded the best returns to investors during the quarter with an average of 7.1% compared to detached units with 5.3%. Ruaka was the best performing market with average total returns to investors of 8.2%.

The performance is as below:

(All Values in Kshs Unless Stated Otherwise)

Top 5: Apartments Performance Q3'2018

Location	**Average of Price Per SQM Q3' 2018**	**Average of Rent Per SQM Q3' 2018**	**Average of Uptake Q3' 2018**	**Average of Rental Yield Q3'2018**	**Average of Price Appreciation Q3'2018**	**Average of Total Return Q3'2018 (q/q)**	**Total Returns Q2'2018 (Annualized)**	**Q/Q Change in Total Returns**
Ruaka	103,769.9	453.5	90.8%	4.9%	3.3%	8.2%	11.1%	(5.6%)
Thindigua	103,645.2	447.1	91.5%	5.0%	3.0%	8.1%	11.2%	(5.8%)
Parklands	120,364.9	565.5	85.0%	5.1%	2.4%	7.4%	5.9%	(0.3%)
Kikuyu	77,218.3	344.8	73.2%	5.3%	1.7%	7.1%	8.1%	(2.3%)
Langata	109,223.2	476.3	78.7%	5.2%	0.8%	6.0%	5.6%	0.1%
Average	**102,844.3**	**457.4**	**83.8%**	**5.1%**	**2.2%**	**7.3%**	**8.4%**	**(2.8%)**

- ***Kikuyu, Langata, Parklands, Ruaka, and Thindigua were the best performing during the quarter with average total returns to investors of 7.3% q/q compared to the market average of 7.1%,***
- ***Ruaka was the best performing market with average returns to investors during the quarter coming in at 8.2% compared to the market average of 7.1%. The town has been increasingly attracting investors' interest, attributable to the continued infrastructural improvements, proximity to upscale neighbourhoods such as Runda and Rosslyn, as well as presence of Two Rivers mall, thus making it attractive to home buyers***
- ***This was followed by Thindigua and Parklands, with average total returns of 8.1% and 7.4%. Parkland's performance was boosted by a relative increase in price appreciation of 3.7% points q/q with q3 recording an average of 2.4% in comparison to the depreciation of 1.3% recorded in Q2'2018. This is as surrounding neighbourhoods such as Westlands and Riverside continuously become commercialized***

The performance is as below:

(All Values in Kshs Unless Stated Otherwise)

Top 5: Apartments Performance Q3’2018

Location	Average of Price Per SQM Q3' 2018	Average of Rent Per SQM Q3' 2018	Average of Uptake Q3' 2018	Average of Rental Yield Q3'2018	Average of Price Appreciation Q3'2018	Average of Total Return Q3'2018 (q/q)	Total Returns Q2'2018 (Annualized)	Q/Q Change in Total Returns

Source: Cytonn Research

We expect the residential sector to continue recording activity in relation to affordable housing, while the market performance and uptake is likely to remain subdued due to factors hindering home purchasing such as the persistent lack of private sector credit growth amidst rising costs of living with investors’ returns sustained by rental yields.

III. Commercial Office Sector:

During Q3’2018, the commercial office sector recorded a marginal improvement in performance with average rental yields of 9.5%, 0.2% points higher than Q2’2018, with 9.3%. This increase in rental yields is largely driven by the 2.7% points rise in occupancy rates coming at 87.3% in Q3’2018 compared to 84.6% in Q2’2018, which is an indication of increased uptake of office spaces as a result of i) political stability that has led to increased economic activities, and ii) entrance of multinationals such as Betmaster, a Russian betting company, that launched its presence into Nairobi as its first African destination in August affirming Nairobi’s position as a regional hub. We, however, note that rental rates during the period stagnated at an average of Kshs 102 per SQFT while asking prices dropped by 2.6% to Kshs 12,202 in Q3’2018 from Kshs 12,527 in Q2’2018. We attribute the stagnation in rents and drop in prices to the oversupply of 4.7 mn SQFT office space as at 2017, as per Cytonn Commercial Office Report 2018, which have created a bargaining chip for firms forcing developers to reduce or maintain prices and rents in order to remain competitive and attract occupants in their office spaces.

The table below highlights the performance of the commercial office sector in Nairobi in Q3’2018:

(All values in Kshs unless otherwise stated)

Nairobi Commercial Office Performance Summary Over Time

Year	FY’2015	FY’2016	FY’2017	Q2 2018	Q3'2018	Q/Q Δ 2018
Occupancy (%)	89.0%	88.0%	83.2%	84.6%	87.3%	**2.7%**
Asking Rents (Kshs/SQFT)	97	97	99	102	102	**0.0**
Average Prices (Kshs/SQFT)	12,776	12,031	12,595	12,527	12,202	**(2.6%)**
Average Rental Yields (%)	9.3%	9.3%	9.2%	9.3%	9.5%	**0.2%**

- ***Occupancy rates in Q3’2018 grew by 2.7% points to 87.3% from 84.6% as at Q2’2018 an indication of increased demand for the office sector which in turn have boost rental yields by 0.2% points to 9.5% in Q3’2018 from 9.3% in Q2’2018.***
- ***Rental rate stagnated during the period Q2/Q3’ 2018 which we attributed oversupply of 4.7 mn SQFT office space in 2017 that has forced developers to reduce or maintain prices and rents in order to remain competitive and attract occupants in their office spaces***

Source: Cytonn Research

In the sub-market analysis, Karen and Westlands recorded the highest yields of 10.8% and 10.0%, respectively, as properties in these areas charge the highest asking rents of Kshs 117 and Kshs 111 per SQFT, respectively. This is because they are regarded as prime locations with Grade A and high quality Grade B offices thus enabling the developers to charge premium rates. Offices along Thika Road and Mombasa Road on the other hand, recorded the lowest rental yields at an average of 8.7% each, 0.9% points lower than the market average at 9.5%. This is owing to the areas offering low quality Grade B and C offices and are also affected by frequent traffic snarl ups that have made them generally unattractive to firms, thus they charge relatively low rental rates with Mombasa road having an average rent of Kshs 82 per SQFT, 24.4% lower than the market average at Kshs 102 whereas Thika road had an average rent of Kshs 85 per SQFT, 20.0% lower than the market average.

The table below shows the performance of the commercial office sector in Nairobi in Q3’2018:

(All values in Kshs unless otherwise stated)

Nairobi Commercial Office Performance by Nodes Q3’2018

Nodes	Price Kshs / SQFT Q3' 2018	Rent Kshs/SQFT Q3 2018	Occupancy (%) Q3 2018	Rental Yield (%) Q3 2018	Price Kshs / SQFT Q2 2018	Rent Kshs/SQFT Q2 2018	Occupancy (%) Q2 2018	Rental Yield (%) Q2 2018	Q/Q Δ in Rents (%)	Q/Q Δ in Yields (%)	Q/Q Δ in Occupancy (%)
Karen	12,888	117	89.0%	**10.8%**	13,776	118	87.2%	10.2%	**(0.7%)**	**0.6%**	**1.8%**
Westlands	10,667	111	89.0%	**10.0%**	12,567	109	84.7%	9.7%	**2.0%**	**0.3%**	**4.3%**
Parklands	12,208	103	86.0%	**9.8%**	12,433	103	85.6%	9.8%	**0.0%**	**0.0%**	**0.4%**
Kilimani	13,031	101	87.3%	**9.6%**	12,694	101	85.4%	9.4%	**0.0%**	**0.2%**	**1.9%**
Nbi CBD	11,333	88	92.1%	**9.1%**	11,750	87	92.1%	8.7%	**1.3%**	**0.4%**	**0.0%**
UpperHill	13,386	100	90.1%	**9.0%**	12,708	101	85.7%	9.0%	**(1.0%)**	**0.0%**	**4.4%**
Msa Road	11,750	82	71.0%	**8.7%**	11,770	83	68.0%	8.6%	**(1.0%)**	**0.1%**	**3.0%**
Thika Road	11,750	85	89.0%	**8.7%**	11,500	85	80.0%	8.7%	**0.0%**	**0.0%**	**9.0%**
Grand Average	**12,202**	**102**	**87.3%**	**9.5%**	**12,527**	**102**	**84.6%**	**9.3%**	**0.1%**	**0.2%**	**3.1%**

· Karen generated the highest yields of 10.8%, as the area offers the highest asking rents of Kshs 117 attributable to it being a prime area with grade A and high quality grade B offices thus enabling the developers to charge premium rates
· Thika Road and Mombasa Road recorded the least rental yields in the sector of 8.7% each, 0.9% points lower than the market average at 9.5%, driven by the low asking rents in the market of Kshs 82 and Kshs 85 attributable to the areas majorly offer low quality grade B and C offices and are also affected by high traffic snarl ups that have made them generally unattractive to firms
· Nairobi CBD recorded the high occupancy rate of 92.1%, 4.8% points than the average at 87.3% since it is the centralized node for business in Kenya thus attracting occupants in the area

Source: Cytonn Research

We also analyzed performance in terms of office classes whereby Grade A offices outperformed other classes recording rental yields of 10.0% compared to Grade B and C with 9.4% and 9.0%, respectively. We attribute the better performance of Grade A offices to the high asking rents of Kshs 114 per SQFT on average, 11.8% higher than the market average at Kshs 102 per SQFT, whereas Grade B and C had Kshs 99 and Kshs 87, respectively. Grade B offices have been recording high occupancy rates throughout attaining 87.9% in Q3’2018, 0.6% points higher than the market average of 87.3% as they offer quality spaces for a relatively cheaper price, 15.2% cheaper than grade A offices.

The table below shows the performance of the different grades in the commercial office sector in Nairobi in Q3’2018:

(All values in Kshs unless otherwise stated)

Nairobi Commercial Office Performance by Grade Q3'2018

Grade	Price Q3 2018	Rent Q3 2018	Occupancy Q3 2018	Rental Yield Q3 2018	Price Q2 2018	Rent Q2 2018	Occupancy Q2 2018	Rental Yield Q2 2018	Q/Q Δ in Price (%)	Q/Q Δ in Rents (%)	Q/Q Δ in Rental Yields (% points)	Q/Q Δ in Occupancy (% points)
Grade A	13,047	114	84.1%	**10.0%**	12,923	110	84.8%	10.0%	**1.0%**	**3.6%**	**0.0%**	**(0.7%)**
Grade B	12,250	99	87.9%	**9.4%**	12,609	100	85.4%	9.3%	**(2.8%)**	**(0.7%)**	**0.1%**	**2.5%**
Grade C	10,092	87	85.2%	**9.0%**	10,782	86	81.4%	8.5%	**(6.4%)**	**1.3%**	**0.5%**	**3.8%**
Grand Average	**12,202**	**102**	**87.3%**	**9.5%**	**12,527**	**102**	**84.6%**	**9.3%**	**(2.6%)**	**0.00**	**0.1%**	**2.7%**

- ***Grade A offices recorded the highest rental yields of 10.0% compared to Grade B and C with 9.4% and 9.0%, respectively attributable to the high asking rents of grade A office at Kshs 114, 11.8% higher than the market average at Kshs 102, whereas grade B and C with Kshs 99 and Kshs 87, 3.0% and 17.2% lower than the market average, respectively***
- ***Grade B offices have been recording high occupancy rates throughout attaining 87.9% in Q3'2018 as they offer quality spaces for a relatively cheaper price***

Source: Cytonn Research

The main highlights in the commercial office sector during third quarter of the year included:

i. Britam Tower, a 32-storey building, owned by British-American Investments Company (Britam), started letting in Upperhill in July. The building whose construction started in September 2013, brought into the Upperhill market a total of 350,000 SQFT of office space. For more information and analysis, please see the Cytonn Weekly #29/2018,
ii. The Anti-Corruption Agency announced plans to acquire the Integrity Centre Building, which hosts Ethics and Anti-Corruption Commission's (EACC) headquarters along Valley Road in Milimani, Nairobi. The National Land Commission (NLC) approved the acquisition of the building built on 1.2 acres from Tegus Limited at Kshs 1.5 bn that is expected to record a rental yield of 9.6%, in line with Kilimani office performance, against a Nairobi market average of 9.3%. For more information and analysis, please see the Cytonn Monthly – July 2018,
iii. Prism Towers, a 33–storey building of 133m in height, developed by Kings Developers Ltd officially opened for occupation in August. The building, situated in Upperhill, and whose construction began in 2014 and brought to the market a total of 250,000 SQFT of lettable office space. For additional information and analysis, please see the Cytonn Weekly #30/2018, and,
iv. Emperor Plaza, a family-owned commercial building located in Nairobi CBD, was set for sale at Kshs 750 mn, exclusive of purchase costs and VAT. The 5-floor building is located at the Junction of Kenyatta Avenue and Koinange Street, and currently hosts the Kenya Institute of Management (KIM) and other tenants. According to local dailies, the vendors value the building at Kshs 750 mn, that is a sale price of Kshs 17,847 per SQFT, with a resultant rental yield of 8.4%. For more information, please see the Cytonn Weekly #34/2018.

Our outlook for the sector remains negative despite the 0.2% improvement in performance as at Q3' 2018 in Nairobi on the account of the oversupply in the sector that stood at 4.7 mn SQFT of office space as at 2017 and is expected to grow by 12.8% to 5.3 mn SQFT by the end of 2018 with the recent openings of Kings Prism and Britam Tower in Upperhill. In light of this, we are of the opinion that investments in the commercial office space should be aimed towards long term gains as we anticipate the market will have picked up in the next 3 to 5 years. We however recommend investments in differentiated concepts such as 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 9.5%.

IV. **Retail Sector:**

In Q3'2018, we witnessed an increase in activities in the retail sector as follows;

- Kiloran Development Group, a UK-based developer with an operational office in Nairobi together with ALL Design, a British architectural firm, announced plans of putting up a Mixed-Use Development (MUD) named, "The Beacon", to be located off Uhuru Highway towards Bunyala Road roundabout. The MUD will be consisting of 261,563 SQFT of retail space and 45,208 SQFT of Grade A office space. For more details, see Cytonn Weekly#34/2018,
- Nairobi Kenya continues to rank as the East Africa regional commercial hub, with the Two Rivers mall located along Limuru road being awarded the best mixed-use development in Africa in the 9th Africa Property Investment (API) Summit and Expo 2018. The mall award was because of work-life and play experience the mall offers, integration of green technologies and intelligent building management systems for effective, sustainable resource usage, and,
- Increased uptake of retail space with several global and local retailers expanding or announcing plans to expand, as shown below:

Retailers Expansion Activities and Plans – Data as at Q3'2018

Name	Country of Origin	Type of Store	Stores opened or announced in Q3'2018	No of Stores in Kenya	Location of Stores in Kenya
Carrefour	French	Supermarket	1 at Nakumatt Mega space	6	Two Rivers Mall, Thika Road Mall, The Hub Karen, Sarit Centre, The Junction Mall, Galleria Mall, Village Market
Bosch	German	Electronics	1 Opened at The Oval	1	The Oval, Westlands
Shoprite	South Africa	Supermarket	1 at Mombasa City Mall	0	Westgate Mall, Garden City, Mombasa City Mall, Waterfront mall and 3 undisclosed
Subway	United States	Fast Food	4 planned at CBD, Upperhill, Lavington, and Mombasa Road	9	Junction Mall, Nairobi CBD, Thika Road Mall, Timau Plaza, Amee Arcade in Parklands, Westgate Mall, University Way, Village Market and The Hub in Karen
Naivas	Kenya	Supermarket	1 at Mwembe Tayari Mall	46	Nairobi, Mombasa, Kisumu, Eldoret, Naivasha, Nyeri, Nakuru etc
Massmart	South Africa	hardware	Undisclosed	0	Undisclosed
Burger King	United States	Fast Food	1 opened at Thika Road Mall (TRM)	4	Thika Road Mall, Two Rivers mall, Nextgen Mall and The Hub
LC Waikiki	Turkey	Clothing	1 planned for opening at Thika Road Mall (TRM)	3	Two Rivers mall, The Hub and Mombasa City mall
Java Group	Kenya	Restaurant	3 planned in Kigali, Rwanda	64	Kenya – Nairobi, Kisumu, Mombasa, Nakuru and Eldoret, Rwanda and Uganda

Source: Cytonn Research

The expansion of both local and international retailers into the country is 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 in the retail sector, 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%, (iv) provision of high-quality spaces in line with international standards as well as infrastructure, and (v) the exit of struggling local retailers, such as Nakumatt and Uchumi, leaving prime locations for occupation, creating an easy gap for the international retailer's expansion.

In terms of Nairobi's market performance in Q3'2018:

1. Rental charges averaged at Kshs 178.9 per SQFT, which is a 5.8% q/q decline from Kshs 190.4 per SQFT in Q2'2018,
2. occupancy rates averaged at 83.7%, a 1.0% points q/q increase from 82.7%, and,
3. Average rental yield of 9.4%, a 0.3% points q/q decline from 9.7% in Q2'2018.

The overall softening of the performance is as result of an oversupply of mall space, currently at 2.0mn SQFT, hence the dynamics of supply and demand.

The retail sector's performance during Q3'2018 is as shown below:

(all figures in Kshs unless stated otherwise)

Summary of Retail Market Performance in Nairobi Over Time

Item	**FY'2017**	**Q2'2018**	**Q3'2018**	**Δ Q3'2018**
Asking Rents (Kshs/SQFT)	185.0	190.4	**178.9**	**(5.8%)**
Occupancy (%)	80.3%	82.7%	**83.7%**	**1.0%**
Average Rental Yields	9.6%	9.7%	**9.4%**	**(0.3%)**

- ***The retail sector rental yield records a 0.3% q/q points decline from 9.7% in Q2'2018 to 9.4% in Q3'2018 as a result of 5.8% decline in rental charges, attributable to an oversupply of mall space, currently at 2.0mn SQFT, hence price wars by developers in a bid to attract retailers and increase occupancy rates.***

Source: Cytonn Research

In terms of performance by nodes, Westlands, Kilimani and Karen are the best performing retail suburbs in Nairobi with average rental yields of 12.4%, 11.8% and 10.8%, respectively, driven by upper-middle and high-end populations with a high purchasing power hence retailers are willing to pay more for retail space in these areas. The worst performing nodes are the Eastlands and Satellite Towns attributable to low rental charges and competition from informal retail space.

The table below shows the retail sector performance by nodes:

(all figures in Kshs unless stated otherwise)

Nairobi Retail Sector Performance by Nodes Q3'2018

Location	**Average Rent Q3'2018 per SQFT per Month**	**Average Occupancy Rate Q3'2018**	**Rental Yield Q3'2018**	**Rent Q2'2018**	**Occupancy Q2'2018**	**Rental Yield Q2'2018**	**Q3'2018 Δ in Rent (%)**	**Q3'2018 Δ in Occupancy (%)**	**Q3'2018 Δ in Yield (%)**
Westlands	218.8	90.2%	**12.4%**	231.0	90.8%	12.4%	(5.3%)	(0.6%)	**0.0%**
Kilimani	184.1	97.5%	**11.8%**	202.9	97.3%	11.9%	(9.3%)	0.2%	**(0.1%)**
Karen	212.8	96.0%	**10.8%**	209.5	95.0%	10.4%	1.6%	1.0%	**0.4%**
Ngong Road	170.5	94.4%	**10.1%**	187.9	93.7%	10.2%	(9.3%)	0.7%	**(0.1%)**
Thika road	194.3	76.5%	**8.8%**	204.3	76.5%	9.8%	(4.9%)	0.0%	**(1.0%)**
Kiambu Road	199.9	67.0%	**8.7%**	219.9	67.0%	9.5%	(9.1%)	0.0%	**(0.8%)**
Mombasa Road	156.2	74.4%	**7.8%**	171.8	74.4%	8.6%	(9.1%)	0.0%	**(0.8%)**
Satellite Towns	124.5	89.3%	**6.6%**	122.0	89.7%	7.3%	2.0%	(0.4%)	**(0.7%)**
Eastlands	149.1	68.2%	**7.0%**	164.0	60.0%	7.0%	(9.1%)	8.2%	**0.0%**
Average	**178.9**	**83.7%**	**9.4%**	**190.4**	**82.7%**	**9.7%**	**(5.8%)**	**1.0%**	**(0.3%)**

- ***The performance softened, recording on average 0.3% points q/q decline in rental yields to 9.4% from 9.7% in H1'2018 as a result of 5.8% q/q decrease in rental charges, due to an oversupply of mall space, currently at 2.0mn SQFT, hence there are price wars among developers in a bid to attract retailers and increase occupancy rates***
- ***Westlands, Kilimani and Karen were the best performing retail suburbs in Nairobi with average rental yields of 12.4%, 11.8% and 10.8%, respectively, driven by high end neighbourhoods hosting most of Nairobi's middle end and high-end populations with a high purchasing power hence retailers are willing to pay more for retail space in these areas***
- ***The worst performing nodes are the Eastlands and Satellite Towns attributable to low rental charges and competition from informal retail space***

Source: Cytonn Research

Despite the oversupply of retail space, 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 the improved macro-economic environment. For developers looking to enter the market, we recommend the county headquarters in some markets such as Mombasa and Mt. Kenya regions that have retail space demand of 0.3mn and 0.2mn SQFT, attractive yields at 8.3% and 9.9% and occupancy rates at 96.3% and 84.5%, respectively according to Cytonn's Kenya retail Sector Report – 2018

V. **Hospitality Sector**

The hospitality sector continued to attract investment from both local and global players during the third quarter of the year as follows;

i. PrideInn Hotels announced plans to open a 3-star business hotel in Mombasa comprising of 40 rooms and conference facilities that can accommodate up to 500 people. For more information, please see our Cytonn Weekly#26/2018,
ii. Mediview Limited, a company based in Dublin, Ireland, announced plans to set up a 200-room, 7-storey, 5-star hotel along Limuru Road on 2.5 acres pending approvals from regulatory authorities such as the National Environmental Management Authority (NEMA). The company has since invited global hotel brands such as JW Marriot Hotel, Accor Hotels and Intercontinental Hotel Group to place bids for managing the facility that will encompass amenities such as a restaurant, meeting rooms, a business center, swimming pool, a gym and spa. For information, please see

Cytonn Weekly#36/2018,

iii. Hospitality Chain, Hyatt Hotels Corporation announced plans to enter Kenya's hospitality market, following an agreement with Kenyan real estate and construction company, Kanha Ltd. The hotel, set to be open in 2020, will be located in Westlands, Nairobi, and will comprise of 173 guestrooms, 60 apartments, 7,700 SQM of conference space, a restaurant and bar, and swimming pool. The corporation currently runs five hotels in Africa; Hyatt Regency Casablanca (Morocco), Hyatt Place Taghazout Bay (Morocco), Hyatt Regency Sharm el Sheikh (Egypt), Hyatt Regency Dar es Salaam (Tanzania) and Park Hyatt Zanzibar, and
iv. The owners of Sentrim Hotels and Lodges, the hotel chain that owns the Sentrim Hotels brand, put up the business for sale, consisting of a portfolio of eight hotels located in prime hospitality nodes across Kenya, at a price of Kshs 5.2 bn. The move is bound to benefit the purchasers in that, the business is relatively established in Kenya with over four decades of operations, thus, a solid customer base and goodwill, in addition to the land, which is over 190-acres, please see our Cytonn Weekly#35/2018 for more details on the hotel chain.

Airlines operating in Kenya continue to increase their flights frequency driven by increased tourist arrivals into the country, and we expect this to result in increased demand for accommodation and other hospitality services, and thus improved performance of the hospitality sector. During Q3'2018, the following airlines announced an increase in flight frequency;

Airline	**Route**	**Previous Flight Frequency per Week**	**New Flight Frequency per Week**
Fly Tristar	Nairobi- Mombasa	4	7
Air France	Paris- Nairobi	3	5
Jambojet	Nairobi- Kisumu	20	24
Qatar Airways	Direct flights to Mombasa from Doha, Qatar	0	4

Source: Cytonn Research

Three industry reports were released, indicating that the sector is expected to record improved performance in 2018 driven by factors such as; (i) increased international arrivals, (ii) continued marketing, (iii) increase in domestic tourism and (iv) international conferences. Key take-outs from the reports include:

i. Jumia Hospitality Report- Kenya the hospitality sector contributed approximately 3.7% to the 2017 GDP, 0.6% points higher than the 3.1% in 2016, and this is expected to increase to 5.2% in 2018. The report also indicated that, hotel bed-nights occupancy rose by 11.0% to 7.2 mn in 2017 from 6.4 mn in 2016, and this is attributable to increased international arrivals, which stood at 1.4 mn in 2017, compared to 1.3 mn in 2016. For more information, please Cytonn Weekly#26/2018,
ii. PWC Hotel Outlook 2018- 2022 Hotel bed-nights occupancy rose by 11.0% to 7.2 mn in 2017 from 6.4 mn in 2016, and this is attributable to increased international arrivals, which stood at 1.4 mn in 2017, compared to 1.3 mn in 2016. The sectors performance was boosted by (i) new air routes such as direct flights to the United States of America by Kenya Airways, expected to commence in Q4'2018, (ii) increased tourist arrivals, and (iii) continued marketing of the country as a destination for experiences. For more information, please see CytonnWeekly#26/2018,

In terms of performance, we tracked the performance of serviced apartments in 7 nodes in Nairobi Metropolitan area and compared with the performance in Q3'2017. From our research, serviced apartments recorded improved performance with the average rental yield coming in at 6.4%, which is 0.9% points higher than 5.5% recorded in Q'3 2017, and this we attribute to the increased demand for accommodation, with occupancy coming in at an average of 74% compared from 72% during the same period in 2017.

The performance of the various nodes was as follows:

All values in Kshs unless stated otherwise

	Monthly Rates											
Node	**Studio**	**1 Bed**	**2 Bed**	**3 Bed**	**Occupancy 2017**	**Occupancy 2018**	**Monthly Charge per SM 2017**	**Monthly Charge per SM 2018**	**Δ in Monthly Charge Per SQM**	**Rental Yield 2017**	**Rental Yield 2018**	**Δ in Rental Yield**
Kilimani	131,667	154,143	203,667	217,857	74%	90%	2,592	2,231	-14%	7.2%	**7.9%**	0.7%
Limuru Rd	135,930	181,620	215,670		80%	91%	1,686	2,435	44%	4.5%	**7.6%**	3.1%
Upperhill		180,000	256,667	310,000		60%	2,333	2,159	-7%	6.6%	**7.4%**	0.8%
Westlands/Parklands*		170,000	226,667	340,000	78%	62%	2,519	2,037	-19%	7.3%	**7.0%**	-0.3%
Kileleshwa	100,000	108,333	111,667	200,000	70%	79%	2,369	1,643	-31%	7.0%	**5.7%**	-1.3%
Thika Rd		113,625	136,350	160,000	69%		901	1,346	49%	2.6%	**4.8%**	2.2%
Msa Road		120,000	136,350	160,000	64%	60%	1,367	1,196	-12%	3.1%	**4.3%**	1.2%
Average	**122,532**	**146,817**	**183,862**	**231,310**	**72%**	**74%**	**1,967**	**1,864**	**-5.2%**	**5.5%**	**6.4%**	**0.9%**
High	**135,930**	**181,620**	**256,667**	**340,000**	**80%**	**91%**	**2,592**	**2,435**		**7.3%**	**7.9%**	**3.1%**
Low	**100,000**	**108,333**	**111,667**	**160,000**	**64%**	**60%**	**901**	**1,196**		**2.6%**	**4.3%**	**-1.3%**

****For Westlands we increased our comparable set to ensure wider coverage, thus the significant difference in occupancy***
****We have estimated an average developer cost of Kshs 200,000-Kshs 231,000 per SQM depending on land prices and allowable plot ratios in the covered nodes in order to calculate yield***

- ***Kilimani area was the best performing node recorded high occupancy rates of 90%, and rental yield of 7.9%, and this we attribute to its easy access from Nairobi Cbd and Jomo Kenyatta International Airport (JKIA), proximity to business nodes such as Westlands and Upperhill, presence of social amenities and also security being within the UN Blue zone and thus suitable for expatriates living***
- ***Mombasa Road recorded the lowest rental yield at 4.3% and this we attribute to; the area is not mapped as a Blue Zone thus not attractive to expatriates due to security concerns***
- ***On overall, the theme recorded higher occupancy coming in at 74% in Q'3 2018, from 72% recorded during the same period 2017. We attribute this to the stable political environment and improved security, which has continued to attract tourists into the country***

Source: Cytonn Research

We retain a positive outlook for the hospitality sector in Kenya driven by (i) increased demand for accommodation and other hospitality services by both local and international guests, with the number of international arrivals which increased by 0.9% to 443,950 by June 2018 compared to 439,807 during the same period in 2017, (iii) the revision of negative travel advisories, warning international citizens, e.g. from the United States against visiting Kenya, (iv) positive reviews from travel advisories such as Trip Advisor who ranked Nairobi as the 3rd best place to visit in 2018, (v) continued marketing efforts by the Kenya Tourism Board, (vi) Jomo Kenyatta International Airport (JKIA) ranking as the best airport in Africa and 38th globally according to Worldwide rankings by Airhelp, and (vii) improved flight operations and systems, which will make it easier and more convenient for travelers.

VI. **Land Sector**

During Q3'2018, the land sector recorded an overall capital appreciation of 4.4%, with high-rise areas recording, the highest price appreciation at 6.0% and this we attribute to the scarcity of development land and increased demand in these areas, as they are zoned for densification, thus high return on capital.

The table below show the performance of the sector during Q[3'2018:

Summary of the Nairobi Metropolitan Area Land Performance Across All regions

	Q2' 2018	**Q3' 2018**	**Q/Q Capital Appreciation**
Nairobi Suburbs- High Rise Residential Areas	205,205,556	220,320,917	6.0%
Nairobi Suburbs- Low Rise Residential Areas	88,713,805	92,042,699	3.7%
Nairobi Suburbs- Commercial Areas	493,116,420	507,515,604	2.5%
Satellite Towns	20,113,779.9	21,016,857.56	5.3%
Average			**4.4%**

· ***High-rise areas recording, the highest price appreciation at 6.0% and this we attribute to the scarcity of development land and increased demand of the same in these areas, as they are zoned for densification, thus high return on capital.***

Source: Cytonn Research

- The high-rise residential areas such as Kileleshwa, Kasarani and Dagoretti, recorded a capital appreciation of 8.7%, 7.1% and 5.2% respectively, with Kileleshwa recording the highest, attributable to increase demand for property in the area, while Embakasi recorded the lowest appreciation of 4.3% attributable to congestion on trunk infrastructure making it unattractive for settlement and thus reduced development activity and demand for land,
- Nairobi low-rise residential areas such as Karen, Spring Valley, Runda, and Kitisuru recorded a capital appreciation of 7.1%, 5.2%,4.3% and 3.5% respectively, with an average land price of Kshs 92.0mn in Q3' 2018 from Kshs 88.7mn as at Q2' 2018. Karen recorded the highest capital appreciation rates of 7.1% against a submarket average of 3.7%, attributed to its affordability as compared to other low-rise residential nodes, with an average capital per acre of land in Karen being Kshs 63mn against a market average of Kshs 92mn for the low-rise residential nodes,
- Commercial zones recorded a capital appreciation of 2.5% in Q'3 2017, lower than both the high rise and low rise residential zones which recorded quarterly increments of 6.0% and 3.7%, respectively, attributable to decreased demand for commercial property given the existing oversupply of 4.7mn SQFT of office space. Nairobi CBD, Riverside and Kilimani recorded the highest capital appreciation, among the commercial zones, at 8.7%, 1.2% and 1.1% respectively, attributable to the high plot ratios allowing for densification of developments, hence high demand due to attractive returns on investment after development and also due to the increased migration of firms to commercial nodes away from the CBD creating demand in areas such as Riverside and Kilimani. In addition, the unavailability of development land in the CBD has resulted in the high capital appreciation recorded in the area. Upperhill recorded the lowest capital appreciation at 0.7%, and this we attribute to decreased demand for commercial property in the area, given the existing oversupply of office space, which currently stands at 4.7 mn SQFT,
- Land in satellite towns such as Ruai, Thika, Ngong, Ruiru and Ruaka recorded a capital appreciation of 9.2%, 8.1%, 5.0% and 2.4% respectively, in Q3' 2018. On overall, the areas recorded a capital appreciation of 5.3%, and we attribute this increase to the growing demand for development land in such areas as Thika, Ruai and Ruaka, which are fairly priced compared to land in suburbs, at an average land price of Kshs 21.0 mn per acre

The opportunity in the sector lies in the high-rise residential areas such as Kileleshwa, and Kasarani, which recorded a capital appreciation rates of 8.7% and 7.1% respectively and satellite towns such as Ruai, Thika and Ngong which are the best performing areas with a capital appreciation of 9.2%, 8.1%% and 8.1%, respectively in Q3'2018.

Other highlights during the quarter;

i. Encroachment of land set for the phase 2 of the Standard Gauge Railway, which is set transverse through Narok, Kajiado and Nakuru Counties, is likely to result in delay of the implementation of the same. According to Abigail Mbagaya, the chairperson of the National Land Commission, relocation of the families has become a challenge as there has been no compensation made to the families.

We retain a positive outlook for the land sector backed by: i) improved demographics evidenced by the growth of middle income population who have an increasing purchasing power indicating sustained demand, ii) an enabling macro-economic environment shown by the waiver of land title search fees, iii) improved infrastructure that exposes areas for investment and iv) the relaxation of zoning regulations that facilitates optimal land use.

VII. **Infrastructure Sector:**

In the infrastructure sector, the government continues to increase its investments in order to boost the country's economic growth through; i) revenue generation, ii) increased employment opportunities, iii) betterment of services and facilities, and iv) improving the ease of doing business in Kenya. Below is a table highlighting infrastructural projects across the country that were announced during Q3'2018:

Infrastructural Project announced for development in Kenya in Q3'2018

	Name of Project	**Type**	**Length (Kms)**	**County**	**Project Value**
1.	Lamu – Isiolo Road	Road	530 km	Lamu/Isiolo	Kshs 62.0 bn
2.	Gilgil to Njoro Road	Road	23 km	Nakuru	Kshs 1.4 bn
3.	Sewerage systems in Murang'a County	Sewer system		Muranga	Kshs 4.0 bn
4.	Konza City Infrastructure	Road, fiber cable connectivity and electricity reticulation	40 km	Machakos	Kshs 40.0 bn
5.	Konza City Infractructure	Data center		Machakos	Kshs 17.0 bn
6.	Industrial area's Enterprise Road to the City Centre flyover	Flyover	2.0km	Nairobi	Plans underway
7	Miritini passenger terminus to Mombasa CBD train station	Railway	22km	Mombasa	undisclosed
8	Garissa Road – Thika Super Highway Bypass	Roads	10km	Kiambu	Kshs.1.5 bn
9	Garissa Road – Kenyatta Highway	Roads	15km	Kiambu	Kshs. 1.5 bn
10	Nairobi Satellite Towns Water and Sanitation Development Programme Project	Water		Kiambu – (Ruiru – Juja) & Kajiado (Kiserian – Ongata)	Kshs. 3.6 bn
11	Standard Gauge Railway (SGR) Phase 2B	Railway	262km	Nakuru & Kisumu	Kshs 380 bn

Infrastructural Project announced for development in Kenya in Q3'2018

	Name of Project	Type	Length (Kms)	County	Project Value
12	Kitengela sewer line	Sewer	45km	Kajiado	Kshs. 1.4bn
13	Extension of the Olkaria 1 units 4 & 5 geothermal power	Power plant	83 MW	Nakuru	Undisclosed
	*Total disclosed projects value				Kshs. 512.4 bn

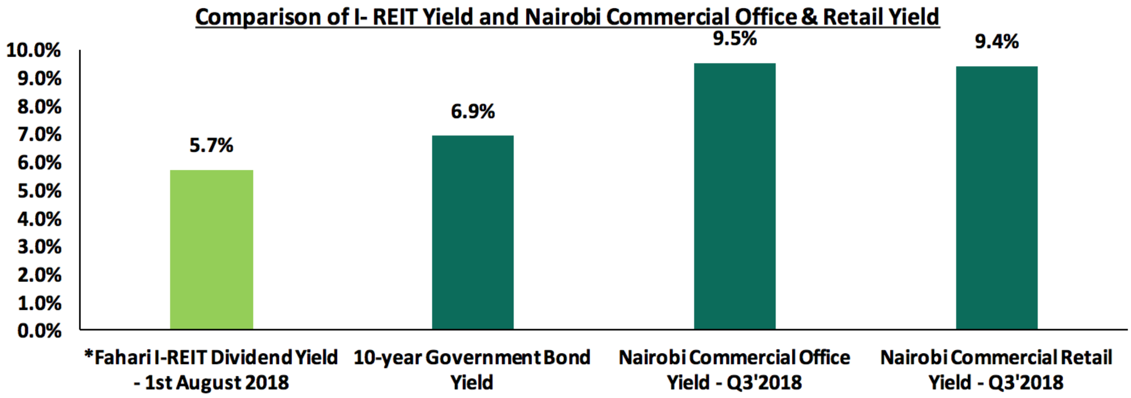
Source: Cytonn Research

In our view, 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, the 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.

VIII. **Listed Real Estate:**

A. **The Fahari I- REIT, Kenya**

Stanlib Fahari I-REIT released their H1'2018 earnings, registering a 16.3% y/y decline in earnings to Kshs 0.36 per unit from Kshs 0.43 per unit in H1'2017, attributable to 7.7% decline in operating income outpacing the 0.9% decline in operating expenses. The operating income decline is attributable to an 18.1% decline in interest income to Kshs 41.9 mn from Kshs 51.1 mn in H1'2017, coupled with a 2.1% decline in rental income to Kshs 135.1 mn from Kshs 138.0 mn in H1'2017. The company, however, noted that the decline in rental income is attributable to a temporary increase in vacancies, coupled with some tenants bargaining for reduced rentals upon the renewal of leases, despite the additional 1-month rental income contribution by their newly acquired property, which is 67 Gitanga Place, which was acquired in May 2018. For example, one of the properties owned by the REIT, the Greenspan Mall had an occupancy of 74.0% in H1'2018 from 90.0% in 2017, which is 5.5% points lower than the Nairobi retail market average at 83.7%. The I-REIT recorded a dividend yield of 5.7%, based on Kshs 10.5 market price per share as at 1st August 2018, assuming the dividend pay-out ratio remains at 91.0%, similar to the FY'2017 pay-out. The yield is relatively low compared to brick and mortar assets with commercial retail and office achieving rates of 9.4% and 9.5% in Q3'2018, respectively, as shown below. While the stagnation of the REIT market is generally blamed on the lack of investor education, the fact is that investors are better off investing in government bonds or commercial buildings than in REITS given the substandard yields offering by listed REITs;

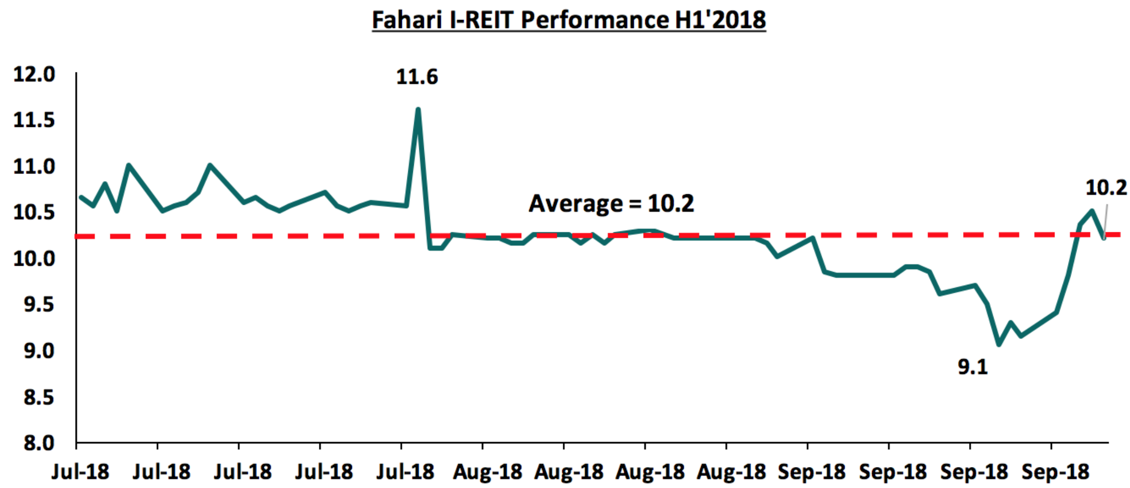


Source: Cytonn Research 2018

For a more comprehensive analysis on the REIT H1'2018 performance, see our Stanlib Fahari I-REIT Earnings Note.

On the bourse, during Q3'2018, Stanlib's Fahari I-REIT price declined by 9.7%, closing at Kshs 10.2 per share from Kshs 11.3 per share at the end of June 2018, but still trading at a 48.9% discount from its listing price of Kshs 20.0 in November 2015. In addition, Fahari I-REIT is trading at a discount of 48.6% to its Net Asset Value per share, which currently stands at Kshs 19.9 as per H1'2018 reporting. The prices for the instrument have remained low averaging at Kshs 10.2 in Q3'2018 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.

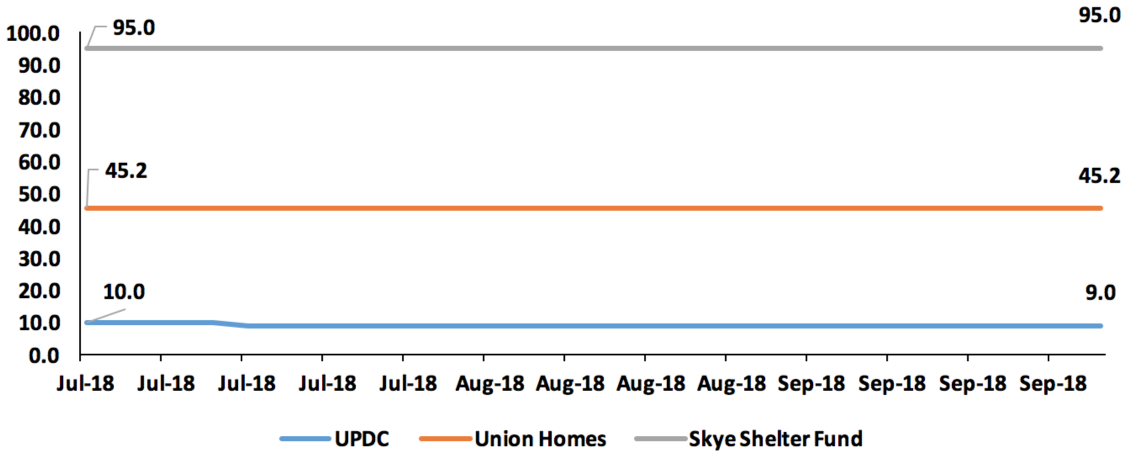
The graph below shows the REIT's performance in Q3'2018;



B. **REITS on the Nigeria Stock Exchange**

In Nigeria, the REITs market continued to remain flat in Q3'2018. Of the three REITs we cover, two, that is, Union Home and Skye Shelter's prices, remained unchanged, while the UPDC REIT declined by 10.0% to NGN 9 from NGN 10 at the end of June 2018. Nigeria's REITs market has plateaued indicating a stalled demand for the past couple of years which is attributable to shallow investor knowledge, poor market regulation amidst a high-interest rate environment; and therefore, we expect the performance to continue on this trend for the long term.

Performance of the Nigerian Stock Exchange Reit - Q3'2018 (Naira)



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 and REITs association of Kenya 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 improved macro-economic environment, as well as sustained investor appetite.

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