



Karen Investment Opportunity, & Cytonn Weekly #04/2019

Focus of the Week

Following the successful completion and handover of “Amara Ridge”, Cytonn’s flagship project located in Karen near the Bomas of Kenya, Cytonn Real Estate has now launched “Applewood”, a signature gated community development comprising of 18 luxury homes in Miotoni, Karen, seated on 10.4-acres. In this week’s topical, we update our research findings on the Karen real estate market by looking at the factors that have contributed to its attractiveness to investors and analyzing the potential returns to investors in the area. We have expanded our coverage of Karen’s real estate performance by also looking at the commercial office and retail sectors. From Cytonn Research conducted in **December 2018**, the average total returns in the Karen residential market came in at 8.8% (rental yield of 4.1% and price appreciation of 4.7%), while the office and retail sectors registered average rental yields at 9.2% and 11.0%, respectively.

In our analysis of the investment opportunity in Karen, we shall cover the following:

- A. Overview of Karen
- B. Real Estate Performance in Karen (Residential, Office and Retail)
- C. Karen Investment Opportunity

A. Overview of Karen

Karen is a high-end neighborhood in Nairobi located approximately 16 km South West of the Nairobi CBD. Previously, it was predominantly a residential area but relaxation of zoning regulations has seen an increase in commercial developments, the most notable ones being The Hub Mall along Dagoretti Road, Galleria Mall at the junction of Magadi and Lang’ata Road and the recently opened, Karen Waterfront along Lang’ata Road. We have seen land values in the area growing at a 7-year Compounded Annual Growth Rate (CAGR) of 12.2% since 2011, from an average of Kshs 25.0 mn per acre in 2011 to Kshs 55.8 mn per acre in 2018, fueled by increased demand for property in the area.

The main factors that have made Karen an attractive area for real estate development include:

1. **Good Transport Network** - Karen is accessible by main roads such as Ngong Road, Lang’ata Road and is served by the Southern Bypass, which was completed during the second half of 2016. The ongoing dualling of Ngong Road, currently in its second phase of development, that will see some feeder roads in Karen, such as Karen Road, expanded, is likely to further improve accessibility of the area,
2. **Relaxation of Zoning Regulations** - Zoning regulations have been relaxed in Karen to allow for commercial in some nodes and single dwelling up to a half an acre in some areas thus increasing real estate activity and increasing property values. From our research, land prices in Karen have grown by a 7-year CAGR of 12.2% between 2011 and 2018, from Kshs 25.0 mn per acre in 2011 to Kshs 55.8 mn per acre in 2018,
3. **High-end Schools** - Karen’s appeal to wealthy individuals is also driven by the presence of some

of the most elite international schools in the country such as Banda School, Gems Cambridge, Brookhouse, and Hillcrest. In 2018, Knight Frank's Wealth Report listed Karen as one of the top investment hotspots globally,

4. **Serene Environment** - With the continued relaxation of zoning regulations and increased development activity, many high-end areas are losing their appeal to high net worth individuals. Karen, located at the foothills of Ngong Hills and in close proximity to forests such as Ngong Sanctuary Forest and Oloolua Forest has maintained its appealing environmental serenity, and,
5. **Recreational Facilities** - Karen has a unique historical heritage preserved in museums such as the Karen Blixen Museum. It also hosts the Bomas of Kenya, the Giraffe Manor, Karen Country Club and malls including The Hub and Galleria, making the place an ideal home for individuals seeking exclusivity, luxury and convenience.

B. Real Estate Performance in Karen

In evaluating Karen Market performance, we will look at the following key metrics:

- **Plinth Area:** Research on the size of the units found in the market allows us to gauge the current offering, and put into consideration the home buyer's preferences for sizes of houses
- **Prices:** Research on prices will be used in comparison of the products in the market over a given time period and allow us to demonstrate capital appreciation
- **Rental Rates:** Research on rental income allows us to inform potential investors on the current rental rates in other developments and also inform the investors on the rental yield they can gain from buying houses in Karen
- **Annual Uptake:** This allows the investor to appreciate the rate at which available homes are sold over a specific period. This helps them gauge on whether it is profitable to invest in a given area
- **Occupancy:** Refers to the units rented out in a development and therefore, indicates the product uptake of an area
- **Rental Yield:** Informs on the returns investors get from a property based on the monthly rental income and hence, the time it will take for an investor to get back the money invested
- **Price Appreciation:** Shows the return on real estate investments through the annual increase in the value of a property/land
- **Total Returns:** This shows the returns investors get back from a real estate investment (Rental yield+ Price Appreciation)

I. Residential Market

The Karen residential scene has notably changed over the years with more gated communities being delivered to the market. In terms of land for development, Karen remains relatively affordable for developers in the high-end market, with the price per acre averaging at Kshs 55.8 mn as at 2018 in comparison to Runda, Kitisuru, and Rosslyn with Kshs 68.8 mn, Kshs 77.3 mn, and Kshs 100.0 mn per acre, respectively. In terms of performance, five bedroom units recorded the highest annual uptake and annual returns in Karen with an average of 27.6% and 10.9%, respectively, in comparison to four bedroom units with 20.8% and 5.5%, respectively, as high-income investors and homeowners prefer large units.

(All Values in Kshs Unless Stated Otherwise)

Karen Residential Research 2018											
Typology	Plinth Area	Average Price 2017	Average Price 2018	Average Rent 2018	Average Price per SQM 2018	Average Rent per SQM 2018	Annual Uptake 2018	Occupancy	Rental Yield 2018	Price Appreciation 2018	Total Annual Returns 2018
4-Bedroom	437	80.0m	84.8m	326,250	180,723.6	618.4	20.8%	71.5%	4.4%	1.1%	5.5%
5-Bedroom	510	93.4m	98.2m	373,750	198,348.3	864.9	27.6%	76.2%	4.0%	6.9%	10.9%
Average	474	86.7m	91.5m	350,000	189,535.9	741.6	24.2%	73.8%	4.1%	4.7%	8.8%
<ul style="list-style-type: none"> • Five bedroom units recorded the highest annual uptake of 27.6% on average in comparison to four bedroom units with 20.8%. This indicates that five bedrooms units have a much higher demand in the area especially from investors as they also continue to show better returns with 2018 registering average total returns of 10.9% whereas four bedroom units registered an average of 5.5%. The performance is also attributable to wealthy investors and home-buyers preference for large units, thus driving prices up • Overall, five bedroom units registered an increase in average total returns of 3.9% points from 7.1% in 2017 to 10.9% in 2018, as rental yields stagnated while price appreciation increased from 3.1% in 2017 to 6.9% on average in 2018 											

Source: Cytonn Research

In comparison to other high-end markets, Karen recorded average total returns to investors of 8.8% in comparison to the residential high-end market average of 6.4% and relatively high annual uptake of 24.2% against the market's average of 20.7%.

(All Values in Kshs Unless Stated Otherwise)

High-End Residential Performance 2018							
Location	Average Price per SQM	Average Rent per SQM	Average Annual Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Average Annual 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%
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%
Rosslyn	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%
<ul style="list-style-type: none"> • Karen came in second after Kitisuru in terms of average total returns with 8.8%, in comparison to the market average of 6.4% • Notably Karen registered the highest annual uptake in 2018 with an average of 24.2% compared to the high-end market average of 20.7% 							

Source: Cytonn Research

II. Commercial Office

Karen's commercial office sector continues to be bolstered by the area's relatively good infrastructure, exclusivity enabled by the restricted zoning regulations thereby attracting differentiated office concepts such as serviced offices and compact office buildings, which attract high-end clientele and premium rental rates. Notable office developments in Karen include the Watermark Business Park, Blixen Court, Nairobi Office Park, The Stables, African Reit and Symbion at The Hub.

Grade C offices recorded the highest rental yields at 10.5% in comparison to Grade A and B, which registered 8.6% and 9.2%, respectively. This is attributable to the period under which majority Grade C offices have been in the market, which is more than Grade A and B, allowing them longer periods of tenure hence high occupancies and rental yields. Overall, Karen recorded an increase in office rental yields from 8.1% in 2017 to 9.2% in 2018, owing to increased occupancy rates from 88.0% in 2017, to 88.6% in 2018.

(All Values in Kshs Unless Stated Otherwise)

Karen Commercial Office Performance							
Office Grade	Average rent Per SQFT	Average Rental Yield 2017	Average Occupancy 2017	Average Occupancy 2018	Average Rental Yield 2018	Y/Y Change in Occupancy 2018	Y/Y Change in Rental Yield 2018
Grade A	122.0	8.3%	83.0%	86.7%	8.6%	3.7%	0.3%
Grade B	120.0	9.4%	87.6%	85.5%	9.5%	(2.1%)	0.1%
Grade C	116.0	9.6%	93.5%	97.5%	10.5%	4.0%	0.9%
Average	118.0	*8.1%	88.0%	88.6%	9.2%	1.9%	0.4%
<ul style="list-style-type: none"> • Grade C offices recorded relatively high rental yields of 10.5%, compared to Grade A and B with 8.6% and 9.5%, respectively. This is attributable to high occupancy rates as Grade C tend to be relatively affordable • 2017's rental yield has been restated to account for 2017's market occupancy rate 							

Source: Cytonn Research

In 2018, Karen office market recorded average rental yields of 9.2%, 1.3% points higher than the Nairobi office average of 8.1% with average occupancy rates coming in at 88.6% in comparison to Nairobi office market average of 83.3%. The average rent per SQFT in Karen's office market is Kshs 118.0, 15.3% higher than the overall Nairobi office market average of Kshs 102.3.

(All Values in Kshs Unless Stated Otherwise)

Nairobi Commercial Office Performance 2018				
Location	Price Kshs/SQFT FY'2018	Rent Kshs/SQFT FY' 2018	Occupancy FY'2018(%)	Rental Yield (%) FY'2018
Gigiri	13,833.3	141.0	88.3%	10.5%
Karen	13,666.0	118.0	88.6%	9.2%
Westlands	12,050.0	109.7	82.1%	9.0%
Parklands	12,493.8	102.1	86.0%	8.4%
Upperhill	12,559.5	99.8	80.7%	7.9%
Kilimani	13,525.2	98.9	88.3%	8.0%
Nairobi CBD	12,424.8	88.8	88.3%	7.6%
Thika Road	12,516.7	86.3	81.5%	6.7%
Msa Road	11,400.0	78.8	65.6%	5.8%
Average	12,572.9	102.3	83.3%	8.1%
<ul style="list-style-type: none"> • In the commercial office sector, Karen recorded the highest occupancy rates in the market with 88.6%, in comparison to the office market average of 83.3% • Office rental yields came in at 9.2%, 1.1% points higher than the market average of 8.1% 				

Source: Cytonn Research

III. Retail Market

Karen's retail sector has grown exponentially a 2-year CAGR of 98.9% from 0.2 mn SQFT in 2016 to 0.8 mn SQFT in 2018. The growth has been driven by relatively good infrastructure particularly with the increased access, the affluent residents, as well as its proximity to upper mid-end neighborhoods such as Kilimani and Lavington. Malls in Karen include Galleria, The Hub, Karen Crossroads, Karen Waterfront and the soon-to-be opened, The Well. Mall developers in Karen benefit from the huge interest shown by international retailers such as Carrefour, LC Waikiki and Game, who have set up shop in the area, attracting other retailer's due to the footfall they attract. Neighborhood malls registered relatively high rental yields of 12.8% on average in comparison to community malls with 10.2%. This is attributable to high occupancy rates with neighborhood malls registering an average of 98.0% against community malls with 85.7%.

(All Values in Kshs Unless Stated Otherwise)

Karen Retail Performance							
Classification	Current Average Rent Per SQM	Average Occupancy Rate 2017	Average Rental yield 2017	Average Occupancy 2018	Average Rental Yield 2018	Y/Y Change in Occupancy Rates	Y/Y Change in Rental Yields
Neighborhood	237	90.0%	10.9%	98.0%	12.8%	9.0%	1.9%
Community	222	76.0%	10.2%	85.7%	10.2%	(10.3%)	0.0%
Average	225	83.0%	10.4%	88.8%	11.0%	(13.8%)	0.9%
• Neighborhood malls recorded the highest average rental yields in 2018 with 12.8%, whereas community malls recorded 10.2%. This is attributable to relatively high occupancy rates coupled by high rental rates due to attractive locations							

Source: Cytonn Research

In comparison to the overall retail market, Karen posted average rental yields of 11.0% compared to the market average of 9.0%, which is also an increase of 0.6% points from 10.4% posted in 2017. This is attributable to increased occupancy in 2018 at 88.8%, 5.8% points increase from 83.0% in 2017.

(All Values in Kshs Unless Stated Otherwise)

Summary of Nairobi's retail Performance - 2018			
Location	Rent Kshs/SQFT 2018	Occupancy Rate 2018	Rental yield 2018
Westlands	219.2	88.2%	12.2%
Karen	224.9	88.8%	11.0%
Kilimani	167.1	97.0%	10.7%
Ngong Road	175.4	88.8%	9.7%
Thika Road	177.3	75.5%	8.3%
Kiambu Road	182.8	69.5%	8.1%
Mombasa Road	161.5	72.4%	7.9%
Satellite Towns	142.1	73.7%	6.7%
Eastlands	153.3	64.8%	6.8%
Average	178.2	79.8%	9.0%
• Karen registered the highest retail rental rates in 2018 at Kshs 224.9 per SQFT in comparison to the market average of Kshs 178.2 per SQFT, attributable to its attractiveness as an affluent neighborhood thus attracting premium rents • In terms of rental yields, Karen registered an average of 11.0%, 2.0% points higher than the retail market average of 9.0% due to its prime rents coupled by the relatively high occupancy rates			

Source: Cytonn Research

IV. Performance Summary

The table below shows a summary of returns for Karen's real estate sector. Average annual total returns from the residential sector came in at 8.8%, with retail and office sectors posting average rental yields of 11.0% and 9.2%, respectively, whereas Karen's capital appreciation currently stands at 12.2%

Karen Real Estate Performance Summary

Real Estate Sector	Rental Yield	Price Appreciation
Residential	4.1%	4.7%
Commercial Office	9.2%	
Retail	11.0%	
Land		12.2%
Average	8.1%	8.5%

- **The average rental yields across all themes in Karen came in at 8.1% with residential posting an average price appreciation of 4.7%**
- **With a capital appreciation of 12.2%, and rental yields ranging from 4.1% to 11.0%, developer returns in Karen stand at 16.3%-23.2%**

Source: Cytonn Research

C. Karen Investment Opportunity

Our outlook for Karen’s residential sector is positive with a neutral outlook for commercial office and retail sectors. Therefore, our outlook for the overall real estate investment sector in Karen is neutral with a bias to positive as shown in the table below:

Thematic Performance Review and Investment Opportunity Outlook			
Theme	Performance	Investment Opportunity	Outlook
Residential	<ul style="list-style-type: none"> • Karen recorded average total returns to investors of 8.8% in comparison to the residential high-end market average of 6.4%. Five bedroom units recorded the highest uptake and returns in Karen with an average of 27.6% and 10.9%, respectively, in comparison to four bedroom units with 20.8% and 5.5%, respectively 	<ul style="list-style-type: none"> • Five bedroom units registered relatively high annual uptake averaging at 27.6%, and total returns of 10.9% • Therefore, Investment opportunity is in five bedroom units with high quality finishes and key amenities such as retailing and swimming pools, in key locations such as Miotoni Road, Windy Ridge and along Langata Road, which are in close proximity to the social amenities and access routes such as the Southern Bypass and Ngong Road 	Positive
Commercial Office	<ul style="list-style-type: none"> • Karen office market recorded average rental yields of 9.2%, 1.0% points higher than the Nairobi office average of 8.2% with average occupancy rates coming in at 88.6% in comparison to Nairobi office market average of 83.3%. 	<ul style="list-style-type: none"> • Investment opportunity is in differentiated concepts in Grade A offices which have a low market share at 29.0%. This is as more firms continue to relocate away from conventional office nodes such as Upperhill and CBD into more exclusive environments 	Neutral

Thematic Performance Review and Investment Opportunity Outlook

Theme	Performance	Investment Opportunity	Outlook
Retail	<ul style="list-style-type: none"> • Karen had average rental yields of 11.0% compared to the market average of 9.0%. Neighborhood malls registered relatively high rental yields of 12.8% in comparison to community malls with 10.2%. This is attributable to high occupancy rates with neighborhood malls posting an average of 98.0% against community malls with 89.0%. 	<ul style="list-style-type: none"> • Investment opportunity is in neighborhood malls due to relatively high occupancy rates and hence rental yields, • However, we are of the view that, increase in mall space might hamper retail performance and thus, developers should carry out demand analysis 	Neutral

Conclusion

We expect real estate performance in Karen to continue on an upward trend as the area continues to register improved performance across themes such as retail and residential as well as attracting high demand across all real estate sectors in comparison to other nodes in each given theme. Additionally, the availability of affordable land for development in comparison to other high-end areas as well as continued infrastructural improvements such as the ongoing dualling of Ngong Road, is set to sustain demand from investors and buyers. For residential sector, Karen recorded relatively high annual uptake of 24.2% compared to the overall Nairobi residential market average of 22.8%; the Karen office sector registered occupancy of 88.6% on average in comparison to the Nairobi office market average of 83.3%, whereas the retail sector registered average occupancy of 88.8%, in comparison to the Nairobi retail market average of 79.8%, attesting to Karen's attractiveness as a real estate investment opportunity.

For more details on our projects in Karen, please see **Applewood**, **Situ Village**, and **Amara Ridge**.

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