Cytonn Annual Markets Review - 2018

Real Estate

In 2018, the real estate sector recorded continued investment across all themes driven by;

i. political stability following the conclusion of the electioneering period in Q1'2018,
ii. the continued positioning of Nairobi as a regional hub that has led to increased entry of multinationals creating demand for residential units, retail centres, commercial offices and hotels,
iii. the kicking off of the affordable housing initiative as part of the Kenyan Government's Big 4 Agenda, which has gained momentum with the launching of projects such as the Pangani Estate in Nairobi, and,
iv. the improving macroeconomic environment, with the country's GDP growing by 6.0% in Q3'2018, higher than the 4.7% recorded in Q3'2017.

In terms of performance, the sector recorded rental yields of 8.1%, in the commercial office, 9.0% in retail and 4.7% in residential, 8.0% in mixed use developments (MUDs) and 7.4% in serviced apartments, resulting to an average rental yield for the real estate market of 7.4%, compared to an average of 8.0% in 2017. Capital appreciation for existing properties came in at 3.8% in 2018, from 6.5% in 2017, resulting in an 11.2% real estate market return, compared to 14.1% in 2017, thus a 2.9% points decline. We attribute this to a decline in demand for property despite the growing supply, evidenced by the 3.0% decline in the residential sector occupancy rates, and the increased supply of mall space in the retail sector recording a growth of 4.8% y/y in Nairobi to 6.5 mn SQFT in 2018 from 6.2 mn SQFT in 2017. However, it is important to note that development returns for investment grade real estate is still estimated to be approximately 23.0% to 25.0% p.a.

Annual Real Estate Returns Summary Table, for Existing Properties

	2017	**2018**	**Change**
Average Rental Yield	7.6%	7.4%	(0.2%)
Average Capital Appreciation	6.5%	3.8%	(2.7%)
Total	**14.1%**	**11.2%**	**(2.9%)**

• The real estate sector recorded 11.2% total returns in 2018, compared to 14.1% recorded in 2017, and this we attribute to a decline in demand for property despite the growing supply, evidenced by the 3.0% decline in the residential sector occupancy rates and the increased supply of mall space in the retail sector which recorded a growth of 4.8% y/y in Nairobi to 6.5mn SQFT in 2018 from 6.2mn SQFT in 2017

Source: Cytonn Research

i. **Residential Sector** - The sector recorded a decline in performance with average rental yields dropping marginally by 0.5% points, attributable to a decline in occupancy rates which reduced by 3.0% points on average, from 84.0% in 2017, to 81.0% in 2018, attributable to increased stock in the market against minimal uptake. Overall, apartments performed better than detached units, with average annual uptake of 26.6% compared to detached units' 20.5%, and average returns of

11.4%, compared to detached units returns of 8.9%. This is attributable to the growth in demand for apartments due to their affordability especially as loans remain out of reach for a majority of aspiring homebuyers,

ii. **Commercial Office Sector** - The commercial office sector performance in Nairobi improved, albeit marginally, with the asking rents increasing by 1.3% from Kshs 101.0 per SQFT in 2017 to Kshs 102.3 per SQFT in 2018. The occupancy rates increased by 0.7% points from 82.6% in 2017 to 83.3% in 2018, resulting in 0.2% points increase in rental yields from 7.9% in 2017 to 8.1% in 2018. The slight improvement is attributed to the political stability that has led to increased economic activities and the continued positioning of Nairobi as a regional hub that has led to increased entry of multinationals,

iii. **Retail Sector** - The retail sector performance softened in 2018, with occupancy rates decreasing by 0.4% points from 80.3% in 2017 to 79.9% in 2018. The rents decreased by 3.8% from Kshs 185.3 per SQFT in 2017 to Kshs 178.2 per SQFT in 2018, resulting in a 0.6%-point decrease in rental yields from 9.6% in 2017 to 9.0% in 2018. The decline in performance is attributed to increased supply of mall space, growing by 4.8% y/y in Nairobi to 6.5mn SQFT in 2018 from 6.2mn SQFT in 2017 through the opening of malls such as the Waterfront in Karen and Signature Mall in Mlolongo, resulting in an oversupply of 2.0mn SQFT,

iv. **Mixed Use Development Sector (MUD)** - MUDs encompassing office, retail and residential themes recorded an average weighted rental yield of 8.0%, outperforming single themed real estate market average of 7.4%, hence, a viable investment suitable for developers and investors looking to diversify their real estate portfolio,

v. **Hospitality Sector** - Serviced apartments recorded improved performance in 2018, with the average rental yield coming in at 7.4%, which is 2.1% points higher than 5.3% recorded in 2017, and this we attribute to the increased demand, which has triggered an increase in charge rates, as well as increased occupancy rates with an average of 80.0% in 2018, compared to 72.0% in 2017. We attribute the improved performance to the stable political environment and improved security, making Nairobi an ideal destination for both business and holiday travelers,

vi. **Land Sector** - The Nairobi Metropolitan Area land prices recorded a 7- year CAGR of 13.7%, and a 3.8% y/y price increase in 2018, driven mainly by (i) provision of trunk infrastructure such as road networks, and (ii) the growing demand for development land especially in the satellite towns such as Ruiru and Syokimau driven by their affordability compared to land in the urban areas,

vii. **Infrastructure Sector -** In 2018, the infrastructure sector recorded increased government investment. According to KNBS Economic Survey 2018, the total expenditure on roads has increased by 54.9% over a 4-year period to Kshs 198.4 bn in 2017/18, from Kshs 89.5 bn in 2013/14. 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, and,

viii. **Statutory Reviews -** During the year, several statutory reviews were made or proposed, all in line to promote efficiency in the property sector and to facilitate the government’s affordable housing agenda.

I. Residential Sector

During the year, the residential sector saw increased focus towards the affordable housing initiative as part of the Big 4 Agenda. Out of the seven Nairobi Urban Regeneration Projects, Pangani Estate was launched towards end of the year. The project will see 1,000 units delivered to the market, and we expect other projects (listed below) to follow suit before the end of 2019.

The Nairobi Urban Redevelopment Plan

Estate	Acreage	Number of Units	Contract Sum (Kshs)	Developers
Jevanjee	7.6	1,500	9.1 bn	Jabavu Village Ltd
Ngong Road Phase I	21.5	2,520	24.0 bn	Erdemann
Ngong Road Phase II				Lordship Africa
New Ngara	4.1	1,500	9.0 bn	KCB
*Pangani	5.2	1,000	5.2 bn	Technofin
Uhuru Estates	7.5	-	3.5 bn	Stanlib Group
Old Ngara	5.2	1,050	7.0 bn	Kiewa Group
Suna Road	5.0	1,050	3.5 bn	Directline Assurance Limited

• Pangani project was launched on December 11,2018 to pave way for the affordable housing initiative that will see 500,000 units delivered to the market by 2022

Source: Online

The year witnessed more efforts towards delivering affordable housing, with policies and financing initiatives geared towards making it a reality. On construction, the value of approved residential buildings by the Nairobi City County took a downturn with the total value for the first ten months coming in at Kshs 105.3 bn, 16.7% lower than the Kshs 126.5 bn recorded for the first 10-months of 2017. The slowdown is attributed to several factors, including the uncertainty surrounding statutory approvals particularly in light of the ongoing demolitions of legally approved buildings and a slowdown in the overall spending power.

Performance

In terms of performance, the sector recorded a decline in performance with average rental yields dropping marginally by 0.5% points, attributable to a decline in occupancy rates, which reduced by 3.0% points from 84.0% in 2017 to 81.0% in 2018, attributable to increased stock in the market against minimal uptake. Overall, apartments performed better than detached units with average annual uptake of 26.6% compared to detached units’ 20.5%, and average returns of 11.4%, compared to detached units 8.9%. This is attributable to the growth in demand for apartments due to their affordability especially as loans remain out of reach for a majority of aspiring homebuyers.

Performance Summary Table

	2016	2017	2018	Y/Y Change
Annual Uptake	25.5%	26.3%	22.8%	**(3.5%)**
Occupancy	83.2%	84.0%	81.0%	**(3.0%)**
Rental Yield	4.9%	5.2%	4.7%	**(0.5%)**
Price Appreciation	7.9%	5.1%	4.2%	**(0.9%)**
Total Returns	**12.9%**	**10.3%**	**8.9%**	**(1.4%)**

• The sector recorded a declined in performance with average rental yields dropping marginally by 0.5% points, attributable to a decline in occupancy rates which reduced by 3.0% points to 81.0% in 2018 from 84.0% in 2017, attributable to increased stock in the market against minimal uptake
• Price appreciation also dropped marginally y/y by 0.9% points indicating as prices softened as developers sought to sell off their backlog. This is attributable to sluggish demand as evidenced by the drop in annual uptake by 3.5% points

Source: Cytonn Research

I. **Detached Units**

A. **High-End**

The high-end market registered average price appreciation of 2.9%, 1.3% points lower than the residential market average of 4.2%. This is attributable to increased supply and sluggish demand for the same evidenced by the relatively low annual uptake rate of 20.7%, in comparison to the residential market's average of 22.8%.

(All Values in Kshs Unless Stated Otherwise)

Top 5: High-End

Row Labels	Average Price per SQM	Average Annual Uptake	Average Rent per SQM	Average Occupancy	Average Rental Yield	Average y/y Price Appreciation	Average Total Returns
Kitisuru	184,097.5	834.9	22.0%	71.7%	4.8%	4.1%	8.9%
Karen	192,053.7	790.9	24.2%	73.8%	4.1%	4.7%	8.8%

Top 5: High-End

Row Labels	Average Price per SQM	Average Annual Uptake	Average Rent per SQM	Average Occupancy	Average Rental Yield	Average y/y Price Appreciation	Average Total Returns
Runda	211,486.5	810.5	19.8%	57.7%	2.9%	5.5%	8.4%
Lower Kabete	174,350.4	438.9	21.8%	89.5%	2.8%	4.2%	7.0%
Roselyn	175,737.1	754.7	15.9%	71.3%	3.3%	(4.2%)	(0.9%)
Average	**187,545.0**	**726.0**	**20.7%**	**72.8%**	**3.6%**	**2.9%**	**6.4%**

• Kitisuru registered the highest total returns with an average of 8.9% attributable to the high rental yields due to attractive rental rates the area attracts and relatively high occupancy rates compared to other areas such as Runda
• Lower Kabete registered the lowest rental yields with 2.8% attributable to a mismatch between the relatively high asking prices against relatively low rental rates indicating developers take longer to recoup their investments within that market
• Meanwhile, Rosslyn posted the lowest total returns attributable to a decline in the rate of price appreciation in the neighborhood as buyers opt for more exclusive neighborhoods such as Runda and Kitisuru

Source: Cytonn Research

B. **Upper Mid-End**

The upper mid-end sector registered the lowest price appreciation in the market for detached units with 0.3%, in comparison to high-end and lower mid-end markets with 2.9% and 3.4%, respectively. This is attributable to the increased densification of majority of the areas such as Lavington, Loresho and Ridgeways, thus making detached units in these areas less appealing to homebuyers.

All values in Kshs Unless Stated Otherwise

Top 5: Upper Mid-End

Location	Average Price per SQM	Average Rent per SQM	Average Annual Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Average Total Returns
Runda Mumwe	149,421.3	633.6	21.7%	65.4%	4.8%	10.0%	14.8%
Lavington	178,683.4	750.2	22.5%	80.7%	4.2%	2.3%	6.5%
Ridgeways	147,325.1	730.9	20.7%	67.2%	4.0%	(0.9%)	3.1%
Loresho	147,536.1	612.7	20.1%	83.5%	4.1%	(1.6%)	2.5%
Lang'ata	171,812.3	728.4	19.7%	75.0%	5.7%	(8.0%)	(2.3%)
Average	**158,955.6**	**691.2**	**20.9%**	**74.3%**	**4.6%**	**0.3%**	**4.9%**

• Runda Mumwe registered the highest total returns in the upper mid-end sub-market with 14.8% attributable to the area's fast growth due to its association with Runda
• Lang'ata and Ridgeways registered the negative price growth attributable to the continued densification of the area making it less appealing for low rise home buyers

Source: Cytonn Research

C. **Lower Mid-End**

The lower mid-end segment registered the highest total returns for detached units with 7.9% on average, attributable to the constantly growing demand for affordable housing units. Juja and Ngong had the highest average total returns with 10.3% and 8.1%, respectively. This is as the areas are increasingly attracting investors due to availability for land for development, which boosts demand for properties due to affordability.

All values in Kshs Unless Stated Otherwise

Top 5: Lower Mid-End

Location	Average Price per SQM	Average Rent per SQM	Average Uptake	Average Occupancy	Average Rental Yield	Average y/y Price Appreciation	Average Total Returns
Juja	54,239.8	241.1	20.4%	61.9%	4.7%	5.6%	10.3%
Ngong	66,161.7	238.7	21.8%	81.0%	5.2%	2.9%	8.1%
Ruiru	85,750.1	360.0	19.0%	94.2%	4.7%	3.1%	7.8%
Athi River	94,665.2	317.8	20.7%	72.2%	3.7%	3.0%	6.7%
Donholm & Komarock	88,233.0	352.4	19.8%	64.1%	4.3%	2.1%	6.4%
Average	**77,810.0**	**302.0**	**20.3%**	**74.7%**	**4.5%**	**3.4%**	**7.9%**

• Juja and Ngong had the highest average total returns with 10.3% and 8.1%, respectively
• Ngong and Athi River also registered the highest capital appreciation rates of 1.5% and 1.9%, respectively, in comparison to the submarket's average of 0.9% indicating growing interest from investors

Source: Cytonn Research

II. **Apartments**

A. **Upper Mid-End**

The upper mid-end segment notably registered the highest annual uptake with 26.6% and average occupancy rates of 89.3% in comparison to the residential market average of 22.8% and 81.0%, respectively. This is as middle-income neighborhoods such as Westlands and Kilimani continue to attract demand from the increasingly growing middle income class.

(All Values in Kshs Unless Stated Otherwise)

Top 5: Upper Mid-End

Row Labels	Average Price per SQM	Average Rent per SQM	Average of Annual Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Average Total Returns
Riverside	175,085.2	763.8	24.7%	88.9%	4.4%	7.1%	11.6%
Kilimani	127,423.8	721.8	29.7%	90.3%	5.7%	5.7%	11.5%
Westlands	135,041.3	757.5	27.9%	87.5%	5.7%	4.7%	10.3%
Loresho	115,289.5	573.5	24.0%	90.4%	5.4%	4.8%	10.3%
Spring Valley	147,453.1	552.9	22.5%	63.6%	3.4%	6.5%	9.9%
Average	**138,209.9**	**704.2**	**26.6%**	**89.3%**	**5.3%**	**5.6%**	**10.9%**

• Riverside registered the highest price appreciation with 7.1% in comparison to the market average of 5.6%. The area attracts high-end high-rise buildings as well as hospitality facilities such as serviced apartments. Meanwhile, Westlands and Kilimani registered the highest average rental yields as they attract premium rents while offering relatively affordable prices
• Spring Valley had the lowest occupancy rates owing to the market's relative high prices

Source: Cytonn Research

B. **Lower Mid-End**

The lower mid-end segment registered higher average rental yields with 6.8% in comparison to the upper mid-end segment with 5.6%. This is as the areas are preferable to majority of Nairobi's population consisting of young families and the working-class due to their affordability and infrastructural improvements that have rendered them increasingly convenient, hence the growing uptake. Donholm and Ruaka had the highest occupancy rates at 100.0% and 95.6%, respectively, indicating high levels of demand.

(All Values in Kshs Unless Stated Otherwise)

Top 5: Lower Mid-End

Location	Average Price per SQM	Average Rent per SQM	Average Annual Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Average Total Returns
Donholm & Komarock	81,015.5	402.1	25.0%	100.0%	6.0%	8.4%	14.4%
Thindigua	97,510.2	502.5	24.6%	81.9%	4.1%	9.6%	13.8%
Ruaka	96,606.2	444.8	23.3%	95.6%	5.3%	6.4%	11.7%
Athi River	68,490.1	359.3	23.6%	73.1%	4.4%	6.2%	10.6%
Rongai	59,695.5	345.2	20.3%	83.3%	5.5%	3.6%	9.1%
Average	**80,663.5**	**410.8**	**23.4%**	**86.8%**	**5.1%**	**6.8%**	**11.9%**

• Donholm-Komarock posted the highest total returns owing to a relatively high rate of price appreciation driven by high demand from investors. The area offers relatively affordable rental rates while being in close proximity to the CBD and other nodes such as Mombasa Road and Thika Road, thus high occupancy rates
• Thindigua registered the highest appreciation in asking prices with 9.6%, in comparison to the submarket's average of 6.8%, attributable to the area's proximity to Runda and proximity to the CBD

The sector recorded a decline in both activity and performance during the year and thus the investment opportunity is in select areas that offer high and stable returns such as Runda Mumwe for detached units, Kilimani for upper mid-end apartments, and Donholm/Komarock, Thindigua for lower mid-end apartments.*Source: Cytonn Research*

Notable projects in the upper mid-end markets launched during the year are as shown below:

Upper Mid-End and High-End Projects Launched in 2018

Developer	Location	Acreage	No. of Units
Hass Consult	Redhill	22	450
Capitaland	Mang'u Juja	25	1,500
Centum Investments	Two Rivers	-	196
Krishna Estates Limited	Thindigua	2	224
Cool Breeze Limited	Mombasa Road	2.3	524
Erdemann Developers Ltd	Ngara Estate	5.7	1,632
CIC Group	Ruiru – Kamiti Road	90	417

Upper Mid-End and High-End Projects Launched in 2018

Developer	Location	Acreage	No. of Units
Lordship Africa	Upperhill	0.8	239
Total			**5,182**

Generally, we expect the current performance of the sector to persist in 2019 with certain areas in the upper mid-end and lower mid-end segments that continue to exhibit growing demand from homebuyers offering investors double digit returns.

II. **Commercial Real Estate Sector**

In 2018, the commercial real estate sector recorded mixed performance with commercial office spaces recording a 0.2% points y/y increase in rental yield attributed to an improved macroeconomic environment, hence boosting economic activities, while the retail sector, recorded 0.6% points decline in rental yields as a result of retail space oversupply, currently at 2.0 mn SQFT. The sector however has pockets of value in differentiated concepts such as Mixed-Use Developments (MUD) with the right balance between the incorporated uses in order to achieve optimal returns. Below is a summary of commercial office, retail and MUD themes:

A. **Commercial Offices**

In 2018, the commercial office sector recorded an improvement in performance recording 0.2% points and 0.7% points y/y increase in average rental yields and occupancy rates, to 8.1% and 83.3% from 7.9% and 82.6%, respectively, in 2017. The positive performance is largely driven by:

i. Political stability that has led to increased economic activities,
ii. The positioning of Nairobi as a regional hub and thus increased entrance of multinationals such as French Based Pharmaceutical firm Sanofi that opened its regional office in Nairobi, AA Japan, a Japanese used vehicle auto dealer that set up its first office in the city in 2018, and Nippon Express, a Japanese logistics firms that opened its first African office in Nairobi in 2018, thus increasing demand for office space, and,
iii. Improving macroeconomic environment, with the GDP growing at 6.0% in Q3'2018, higher than the 4.7% recorded in Q3'2017, and expected to close at 5.6% for the year 2018.

Asking rents increased marginally by 1.3% to an average of Kshs 102.3 per SQFT from Kshs 101.0 per SQFT in 2017, while asking prices dropped by 0.6% to Kshs 12,573 in 2018 from Kshs 12,649 in 2017. We attribute the slow rise in rents and the drop in prices to the oversupply of 4.7 mn SQFT office space as at 2017, as per Cytonn Commercial Office Report 2018, which has created a bargaining chip for firms forcing developers to reduce or maintain prices and rents in order to remain competitive and attract occupants to their office spaces.

The table below highlights the performance of the commercial office sector in Nairobi over time:

All values in Kshs unless stated otherwise

Summary of Commercial Office Returns in Nairobi Over Time

Year	*FY'15	*FY'16	*FY'17	FY'18	Δ Y/Y 2016/17	Δ Y/Y 2017/18
Occupancy (%)	89.0%	88.0%	82.6%	**83.3%**	(5.4%) points	**0.7% points**
Asking Rents (Kshs/Sqft)	97	103	101	**102**	(1.9%)	**1.3%**
Average Prices (Kshs/Sqft)	12,776	13,003	12,649	**12,573**	(2.7%)	**(0.6%)**
Average Rental Yields (%)	8.1%	8.4%	7.9%	**8.1%**	(0.5%) points	**0.2% points**

Restated rental yields including average market occupancy rates for FY'15, FY'16, and FY'17. The average rental yield for offices published in our previous reports assumed 100% occupancy rates

• Occupancy rates in 2018 increased marginally by 0.7% points to 83.3% from 82.6% in 2017 an indication of recovery of the market due increased demand for the office sector which in turn has boosted rental yields by 0.2% points to 8.1% in 2018 from 7.9% in 201

• Rental rates increased marginally by 1.3%, while asking prices reduced by 0.6% in 2018, attributed to an oversupply of 4.7 mn SQFT office space as at 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 2018

In terms of submarket analysis in Nairobi, Gigiri, Karen and Westlands were the best performing nodes in 2018 as a result of their superior locations hosting multinational companies and offering quality Grade A offices, enabling them to charge premium on rentals. These areas attracted yields of 10.5%, 9.2% and 9.0%, respectively. Thika Road and Mombasa Road had the lowest returns recording average rental yields of 6.7% and 5.8%, respectively. This is attributable to poor quality offices, which are mostly Grade Cs, and poor location characterized by traffic jam that have made these areas unattractive to firms.

All values in Kshs unless stated otherwise

Nairobi Commercial Office Submarket Performance 2017-2018

Location	Price Kshs/ SQFT FY 2018	Rent Kshs/SQFT FY 2018	Occupancy FY 2018(%)	Rental Yield (%) FY 2018	Price Kshs/ SQFT FY 2017	Rent Kshs/SQFT FY 2017	Occupancy FY 2017(%)	Restated Rental Yield (%) FY 2017	Δ in Rent Y/Y	Δ in Occupancy Y/Y (% points)	Δ in Rental Yields Y/Y (% points)
Gigiri	13,833.3	141.0	88.3%	10.5%	13,750.0	138.3	81.4%	9.8%	1.9%	6.9%	0.7%
Karen	13,666.0	118.0	88.6%	9.2%	13,167.0	113.0	89.2%	9.2%	4.4%	(0.6%)	0.0%
Westlands	12,050.0	109.7	82.1%	9.0%	12,872.0	103.0	88.5%	8.5%	6.5%	(6.4%)	0.5%
Parklands	12,493.8	102.1	86.0%	8.4%	12,729.0	103.0	85.7%	8.3%	(0.9%)	0.3%	0.0%
Kilimani	13,525.2	98.9	88.3%	8.0%	12,901.0	101.0	84.5%	7.9%	(2.1%)	3.8%	0.1%
Upperhill	12,559.5	99.8	80.7%	7.9%	12,995.0	99.0	82.0%	7.5%	0.8%	(1.3%)	0.4%
Nairobi CBD	12,424.8	88.8	88.3%	7.6%	12,286.0	88.0	84.1%	7.2%	0.9%	4.2%	0.4%
Thika Road	12,516.7	86.3	81.5%	6.7%	11,500.0	82.0	73.6%	6.3%	5.3%	7.9%	0.4%
Msa Road	11,400.0	78.8	65.6%	5.8%	11,641.0	82.0	74.2%	6.3%	(4.0%)	(8.6%)	(0.5%)

Nairobi Commercial Office Submarket Performance 2017-2018

Location	Price Kshs/ SQFT FY 2018	Rent Kshs/SQFT FY 2018	Occupancy FY 2018(%)	Rental Yield (%) FY 2018	Price Kshs/ SQFT FY 2017	Rent Kshs/SQFT FY 2017	Occupancy FY 2017(%)	Restated Rental Yield (%) FY 2017	Δ in Rent Y/Y	Δ in Occupancy Y/Y (% points)	Δ in Rental Yields Y/Y (% points)
Average	12,572.9	102.3	83.3%	8.1%	12,649.0	101.0	82.6%	7.9%	1.3%	0.7%	0.2%

Restated rental yields including average market occupancy rates for FY 2017. The average rental yield for offices published in our previous reports assumed 100% occupancy rate

• Nairobi Metropolitan area recorded 0.2% points y/y increase in rental yields to 8.1% in 2018 from 7.9% in 2017, attributable to improved economic environment hence increased activities translating to improved office occupancy

• Gigiri, Karen and Westlands were the best performing offices markets recording average rental yields of 10.5%, 9.2% and 9.0%, respectively due to superior locations hosting multinational companies and Grade A offices which attract premium rents

• Thika Road and Mombasa Road were the worst performing markets due to poor quality offices and also affected by traffic snarl ups that have made them generally unattractive to firms

Source: Cytonn Research 2018

The main highlights for the commercial office sector for 2018 include the opening of Prism Towers, a 33–storey building of 133m in height in Upperhill, developed by Kings Developers Ltd with a total of 250,000 SQFT of lettable office space. The Federation of Kenya Employers (FKE) and Zamara Umbrella Solutions, a retirement and benefit fund, announced of plans to build an 8-storey office building in Upper Hill and, a 16 and 30 floor twin tower in Westlands, respectively. The supply of office space is expected to continue increasing in the next 5-years with various office blocks under construction such as Garden City Business Park along Thika Road, Global Trade Centre in Westlands and Pinnacle Towers in Upperhill.

We remain cautiously optimistic on the performance of commercial office space in Nairobi, this is as despite the marginal increase in returns, and occupancy, the sector has an oversupply of 4.7mn SQFT, and thus investors are likely to face challenges on exit, when selling and renting. We are of the opinion that investments in the commercial office space should be aimed towards long term gains as we anticipate the current stock in the market will be taken 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% of commercial office stock and high returns with average rental yields of 13.4%, compared to a market average of 8.1%.

B. **Retail Sector**

The Nairobi Metropolitan Area retail market softened in 2018, recording average rental yields of 9.0% from 9.6% in 2017 and average occupancy rates of 79.8% from 80.3% in 2017. The decline in performance is attributed to:

i. Increased supply of mall space, growing by 4.8% y/y in Nairobi to 6.5 mn SQFT in 2018 from 6.2 mn SQFT in 2017 through the opening of malls such as the Waterfront in Karen and Signature Mall in Mlolongo - with an oversupply of 2.0 mn SQFT, and,
ii. Tough operating environment characterized by low private sector credit growth, which averaged at 4.4% as at October 2018, compared to a 5-year average of 14.0% (2013-2018).

The performance of the retail sector in Nairobi over time is as shown below;

All values in Kshs unless stated otherwise

Retail Sector Performance 2016-2018

Item	2016	2017	2018	∆ Y/Y 2017	∆ Y/Y 2018
Average Asking Rents (Kshs/SQFT)	186.9	185.3	178.2	(0.9%)	**(3.8%)**
Average Occupancy (%)	89.3%	80.3%	79.8%	(9.0%) points	**(0.4%) points**
Average Rental Yields	10.0%	9.6%	9.0%	(0.4%) points	**(0.6%) points**

- ***The average rental yields declined by 0.6% points, from 9.6% last year while occupancy rates reduced by 0.4% points to 79.8% from 80.3% in 2017. The softening of the performance is attributable to an oversupply of mall space in Nairobi, currently at 2.0mn SQFT, hence price wars by developers leading to a 3.8% decline in monthly rental charges in a bid to attract retailers and increase occupancy rates hence a reduction in developers' returns***

Source: Cytonn Research 2018

In terms of submarket analysis in Nairobi, Westlands, Karen and Kilimani were the best performing retail suburbs with average rental yields of 12.2%, 11.0% and 10.7%, respectively, as a result of being affluent neighborhoods with high consumer purchasing power and thus investors are willing to pay higher rents for retail space in the area. The worst performing nodes are the Nairobi Satellite Towns and Eastland's recording average rental yields of 6.7% and 6.8%, respectively, attributable to low rental charges as a result of competition from informal retail space. Ngong Road, Nairobi Eastland's and Kilimani, recorded the largest increase in rental yields y/y of 1.0%, 0.7% and 0.4% points, respectively, attributable to a 7.0%, 3.1% and 10.0% points increase in occupancy levels, for Ngong Road, Nairobi Eastland's and Kilimani, respectively. The increase in occupancy rates is attributable to prudent methods employed by developers, such as targeting international retailers as anchor tenants, these include; Carrefour, The Game and Shoprite. Kiambu Road, Westlands and Nairobi Satellite Towns, recorded the largest y/y decline in rental yields of 2.4%, 1.3% and 0.9% points, respectively, attributable to a 40,000-SQFT, 232,340-SQFT and 134,760-SQFT increase in retail space supply.

All values in Kshs unless stated otherwise

Summary of Nairobi's Retail Market Performance 2017-2018

Location	Rent Kshs/SQFT 2018	Occupancy Rate 2018	Rental Yield 2018	Rent Kshs/SQFT 2017	Occupancy Rate 2017	Rental Yield 2017	∆ Y/Y in Rental Charges	∆ Y/Y in Occupancy Rates (%points)	∆ Y/Y in Rental Yields (% points)
Westlands	219.2	88.2%	12.2%	234.7	91.0%	13.5%	(6.6%)	(2.8%)	(1.3%)
Karen	224.9	88.8%	11.0%	206.2	96.3%	11.2%	9.1%	(7.6%)	(0.3%)
Kilimani	167.1	97.0%	10.7%	181.0	87.0%	10.3%	(7.7%)	10.0%	0.4%

Summary of Nairobi's Retail Market Performance 2017-2018

Location	Rent Kshs/SQFT 2018	Occupancy Rate 2018	Rental Yield 2018	Rent Kshs/SQFT 2017	Occupancy Rate 2017	Rental Yield 2017	Δ Y/Y in Rental Charges	Δ Y/Y in Occupancy Rates (%points)	Δ Y/Y in Rental Yields (% points)
Ngong Road	175.4	88.8%	9.7%	170.7	81.8%	8.7%	2.7%	7.0%	1.0%
Thika road	177.3	75.5%	8.3%	199.2	75.3%	8.7%	(11.0%)	0.3%	(0.4%)
Kiambu Road	182.8	69.5%	8.1%	216.1	78.2%	10.6%	(15.4%)	(8.7%)	(2.4%)
Mombasa road	161.5	72.4%	7.9%	180.4	68.8%	8.3%	(10.4%)	3.7%	(0.5%)
Eastland's	153.3	64.8%	6.8%	148.9	61.8%	6.1%	3.0%	3.1%	0.7%
Satellite Towns	142.1	73.7%	6.7%	130.1	82.5%	7.7%	9.2%	(8.8%)	(0.9%)
Average	**178.2**	**79.8%**	**9.0%**	**185.3**	**80.3%**	**9.6%**	**(3.8%)**	**(0.4%)**	**(0.6%)**

• Performance softened, with yields declining by 0.6% points y/y as a result of an oversupply of retail space, currently at 2.0mn SQFT leading to 0.4% points y/y decline in occupancy levels and 3.8% y/y decline in rental charges

• Westlands, Karen and Kilimani were the best performing submarkets, with a yield of 12.2%, 11.0% and 10.7%, respectively, with Kilimani having the highest average occupancy rates of 97.0%. This is due to the fact that they are affluent neighbourhood hosting middle – high end income earners with high consumer purchasing power and thus investors are willing to pay higher rents for retail space in the area

• Ngong Road, Nairobi Eastland's and Kilimani, recorded the largest increase in rental yields y/y of 1.0%, 0.7% and 0.4% points, respectively, attributable to a 7.0%, 3.1% and 10.0% points increase in occupancy levels, for Ngong Road, Nairobi Eastland's and Kilimani, respectively

• The increase in occupancy rates is attributable to prudent methods employed by developers, such as targeting international retailers as anchor tenants, these include; Carrefour, The Game and Shoprite

Source: Cytonn Research 2018

The main highlights for the retail sector for 2018 include;

- Signature mall in Mlolongo and the Waterfront mall in Karen formally opened their doors, with both malls adding 240,000 sqft and 250,000 sqft of space to the sector, respectively,
- Entry of the international retailers into the Kenyan market that included South African retailer, Shoprite, Spanish fashion house Mango and German fashion house Hugo Boss opening stores at the Westgate Mall in Westlands, Nairobi, and
- The expansion strategies by local retailers such as Naivas Supermarket opening 3 shops at Mwembe Tayari Mall, Freedom Height Mall in Lang'ata and Kitengela bringing the total stores in Kenya to 46 and Java house opening 2 restaurants at Engen service station in Parklands & at Shell service station in Lavington, bringing its total stores in Kenya to 62.

We expect reduced development activity of malls supply in 2019 due to the current oversupply of 2.0mn SQFT. However, our outlook for the sector is positive as the sector continues to attract both local and international retailers driven by (i) a conducive macro-economic environment, with an average GDP growth of above 5.0% over the last 5-years and (ii) a low retail penetration rate of 35.0% that serves as an incentive for formal retailers.

C. **Mixed Use Development (MUD) Sector**

MUDs encompassing office, retail and residential themes recorded an average rental yield of 8.0% in 2018. MUDs in the Limuru Road and Karen nodes are the best performing, recording a rental yield of 9.6% and 9.4%, respectively. The performance is attributable to the fact that these developments are located in high-end neighbourhoods (Karen, Runda, Rosslyn, Kitisuru, among others) hosting Nairobi's middle-end and high-end population, with higher purchasing power and who are thus willing to pay a premium for class and amenities provided. Areas characterized by traffic congestion and a low-income population with low purchasing power such as Mombasa road and Eastland's, are the worst performing nodes recording average rental yields of 5.7% and 5.4%, respectively. For more details see our Nairobi Metropolitan Area Mixed Use Developments Report-2018.

The performance of the key nodes in the Nairobi Metropolitan Area is as summarized below:

All values in Kshs unless stated otherwise

Nairobi's Mixed-Use Developments Market Performance by Nodes 2018

	Development Composition %			Retail Performance				Office Performance				Residential Performance				
Location	**Retail %**	**Office %**	**Resi. %**	**Price Kshs / SQFT**	**Rent Kshs /SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price Kshs / SQFT**	**Rent Kshs/SQFT**	**Occup. %)**	**Rental Yield (%)**	**Price Kshs /SQM**	**Rent Kshs /SQM**	**AnnualUptake %**	**Rental Yield %**	**Average MUD yield**
Limuru Rd	60.0%	20.0%	19.0%	23,975.0	277.0	80.0%	11.1%	13,500.0	103.0	70.0%	6.4%	177,935	1,259	25.0%	8.5%	9.6%
Karen	51.0%	48.0%	5.0%	23,333.0	186.0	99.0%	9.4%	13,409.0	120.0	87.0%	9.3%	215,983	821	27.0%	4.6%	9.4%
UpperHill	10.0%	90.0%		15,903.0	147.0	72.0%	7.7%	13,095.0	113.0	86.0%	8.8%					8.7%
Kilimani	25.0%	75.0%		19,571.0	168.0	87.0%	9.1%	12,875.0	102.0	82.0%	7.7%					8.6%
Thika Rd	36.0%	14.0%	50.0%	35,000.0	297.0	95.0%	9.7%	12,500.0	111.0	90.0%	9.6%	161,849.0	756.0	20.0%	5.6%	7.6%
Westland	27.0%	58.0%	59.0%	16,399.0	179.0	65.0%	8.1%	12,845.0	113.0	76.0%	8.1%	201,274.0	636.0	31.0%	3.8%	7.0%
Msa Rd	51.0%	10.0%	39.0%	20,000.0	180.0	50.0%	5.4%	13,200.0	96.0	75.0%	6.5%	171,304.0	843.0		5.9%	5.7%
Eastland's	25.0%		75.0%	20,000.0	132.0	76.0%	6.0%					81,717.0	351.0	20.0%	5.1%	5.4%
Average	**58.1%**	**30.9%**	**41.3%**	**19,663.5**	**181.2**	**76.9%**	**8.5%**	**13,014.6**	**110.3**	**81.1%**	**8.2%**	**168,343.5**	**777.5**	**24.5%**	**5.6%**	**8.0%**

• Retail outperforms other themes, recording a rental yield of 8.5%, followed by office space at 8.2% and the residential theme at 5.6%, translating to a weighted average rental yield of 8.0% p.a.

• Limuru Road and Karen are the best performing nodes, recording a rental yield of 9.6% and 9.4%, respectively. The performance is attributable to the fact that these are high-end neighbourhood hosting most of Nairobi's middle-end and high-end population, with higher purchasing power and thus willing to pay a premium for class and amenities provided

• Mombasa road and Eastland's are the worst performing nodes, attributable to traffic congestion in Mombasa road and competition from informal real estate developments in Eastland's hence leading to low market price and rental charges

Source: Cytonn Research 2018

The main highlights for the MUD sector for 2018 include;

- 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, and,
- Jesus House of Praise International Church launched plans to build a 30-floor commercial property in Meru County located 1.6 km from Meru Town along the Meru-Embu-Nairobi Highway (size and other details undisclosed). The development will comprise of office spaces, retail complex, serviced apartments, hotel, church and conference halls.

We retain a positive outlook for the sector, with MUD recording an average weighted rental yield of 8.0%, outperforming single themed real estate market average at 7.4%. MUDs are, therefore, a viable investment suitable for developers and investors looking to diversify their real estate portfolio, given that some themes such as office and retail are oversupplied with 4.7mn and 2.0mn SQFT space, respectively, in Nairobi Metropolitan Area.

III. **Hospitality Sector**

In 2018, the hospitality sector in Kenya recorded increased investment driven by demand for hospitality services from both local and international guests, with the number of international arrivals growing by 7.8% between January and September 2018 to 776.4 mn persons, compared to 720.4 mn during the same period in 2017 according to Leading Economic Indicator October 2018. According to the KNBS Economic Survey 2018, following a 5-year slump between 2011 and 2015 that was because of insecurity and terrorism, the number of international arrivals into the country has been on the rise growing by 13.5% from 1.2 mn in 2015 to 1.3 mn in 2016 and by 8.0% to 1.4 mn in 2017. Mirroring this growth, the total number of hotel bed nights grew by 9.5% from 5.9 mn in

2015 to 6.4 mn in 2016 and by 11.3% to 7.2 mn in 2017. We attribute the growth primarily to the marketing efforts by the government and improved security.

With this promising growth, hoteliers continued to expand their brands and as a result, in 2018, the sector recorded significant hotel openings and acquisitions including:

Hotels Opened in 2018

Name of Hotel	Brand	Location	Star Rating	No of Hotel Rooms	Month Opened
City Lodge Hotel	City Lodge Hotel Group	Kiambu Road	3	171	January 2018
Tamarind Hotel	Tamarind Group	Lang'ata Road	3	162	March 2018
Trademark Hotel		Kiambu Road	5	215	April 2018
Movenpick Hotel	Movenpick Hotel & Resorts	Westlands	5	128	April 2018
Hilton Garden Inn	Hilton Group	Mombasa Road	5	171	October 2018
Nyali Golf View Residences (serviced apartments)		Mombasa		65	November 2018
Total				**912**	

Source: Cytonn Research

During the year, a few hotels also embarked on rebranding, aiming at leveraging on international brands and gaining competitive advantage in the wake of stiff competition in the sector:

Hotels Rebranded in 2018

Name of Hotel	Current Brand	Location	Star Rating	No of Hotel Rooms	Month Rebranded	Former Brand
Crowne Plaza	Inter-Continental	Mombasa Road	4	144	May 2018	Lazizi Premiere
Double Tree by Hilton	Hilton Group	Ngong' Road	4	109	February 2018	Amber Hotel
Total				**253**		

Source: Cytonn Research

In addition, during the year, several hotel brands announced plans to enter the Kenyan hospitality market, adding approximately 785 keys to the existing number in the pipeline, as shown below:

Hotel Projects Launched in 2018

Name of Hotel	Brand	Location	Star Rating	No of rooms	Year of Completion
Nairobi Institute of Business Studies Hotel (NIBS)	Undisclosed	Kileleshwa	5	72	2019

Hotel Projects Launched in 2018

Name of Hotel	Brand	Location	Star Rating	No of rooms	Year of Completion
PrideInn Hotel	PrideInn Hotels	Mombasa	3	40	Undisclosed
Mediview Limited		Limuru Road	5	200	Undisclosed
Undisclosed	Hyatt Hotels	Westlands	5	173	2020
Rotana Hotel	Rotana Hotel & Resorts	Upperhill	5	200	2022
Arjaan Hotel Apartments	Rotana Hotel & Resorts	Upperhill		100	2022
Total				**785**	

Source: Cytonn Research

The activities above are a clear indication of the attractiveness of the sector for investment and will result in (i) better accommodation and service standards, as hotels rebrand and other brands set foothold in the market, in the wake of stiff competition from global brands such as Radisson Blu, Mariott and now Movenpick, and (ii) increased room capacity to meet the growing demand for accommodation as seen in the increase in tourist arrivals between January and September 2018 to 776.4 mn, compared to 720.4 mn during the same period in 2017, according to the Leading Economic Indicator October 2018.

In terms of performance in 2018, we tracked the performance of serviced apartments in 7 nodes in Nairobi Metropolitan area. From our research, serviced apartments recorded improved performance in 2018 with the average rental yield coming in at 7.4%, which is 2.1% points higher than 5.3% recorded in 2017, and this we attribute to the increased demand, which has triggered an increase in charge rates, as well as increased occupancy rates with an average of 80.0% in 2018, compared to 72.0% in 2017. We attribute the improved performance to the stable political environment and improved security, making Nairobi an ideal destination for both business and holiday travelers.

The serviced apartments performance was as follows:

All values in Kshs unless stated otherwise

Serviced Apartments Performance in 2018

Node	Occupancy 2017	Occupancy 2018	Monthly Charge per SM 2018	Devt Cost per SM	Rental Yield 2017	Rental Yield 2018	Δ in Rental Yield
Kilimani	74.0%	86.0%	3,567	202,662	7.2%	10.9%	3.7%
Westlands& Parklands	78.0%	76.0%	4,044	209,902	7.3%	10.6%	3.3%
Limuru Road	80.0%	84.0%	3,685	231,715	4.5%	9.7%	5.2%

Serviced Apartments Performance in 2018

Node	Occupancy 2017	Occupancy 2018	Monthly Charge per SM 2018	Devt Cost per SM	Rental Yield 2017	Rental Yield 2018	Δ in Rental Yield
Kileleshwa& Lavington	70.0%	83.0%	2,686	206,132	7.0%	7.8%	0.8%
Nairobi CBD	70.0%	74.0%	2,374	224,571	4.2%	5.7%	1.5%
Upperhill		60.0%	2,580	209,902	6.6%	5.3%	-1.3%
Msa Road	64.0%	85.0%	1,642	200,757	3.1%	5.0%	1.9%
Thika Road	69.0%	90.0%	1,361	200,757	2.6%	4.4%	1.8%
Average	**72.0%**	**80.0%**	**2,742**	**210,800**	**5.3%**	**7.4%**	**2.1%**

• In 2018, the rental yields came in at 7.4%, recording a 2.1% points increase from 5.3% recorded in 2017, and this we attribute to the political stability, increased popularity of the serviced apartments concept, thus an increase in the occupancy

Source: Cytonn Research

- Kilimani area was the best performing node in 2018, recording high occupancy rates of 86.0%, and a rental yield of 10.9%, and this we attribute to its easy access from Jomo Kenyatta International Airport (JKIA), proximity to business nodes such as Westlands and Upperhill, and the good transport network thus ease of accessibility,
- Thika Road node (Muthaiga North, Mirema and Garden Estate) recorded the lowest rental yield at 4.4%, and this we attribute to its unpopularity, given the distance from main commercial zones, the lack of modern and quality serviced apartments, in addition to not being mapped within the UN Blue Zone, thus not attractive to expatriates due to security concerns,
- The investment opportunity lies in Kilimani and Westlands, which were the best performing areas with average rental yields of above 10.0%. For more details on supply and performance of the serviced apartments sector, see the Serviced Apartments Research Report 2018.

The main challenges that continue to face the sector include: (i) negative publicity of some parts of Kenya such as Mandera, Wajir, Lamu and Eastleigh in Nairobi due to instances of terrorist attacks and thus hampering tourism in these areas, and, (ii) slow infrastructural development and delays in the completion of the same which continues to cripple the opening up of areas for development and access. For instance, the expansion of the JKIA runway, which is yet to kick off, and was intended to meet the needs of the increasing number of passengers passing through Kenya's main airport and attract global airlines.

We project further growth in the hospitality sector in 2019 fueled by (i) political stability and improved security, (ii) improved flight operations and systems making it easier and more convenient for travelers, (iii) positive reviews from travel advisories such as Global Traveler(GT) who crowned Kenya as the best travel destination in the world, and named Kenya Airways as the third best airline in Africa , and (iv) improved hotel standards with the entry of global hotel brands while existing hotels refurbish their developments.

IV. **Land Sector**

During the year 2018, land continued to attract investors and developers, supported by the political stability, which has led to increased economic activities. The Nairobi Metropolitan Area land prices recorded a 7- year CAGR of 13.7%, and a 3.8% y/y price change in 2018. The land performance was positively driven mainly by, (i) provision of trunk infrastructure such as road network, (ii) the growing demand for development land especially in the satellite towns such as Ruiru and Syokimau due to their affordability compared to land in the urban areas. However, the key challenge facing the land sector was the uncertainty surrounding statutory approvals particularly in light of the ongoing demolitions of legally approved buildings, thus decreased transactions in the land sector.

The summary below shows the performance of the theme in 2018:

All values in Kshs unless stated otherwise

Nairobi Metropolitan Report Performance 2018

Location	*Price in 2011	*Price in 2017	*Price in 2018	7 YR CAGR	% Price change from 2011	Annual Capital appreciation
Nairobi Suburbs - Low Rise Residential Areas	56.0 mn	82.4 mn	89.4 mn	6.9%	**2.6**	**9.2%**
Unserviced land	9.0 mn	20.4 mn	22.7 mn	14.1%	3.5	**5.7%**
Nairobi Suburbs - Commercial Areas	156.0 mn	470.7 mn	492.6 mn	17.9%	**3.3**	**5.4%**
Serviced land	6.0 mn	14.4 mn	14.3 mn	13.2%	**3.5**	**0.6%**
Nairobi Suburbs - High rise residential Areas	46.0 mn	134.6 mn	135.0 mn	16.6%	**2.4**	**0.2%**
Average	**66.0 mn**	**175.5 mn**	**182.8 mn**	**13.7%**	**3.0**	**3.8%**

• In 2018, land in the Nairobi Metropolitan Area recorded a 13.7% 7- Year CAGR, with commercial areas recording the highest at 17.9% supported by high demand for land in these areas due to attractive returns on investment after development and proximity to amenities such as shopping malls and the Jomo Kenyatta International Airport(JKIA), in addition to the good road network in the areas making them easily accessible

Source: Cytonn Research

The key highlights are as follows:

i. Land prices in commercial zones such as Kilimani, Nairobi CBD, Westlands and Upperhill recorded a 7-year CAGR of 17.9%, and a 5.5% y/y capital appreciation in 2018, attributable to the high plot ratios allowing for densification of developments. This has thus resulted in high demand for land in these areas due to attractive returns on investment after development, proximity to amenities such as shopping malls and the Jomo Kenyatta International Airport (JKIA), scarcity of development land in addition to the good road network in the areas making them easily accessible. Kilimani was the best performing commercial node, recording a 10.7% y/y capital appreciation, and we attribute this to the high demand for development in the area, as it is a growing commercial zone,
ii. Unserviced land prices in satellite towns such as Ruaka, Utawala and Juja recorded a 7-year CAGR of 14.1% and a 5.7% y/y capital appreciation in 2018, attributed to the increased demand for property driven by (i) the relatively low prices thus preferred for development, and (ii) the improved infrastructure such as the road network, for instance the dualing of the Northern bypass which on completion is expected to opened up the areas in Ruaka for development. On the other hand, serviced land recorded a 13.2% 7 year CAGR, 0.9% points lower than the 14.1% recorded by unserviced land prices, and we attribute the drop in prices to decreased demand for site and service schemes as developers and investors prefer to buy unserviced plots and service instead of paying a premium as developers double the price the land for the services, facilities and amenities

provided,

iii. Land prices in high rise residential areas such as Kileleshwa, Kasarani and Kilimani recorded a 7-year CAGR of 16.6% and 0.2% y/y capital appreciation, attributed to low demand for development land in the area due to the high population in the areas thus strained infrastructure and amenities, in addition to hosting low income earners with low purchasing power thus investors are not able to charge more for the housing units, resulting in low returns and thus the stagnation of land prices, and,

iv. Land prices in low-rise residential areas such as Kitisuru, Runda and Karen recorded a 6.9% 7-year CAGR, which is 9.7% points lower than that of high-rise residential areas, and we attribute the scenario to the limiting plot ratios on land, thus reducing the return on investment for investors in these areas.

In conclusion, the investment opportunity in the Nairobi Metropolitan Area land sector lies in Satellite Towns such as Ruaka, Utawala, Ruiru and Thika, evidenced by high capital appreciation of 16.2%, 17.5%, 4.7%, 7.7% y/y capital appreciation, respectively, in addition to other areas such as Kilimani, Karen and Kitisuru, which had rates of 10.7%, 10.3% and 10.5% y/y capital appreciation, respectively.

We retain a positive outlook for the land sector backed by (i) improved infrastructure that exposes areas for investment, (ii) political calm in the country, and (iii) the focus of the Kenyan Governments Big 4 agenda on the provision of affordable housing.

V. **Infrastructure Sector**

During the year, we saw continued government investment in the infrastructural sector and its impact on the country's macroeconomic growth. According to KNBS Economic Survey 2018, total expenditure on roads has increased by 54.9% over a 4-year period to Kshs 198.4 bn in 2017/18, from Kshs 89.5 bn in 2013/14. 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 notable infrastructural projects in the Nairobi Metropolitan Area in 2018:

Infrastructural Projects in the Nairobi Metropolitan Area in 2018

	Name of project	Type	Length (Kms)	County	Project Value	Progress
1	Ngong Road Expansion (Phase 1) – dualing of road from the Kenya National Library to the junction at Kilimani Ring Road	Road	2.57 km	Nairobi	Kshs 2.3 bn	Completed in Q1'2018
2	Four link roads that is set to connect the Garissa Highway to the upcoming Thika Bypass	Road	2 km, 3 km, 3 km and 8 km	Kiambu	Kshs 1.5bn	Commenced in February 2018
3	Construction of phase 2A of the Standard Gauge Railway (SGR) traversing through the Nairobi National Park	Railway	120 km	Nairobi, Kajiado, Nakuru, Kiambu, Naivasha and Narok,	Kshs 150.0 bn	Commenced in March 2018
4	Ngong Road Expansion (Phase 2)	Road	2.4 km	Nairobi	Kshs 2.2 bn	Commissioned in March 2018

Infrastructural Projects in the Nairobi Metropolitan Area in 2018

	Name of project	Type	Length (Kms)	County	Project Value	Progress
5	Superhighway linking Jomo Kenyatta International Airport to Rironi area in Limuru along the Nakuru- Nairobi highway	Road	43.5 km	Kiambu	Kshs 59.0 bn	Designs commenced February 2018, project to commence in Q1'2019

Source: KenHA, KERRA, KURA

Other projects launched in 2018 in the rest of the country include:

- Eldoret Southern Bypass - (20 km) in Uasin Gishu County
- Dongo-Kundu Bypass (11 km) – Phase 2 & 3 in Mombasa County
- Lamu – Isiolo Road (530 km) in Lamu/Isiolo County
- Gilgil to Njoro Road (23 km) in Nakuru County
- Upgrade of Kimbimbi-Karoti – Kajiji Roads, Pi – Mumbi Roads (217 km) in Kirinyaga County
- Extension of the Olkaria 1 Units 4 & 5 Geothermal Power
- Dualing of the Salgaa-Mau Summit Highway (22 km)
- Miritini passenger terminus to Mombasa CBD train station (22 km) in Mombasa County
- Expansion of the Mombasa Port Second Container Terminal

Infrastructural development will play a key role in economic growth by enhancing connectivity and creating a better operating environment for individuals and businesses. It will open up previously inaccessible areas improving connectivity and thus lead to increased demand for property resulting in an increase in property prices.

In terms of infrastructure supply in the Nairobi Metropolitan Area, according to Cytonn Research, Nairobi and Kiambu Counties offers the best investment opportunity due to presence of relatively good coverage of all infrastructure sub-sectors, in comparison to other counties. For more information and analysis, see Nairobi Metropolitan Area Infrastructure Report 2018.

In conclusion, the presence and quality of infrastructure, that is, transportation and utilities, is one of the most important factors influencing real estate investments, and the country's economy as a whole. We, therefore, expect the infrastructural development to remain a top priority for the government in line with its Big Four Agenda to improve the housing deficit and scale up the manufacturing sector.

VI. **Statutory Reviews**

During the year, several statutory reviews were made or proposed, all in line to promote efficiency in the property sector and to facilitate the government's affordable housing agenda.

The following are the key reviews;

i. Signing into law the amendment of the Stamp Duty Act to exempt first time homebuyers under the affordable housing from paying stamp duty, thus reducing their financial burden, Cytonn Weekly #28/2018
ii. Signing into law an amendment to the Income Tax Act stating that homebuyers under the affordable housing plan are eligible to a 15 % relief on their gross monthly earnings, but not exceeding Kshs 108,000 annually, Cytonn Weekly #28/2018
iii. Amendment of the Employment Act 2012, allowing the government to fund raise through National Housing Development fund, by introducing a 1.5% levy that would be deducted from the wages of formal industry workers with a similar amount remitted by their employers. In December 2018,

the high court suspended implementation of the levy pending the hearing and determination of the application made by the Central Organization of Trade Unions (COTU), Cytonn Weekly #49/2018

iv. The Kenyan Parliament approved regulations set to facilitate the implementation of 7 new land laws, which among other items outline the mandates of various parties, including the Ministry of Lands, the National Land Commission and the County Governments. These regulations include a) The Land (Extension and Renewal of Leases) Rules, 2017; b) The Land (Conversion of Land) Rules, 2017; c) The Land (Assessment of Just Compensation) Rules, 2017; d) The Land (Allocation of Public Land) Regulation, 2017; e) The Land Registration (General) Regulations, 2017; f) The Land Registration (Registration Units) Order, 2017 and g) The Land Regulations, 2017. The regulations are meant to establish procedures for land-related transactions promoting efficiency and reducing cost on both developers and the end-user in the real estate sector,
v. Launch of the Sessional Paper No. 1 of 2017 National Land Use Policy (NLUP), aimed at curbing land grabbing and poor land management, Cytonn Weekly #24/2018

VII. **Listed Real Estate Sector**

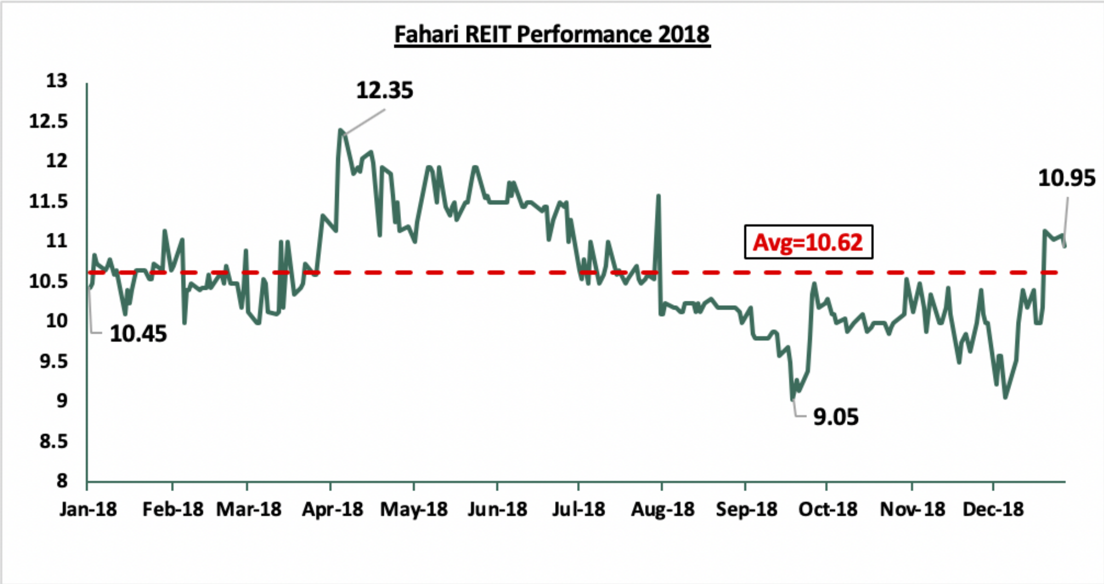
During the year, Stanlib Fahari I-REIT acquired 67 Gitanga Place office building in Lavington at Kshs 850.0 mn in compliance with the Capital Market's Authority's (CMA) requirement for listed REITs to invest a minimum of 75.0% of assets in income-generating real estate. The acquisition of 67 Gitanga road office block thus raised their real estate assets share in the fund to 90.0%, from 67.0% invested in Greenspan Mall, Signature International Limited, and Bay Holdings Ltd. The newly acquired property is expected to generate a net income of Kshs. 73.8Mn p.a, translating to an 8.7% rental yield.

On performance, Stanlib Fahari I-REIT released their H1'18 earnings, and the key highlights were as follows;

- The instrument registered a 16.3% y/y decline in earnings to Kshs 0.36 from Kshs 0.43 per unit in H1'2017, driven by a 7.7% decline in operating income, which outpaced the 0.9% decline in operating expenses to Kshs 111.5 mn from Kshs 112.5 mn in H1'2017,
- 65.9% of expenses were attributed to fund-operating expenses, mainly acquisition fees for the new property; while property expenses that include maintenance of tenants and properties, filling vacancies, marketing, and public relations accounted for 34.1% of the total operating expenses,
- Rental income declined by 2.1% y/y to Kshs 135.1 mn from Kshs 138.0 mn in H1'2017 attributable to a temporary increase in vacancies, coupled with some tenants bargaining for reduced rentals upon the renewal of leases. For example, the Greenspan Mall had an occupancy of 74.0% in H1'2018, which is 5.5% points lower than the Nairobi retail market average at 79.5%

Stanlib Fahari I-REIT closed at a price of Kshs 10.9 as at 31st December, 2018, and a projected FY'2018 dividend yield of 5.7%, assuming the dividend payout ratio remains at 91.0%, similar to the FY'2017 payout. For a more comprehensive analysis, see our Stanlib Fahari I- REIT Earnings Note

On the bourse, Stanlib's Fahari I-REIT value declined by 5.9% y/y trading at an average of Ksh 10.6 in 2018 compared to Kshs 11.3 in 2017. The REIT closed at a price of Kshs 10.9 per unit, 45.5% lower than its listing price of Kshs 20.0 in November 2015. The prices of the instrument have remained low 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 in 2019. Below is the Fahari REIT Performance for 2018:



We retain a negative outlook for the listed real estate sector mainly due to market structures and poor market sentiment, however, attempts by key real estate industry players in the region such as East Africa Forum for Structured products 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.

In 2018, the real estate sector recorded continued investment across all themes mainly driven by the political stability following the conclusion of the electioneering period in Q1'2018. We continue this to result in increased economic activities going forward and thus improved performance in the real estate sector.