Cytonn INVESTMENTS

Cytonn Annual Market Outlook ? 2016

Cytonn Weekly

Executive Summary

- **Global Market Outlook:** Global market outlook likely to be shaped by the divergence in monetary policy between the United States and Eurozone, as they both undertake contrasting policies, with US in tightening monetary policy and Eurozone loosening its monetary policy, but both aim to spur growth and positive inflation amidst slowing growth in China;
- **Kenya Macroeconomic Outlook:** GDP growth expected to be in line with 2015, at between 5.5% and 6.0%, underpinned by expectations of a strong performance in the energy sector, construction sector, information and communication sector and the recovery of the tourism sector;
- **Fixed Income Outlook:** The Government is expected to experience high pressure to finance the budget due to the high amounts of maturities of Government securities in the last 6 months of the fiscal year;
- **Equities Outlook:** The equities market is expected to remain under downward pressure but the valuations have improved with some pockets of value, hence a stock-pickers market;
- **Private Equity Outlook:** Private equity to continue attracting global capital flows, spread out across all sectors as Kenya remains an attractive and vibrant PE destination;
- **Real Estate Outlook:** We expect increased development of Grade A offices and a stagnation of rents of Grade B offices in select areas. We also expect an increase in retail and residential developments as developers continue to invest heavily in these sectors. Growing middle class population bracket will drive demand for middle income housing in 2016.

Company Updates

- Our Investment Manager, Maurice Oduor discussed the 2015 Kenya markets review and outlook for 2016. See link on KTN
- Our Head of Private Equity Real Estate, Shiv Arora discussed Kenya Revenue Authority challenges in revenue collection. See clip here on CNBC Africa
- Our Senior Investment Analyst, Duncan Lumwamu discussed the decline in the value of the Nairobi Securities Exchange during 2015. See clip here on CNBC Africa
- Our Senior Investment Analyst, Duncan Lumwamu also discussed the performance of the Kenyan shilling against the dollar. See clip here on CNBC Africa

Introduction

In our last Cytonn Report, we gave the Annual Market Review for 2015, where we analyzed the key market happenings that shaped the investment environment during the year 2015.

This week, we turn our focus to the future with the Cytonn Annual Market Outlook ? 2016, where we provide our investors with key insights and analyze the trends that will shape the investments landscape over the next 12 months in Kenya. Our recommendation to the average investor is a balanced portfolio, consisting of 40% fixed income, 30% equities, 20% alternative investments (real

estate and private equity) and 10% in offshore investments. We believe that come end of 2016, this balance portfolio will outperform on a risk-adjusted basis.

2016 Global Market Outlook

2015 was characterized by 4 key events in the global markets: (i) the US Federal Reserve (Fed) raised rates by 25 bps (0.25%) in December, after months of uncertainty, (ii) there was further monetary loosening in the Eurozone to spur growth, (iii) the transition of China from an export dependent economy to a service driven economy, leading to a slowdown in growth, and (iv) the continued fall in oil prices as a result of reduced demand from China coupled with failure by OPEC to reduce oil supply.

The key events, all of which materialized towards December 2015, laid a foundation to the key economic themes that will shape the global markets in 2016. We look at the key themes that will shape markets:

Divergence of monetary policy may turn disruptive for global markets?

The big message for investors going into 2016 is monetary policy divergence. The large developed economies are divided by (i) the direction of monetary policy, as the US tightens by raising rates, and the Eurozone embarks on another phase of zero rates and quantitative easing, and (ii) divided regional and sectoral growth outlook, with the greatest signs of recovery in large, consumer driven markets such as the United States, with the Europe struggling to recover from the commodity route and deflationary pressure in Asian countries such as Japan. Investors will have to remain wary of the repercussions of this divergence, especially when it comes to economies trying to pick up inflation and have convergence on economic growth, despite using opposite measures to get there. The high market correlation due to globalization e.g. between the S&P 500 in US and Stoxx 600 in Europe is now at 0.62, a very high level, making it difficult for investors to diversify away from a market.

Falling oil prices, is there an end?

The Organization of the Petroleum Exporting Countries (OPEC) meeting in December was a key highlight in 2015, as the members present failed to agree on reduction of oil supply. In as much as the decline in oil prices is driven by over-supply, global demand has faltered in 2015 and showing no signs of recovery in 2016, largely dominated by reduced Chinese manufacturing output, which has repercussions throughout the world.

Global powerhouses such as US, Japan and those in the Eurozone are struggling to raise inflation, and will probably struggle throughout the year as currencies reach the limit of their downside, despite heavy stimulus across markets.

Winners and losers from China?s slowdown?

A recent report by the IMF estimated that each 1% decrease in China?s investment growth could reduce global growth by 0.1%, 5 times greater than in 2000, showing the increased dependence on the world?s largest economy by population. However, the impact of China on the global markets in 2016 is likely to be uneven.

Biggest losers are expected to be (i) Eurozone economies who depend so largely on China as a market for their manufactured capital goods products and services; 30% of Eurozone?s exports are dependent on emerging markets, (ii) Middle-East and West African countries who depend on China as one of the largest consumers of oil, and (iii) Commodity dependent nations in Sub Saharan Africa and Latin America for whom China is a key commodity partner. However, on the flip side, economies dependent on consumer expenditure such as India and US are likely to benefit, as the savings due to lower energy and commodity costs flow through to consumption and consumers, account for 70% of

their GDPs.

Having considered the key themes that will drive 2016, we now look at specific economic regions and our expectations on their performance in 2016:

United States

US economy is expected to remain on a policy tightening path, however this is expected to be moderate in terms of the pace of increasing interest rates so as to protect the benefits achieved so far, with analysts projecting a maximum of 4 rate increases in 2016. The US economy is strong enough to warrant the gradual rate hikes, however (i) tighter financial conditions when it comes to credit disbursement, (ii) weak global demand, and (iii) the strengthening US Dollar will probably keep GDP growth rate at around 2%.

Eurozone

Eurozone growth is estimated to come in at 1.5% for 2015, and we expect further growth in 2016 on the back of (i) increased stimulus by the European Central Bank (ECB), (ii) an increase in private investment, (iii) the notable strong growth in the peripheral countries of Spain and Italy, and (iv) the increase in domestic demand given higher consumer confidence and falling oil prices, which increase consumption expenditure.

However, a key risk remains to Eurozone growth, inflation; with inflation struggling to reach a 1% level and may complicate growth prospects. A key factor for the weaker inflation is partly disinflationary pressures in Eurozone countries, as a result of (i) unemployment remaining well above the long-term average, (ii) average Eurozone GDP growth rate still well below 2%, and (iii) the renewed decline in world oil prices.

China

China witnessed a significant slowdown in the industrial side of the economy in 2015 as the country transitioned: (i) from industrial-driven to consumer and services driven growth, with lower dependence on the export market, and (ii) to a free-market economy from the controlled market it was previously. The trend is expected to continue into 2016, causing disinflationary effects on the global economy. However, the services sector has been much more resilient, and expected to account for a much larger share of GDP, driving GDP growth in 2016 to estimates of 6.5%. In addition, in early 2016, further stimulus is expected by the People?s Bank of China (PBoC) as the economy transitions and financial conditions to access credit remain tight.

Kenya 2016 Macroeconomic Outlook

2015 was a year characterized by a challenging macroeconomic environment, which saw GDP growth downgrades by the IMF, World Bank and the Treasury, from 6.9%, 6.0% and 6.9% to 5.6%, 5.4% and 6.0%, respectively. The growth projections were ambitious and based on high government spending on infrastructural developments. However, during the year, the growth was deemed unachievable mainly due to a tough operating environment characterized by high interest rates and a depreciating shilling, hence the respective downgrades. 2016, being a unique year as it precedes the Kenyan General Elections of 2017, the political environment is bound to take the center stage and be among the key determinants of spending and government policy. However, based on past experiences, the business community might ignore the politicking and focus on business. We expect high level of government spending in their infrastructural developments as they race to make strides, which they can leverage on for votes. These includes roads, railways and airports at the national and county level, where devolution has taken centre stage and placed the onus on county leaders to drive development in their elected areas. Security concerns have reduced and this is

expected to be a key support factor for economic growth in the year.

There has been gradual increase in the growth of private sector credit for the most part of 2015, private sector growth has been within the CBK target of 18%. Rapid credit growth often, but not always, underpins strong growth in asset prices such as housing or equities. With the reversal of capital flows, the prices of such markets can often correct quite sharply and rather quickly. However, we expect credit growth to maintain the momentum going into 2016, and barring any volatility in the interest rate environment, the credit growth rate should increase.

In the 2015/16 fiscal year, overall expenditure was projected at Kshs. 2.0 tn (30.6% of GDP), up 11.1% from the estimated Kshs. 1.8 tn (31.6% of GDP) for the 2014/15 fiscal year. This expenditure was to be financed by tax collection (1.4 trillion), domestic borrowing (219.0 bn) and foreign borrowing (357.0 bn), with the balance from grants and aid (73.5 bn). The government having missed their tax collection target for the first quarter of the 2015/16 fiscal year by Kshs 28 bn, we expect the Excise Duty Bill to increase their tax income and the Tax Procedural Bill to help ease their tax collection mechanisms. However, the government may not meet their 2016 tax collection targets, and of keynote is that all proposed increases in excise and VAT have been done before, been unsuccessful, and limited efforts are being made to target the growing informal sector, which would provide a large source of taxable revenues. With this in mind, the government may need to look for other ways to finance the budget. However, based on past experiences, this has not been an issue since expenditure has always been below target as was the case in the first quarter of the fiscal year. Given the conditions in the global markets, floating of a sovereign bond might be difficult and also very expensive, especially given the recent noise around the Eurobond cash usage. This would mean that the budget deficit might be higher than the current 8.7% of GDP.

We also expect the government to step up domestic borrowing to cover for maturities and offset any deficit in any of their financing avenues. In the next budget reading, in June, we expect an expansionary budget, focused on further infrastructural developments. Given our view that tax increases will not meet expectations, and that steps to target the informal sector are limited, we expect the increased budget to be underpinned by larger domestic and foreign borrowing to continue financing the budget deficit and may put pressure on borrowing since the debt to GDP has increased to 58.7% in 2015, compared to 44.2% in 2014. The increased government borrowing in the current and the next fiscal year may result in an upward pressure on interest rates.

In terms of GDP growth, 2016 is shaping up to be a more promising year for investments, underpinned by strong performance in key sectors among them energy, construction, information and communication and the recovery of tourism. We are however of the view that Agriculture and Financial Intermediation, which contributed 24.9% and 5.4% to GDP, respectively, will grow at a slower pace than 2015. The main driver of a slower growth in Agriculture is the expectations of drought, which usually comes after an El ? Nino phenomenon. The expected volatility in interest rates shall affect the Financial Intermediation sector, due to the added uncertainty. We expect Agriculture and Financial Intermediation to grow at 3.6% and 6.5%, respectively in 2016, compared to 4.7% and 7.6% in 2015.

Overall, we expect the economy to grow at between 5.5% and 6.0%. This is despite the challenges of (i) uncertainty of interest rates, (ii) inflation at levels above 8.0%, and (iii) the weakening shilling.

After depreciating by 13% in 2015, the Kenya Shilling is expected to remain under pressure in 2016 due to:

- Strong dollar in the global market,
- Continued infrastructure and real estate investments, leading to increased importation of capital goods, and,
- Reduced capital inflows into the capital markets given the flight to quality by investors from

emerging and frontier markets.

Despite all these challenges, the Kenya Shilling currently seems supported by (i) the current account deficit, which has narrowed to 6.9% in Q4?2015 from 10.4% in Q1?2015, (ii) the forex reserves remain high at 4.6 months of import cover above the 4 months target threshold, (iii) diaspora remittances have continued to increase, 7.7% y/y based on the 12 month cumulative inflows of USD 1.5 bn from USD 1.4 bn the previous year, (iv) approval for the USD 688 mn (Kshs 70 bn) precautionary IMF facility to provide a buffer to protect the shilling against any economic shocks, and (v) increased activity by the Central Bank in support of the shilling through liquidity management. All these considered, we project an 8.5% depreciation in the shilling to Kshs 111.8 by the close of 2016.

2015 witnessed relatively low inflation rates, which remained in the single digit levels, however increasing to a 16-month high of 8.0% by December due to (i) increase in food prices due to El-nino rains, and (ii) increases in food, beverage and cigarette prices owing to the amendment to the Excise Duty Bill. In 2016, despite the decline in oil prices in the international markets, inflation will remain high driven by:

- **El ? Nino rains and the drought thereafter** ?This will have an uptick effect on food prices as destruction of crops and roads caused by the El ? Nino rains are still persistent in the early months of 2016. Meteorologists predict a drought after the El ? Nino rains and this will also affect food prices, which contribute 36.0% of the CPI
- **Effect of the amended Excise Duty tax** ? price increases on goods will persist into Q1?2016 as manufacturers will continue to pass on the charge down to the consumers
- **VAT tax on petroleum products** - In September 2016, the Government will impose a 16.0% VAT on petroleum products, offsetting any effect of low oil prices.

Hence, we expect inflation to be above the CBKs target but within the single digit levels, as it supports economic growth, with minimal Central Bank Rate increases.

Below is a summary of the various macro-economic factors and the possible impact on the business environment in 2016:

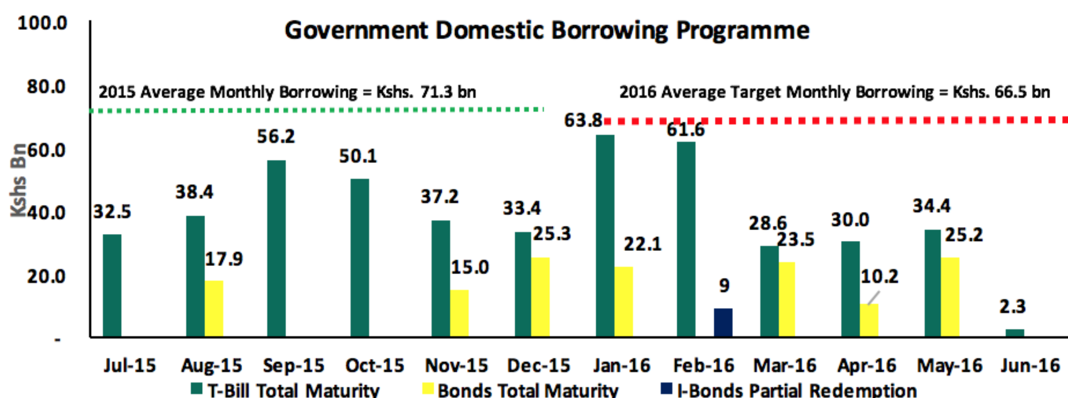
Macro-Economic Indicators	Outlook ? 2016	Effect
GDP	5.5% - 6.0% growth in 2016	**Positive**
Interest Rates	Upward pressure on rates in 2016	**Negative**
Inflation	To remain within single digit levels, but above CBK?s upper bound of 7.5%	**Neutral**
Exchange Rate	Shilling to depreciate against major currencies	**Negative**
Corporate Earnings	Stock market seems to be fairly valued, trading at a PE of 12.8x compared to historical average of 13.8x. Assumption of corporate earnings growth rate of approximately 10.0% gives a forward PE of 11.9x ? 11.6x compared to historical averages.	**Neutral**
Investor sentiment	Flows out of Kenya from the rate hike have been priced into the market, and neutral stance on corporate earnings means no large foreign investor inflows	**Neutral**
Security	Expected to improve given Government initiatives to eradicate extremism	**Positive**

Fixed Income 2016 Outlook

The Government?s domestic borrowing programme is currently on track, having borrowed Kshs. 130.5 bn in the first half of the fiscal year against a target of Kshs. 114.1 bn (assuming a pro-rated borrowing throughout the financial year of the budgeted Kshs. 219 bn of total domestic borrowing for this year). However, this is under threat given the large amounts of maturities of Kshs. 85.9 bn in

January, Kshs. 70.3 bn in February and Kshs. 52.0 bn in March. As indicated previously in this report, the upward pressure on rates as the government seeks to finance the budget will be mitigated by an increase in liquidity in the economy from these same maturities. Large participants in the Government T-bill programmes are financial institutions, who currently lack suitable fixed-income investment options to invest their funds.

In order to meet their domestic borrowing target and cover for the large amounts of maturities, the government needs to borrow an average of Kshs. 66.5 bn every month, as illustrated in the graph below.



We believe that in order to meet their borrowing target and refinance their obligations, the government will have to accept more from the 182-day and 364-day papers from the money market, and issue more bonds as they will mature in the 2016/2017 fiscal year.

In 2015, the high interest rate environment was mainly as an effect of aggressive government borrowing by the government to finance the budget and to finance the repayment of maturing obligations and the same can be seen with the high amounts of maturities in the final half of this fiscal year, totaling Kshs 310.7 bn, compared to 306.0 bn in the first half.

We expect volatility in interest rates environment in 2016, as the government will be keen to meet their domestic borrowing target and repay the obligations as they fall due. Our view is that rates will increase, however not at the rates and / or levels witnessed in 2015, where the 91-day T-bill peaked at 22.5%.

The impact of the high and volatile interest rate environment is expected to result in subdued activity in the secondary bonds market, as investors will prefer high yielding treasury instruments in the primary market. Liquidity in the money market is expected to increase given the high amounts of maturities of government securities.

In 2015, Kshs 21.5 bn was raised in the primary corporate bonds market as shown below. Corporate bond activity in the secondary market was high, with turnover increasing by 33.7% to Kshs. 2.8 bn from Kshs 2.1 bn in 2014.

Below is a summary of the companies that floated corporate bonds in 2015 and the amounts raised.

Company	Date	Bond Value (Kshs bns)
Centum	15-Jun-15	6.0
Imperial Bank	25-Aug-15	2.0
Chase Bank	10-Jun-15	4.8
Family Bank	26-Oct-15	2.0
Real People	10-Aug-15	1.6
EABL	23-Mar-15	5.0
Total		**21.5**

In 2016, we expect subdued activity in the primary market for corporate bonds due to the expectation that interest rates will be high and volatile, and this will be detrimental to any company raising capital in the debt market.

Going by the results of the recent Infrastructure bond tap sale which was seriously undersubscribed, and was offering a tax exempt yield of 14.8% (equivalent to a taxable yield of 17.4%) for a weighted tenor of 7 years, investors will continue demanding significant premiums to invest in Treasury instruments.

As a result,we maintain our view that investors should be biased towards short-term fixed income instruments for 2016 given the expected volatility in the interest rate environment.

Equities 2016 Outlook

The year 2015 witnessed a slump in the equities market with NASI and NSE 20 both falling 10.6% and 21.0%, respectively, and having the highest number of listed firms reporting profit warnings during a particular year at 16.

Going into 2016, the factors that will affect the direction of the equities market include:

- **Corporate Earnings:** Corporate earnings are expected to remain subdued in 2016, owing to the high interest rate environment, depreciating shilling, inflationary pressures and a slowdown in credit growth. Hence, we expect earnings for listed firms to grow by approximately 10.0% during the year;
- **Foreign Investor Sentiment:** Foreign investor risk appetite for securities in emerging and frontier markets has reduced following the expected path of monetary policy tightening in the US that has made the US market more attractive. Despite the bleak prospects for a recovery in corporate earnings in 2016, we expect Kenya to continue to attract relatively the same levels of foreign investor flows as 2015, given that these rate hikes and alternative market destinations for investment have already been priced into the market;
- **Interest Rates:** We expect upward pressure on interest rates in 2016, which will result in a decline in private sector credit growth, stifling business expansions and resulting in lower revenue for firms;
- **New Listings:** We do not expect many major listings at the Nairobi Securities Exchange in 2016. We do however expect an increase in products offered, due to continued acceptance of REITs, the expected introduction of the futures exchange and derivatives trading at the bourse;
- **Diversification of Capital Markets:** Following Stanlib Investments Kshs 3.6 bn REIT that started trading at the NSE, we expect other property developers to issue more REITS in the future. This will thus increase asset allocation towards the equities market.

As can be seen in the table below, we expect a pick up in the equities market activity in 2016, supported by (i) relatively high expected GDP growth rate for the year at between 5.5% -6.0%, (ii) political stability in the country, (iii) attractive valuations, with the market currently at a PE of 12.9x compared to 14.8x at the same time last year, and (iv) the same level of foreign investor flows that drive the market.

Equities Market Drivers	Outlook - 2016	Effect
Macro-economic environment	Key metrics are expected to be relatively favorable; inflation within single digit, 5.5% - 6.0% GDP growth and currency within the range bound.	**Neutral**

Corporate earnings growth and Valuations (P/E)	Stock market seems to be fairly valued, trading at a PE of 12.8x compared to historical average of 13.8x. Assumption of corporate earnings growth rate of approximately 10.0% gives a forward PE of 11.9x ? 11.6x compared to historical averages.	**Neutral**
Investor Sentiment	Flows out of Kenya from the rate hike have been priced into the market, and neutral stance on corporate earnings means no large additional foreign investor inflows.	**Neutral**

We revise our 2016 recommendation slightly upwards to ?NEUTRAL? from ?neutral with a bias to negative? on equities since, despite the lower earnings growth prospects for this year, the market decline so far has made the valuations attractive. The market remains purely a stock pickers? market, with few pockets of value.

Next week we will name the "Cytonn 10", our portfolio of the 10 best Kenyan stocks to hold in 2016.

Private Equity Outlook

As it was the case in 2015, we expect increased activity in the Sub-Saharan Africa region and in particular, Kenya. Kenya has remained a preferred capital haven for both local and global private equity firms driven by (i) ease of doing business, (ii) high return potential across all sectors, (iii) a well-diversified economy, and (iv) ease of exit for PE investors.

Private equity players have remained sector-focused all across their investments. This is expected to remain the trend in 2016, with the key focus sectors being:

- **Financial Services:** Financial services will be a key focus for most of the private equity funds. Despite a high level of financial inclusion in Kenya, the sector still offers high growth opportunities driven by adaptions and innovation. The focus on financial services sector is driven by (i) a rapidly growing and entrepreneurial population and demand for credit in Kenya, (ii) growing financial services inclusion in the region, (iii) increased innovations around financial tools with the financial sector, and (iv) increasing ease of exit in the financial services sector.
- **Healthcare:** Health remains a key area of focus in 2016 for vast majority of the PE firms. Kenya is currently underserved in healthcare driven by (i) low level of investment into the sector, and (ii) relative high cost of medical services, and (iii) failure of the Government to provide basic services which has created room for private capital to drive growth. Private equity involvement in this sector cuts across the whole value chain, from Dispensaries, Hospitals and Pharmacies.
- **Education:** Education sector remains a lucrative investment sector in Kenya. There is an increased interest in the private sector to provide education in the country given the high reliance on government / public schools. The growing middle class has remained supportive of the sector, with a desire to send their children to aspirational private schools.
- **Information and Communications Technology (ICT):** This is also a sector of interest, driven by a young and dynamic Kenyan population. Kenya has registered rapid growth in ICT, driven by entry of global brands, entrepreneurial business offering services and a supportive regulatory framework. We expect increased injection of private equity funds to drive further growth in this sector.

We remain bullish on PE as an asset class given (i) the abundance of global capital looking for opportunities in Africa, (ii) the attractive valuations in private markets compared to public markets, and (iii) better economic growth in Sub Saharan Africa as compared to global markets.

Real Estate

As per the latest data released by KNBS, the real estate sector?s year on year growth as at Q3?2015

was 5.4% and with the overall sector contribution to GDP remaining is 8%. The growth in the real estate sector has been driven by (i) heavy government investment in infrastructure, which has opened up satellite towns, for instance the Nairobi metropolis, towns such as Ruaka, Mlolongo and Athi River, (ii) the devolved government system that have also created investment and development opportunity in the counties as the onus is on each county to fund development, and (iii) favorable demographic trends, including the burgeoning middle class that is spurring development across all real estate sectors.

Below are the key drivers that shall drive Real Estate in 2016

- **Growing Middle Class**: The rapidly expanding middle class in the country is searching for affordable, secure, and aspirational living, which meets their housing needs. With the increased congestion within the crowded city centers, this middle class will have to be housed in the outskirts of Nairobi which have benefited from infrastructural upgrades
- **Huge Housing Deficit:** According to the National Housing Corporation (NHC), there is an effective housing deficit of over 200,000 units per annum to cater for the low to middle income market with Nairobi and its metro accounting for over 50%
- **Continued investment on Infrastructure:** Increased development along key infrastructural nodes, which have been brought about by the development bypasses e.g. Ruaka and Karen are now attractive real estate development zones. The SGR and LAPPSET corridors will also experience the same effect
- **Widespread Economic Growth:** Increased need for real estate development in devolved units to offer accommodation to the SMEs and the County staff. This is further increased through the rapid growth of SMEs which employ up to 85% of the work force and require space for office use
- **Demographic Trends:** such as the youth bulge (21 to 35 years), as well as rapid urbanization, have created an opportunity for development which caters to their needs e.g. middle-income housing, and their lifestyle e.g. suburban retail malls
- **Devolution and Political Goodwill:** Devolution is assisting real estate development as it is placing onus on the County governments to improve the real estate landscape, which has led to reduced bureaucracy and investment in infrastructure. Nevertheless, the upcoming general election in 2017 will see a slowdown in selected markets especially areas previously affected by political tensions in the past. For instance parts of Rift Valley, Nyanza region and the Coastal regions.

Below is a summary of our sectoral outlook:

Residential Sector

In 2015 there was increased interest in the low to middle income housing segment. Despite the interest, the number of units that come to market is difficult to ascertain but they remain significantly below the 200,000 units required per year. The prices of houses are varied depending on the location and type of houses. Rental yields for this market range from 5% to 8%, depending on the location of the development. In particular, apartments have been seen to earn higher yields ranging from 6.5% to 7%, while single detached units fetch lower yields ranging from 5% to 6%. This is because there?s higher demand for apartments due to their relative affordability. Three bedroom apartments in Westlands were found to offer the highest yields at 7.2% where apartments are sold at Kshs 25 mn and rent out at an average price of Kshs 150,000 per month.

Below is a summary of the yields from various markets within Nairobi:

Location	Type	Rental Income per month (Kshs.)	Sale Price (Kshs.)	Yield (%)
Westlands	Apt 3br	150,000	25,000,000	**7.20%**
Kilimani	Townhouses	250,000	65,000,000	**4.60%**
Ruaka	Apt 3br	35,000	10,000,000	**4.20%**
Lavington	Townhouses	200,000	60,000,000	**4.00%**
Rongai	Apt 3br	30,000	9,000,000	**4.00%**
Kitengela	Apt 3br	25,000	8,000,000	**3.80%**
Thika Rd	Apt 3br	35,000	12,000,000	**3.50%**
Karen	Villa (Modest)	200,000	75,000,000	**3.20%**
Langata	Apt 3br	50,000	20,000,000	**3.00%**
Kasarani	Apt 3br	35,000	20,000,000	**2.10%**

The rental growth in some of the high-end rental markets like Kilimani has been low in the year. We expect that this will remain the same this year as the market nears saturation point. We also expect the focus on low income housing to progress into this year as developers explore satellite towns and alternative building technology in a bid to provide more affordable housing.

Commercial Sector

Office yields have remained stable over the last couple of years ranging between 8 and 9% for prime offices and 7% for grade B Offices. In 2015 Grade A offices fetched higher rents of between 120 shillings to 150 shillings per month per square foot. While grade B offices fetched an average of 80 shillings. The average price per square foot of office space was approximately 12,000 shillings. Grade A offices had higher occupancy of averagely more than 80%, while Grade B offices had lower occupancy levels, averaging at 60%. These rates were more than a 10% decrease from 2014. Demand for Grade A offices has primarily been driven by multinationals setting up office in Nairobi, especially in the high end suburb areas of Lavington, Westlands, Kilimani, Gigiri and Karen. Grade B offices on the other hand, are oversupplied in some areas like Mombasa Road and there is thus a stagnation of rents and therefore yields. We expect development of Grade A offices to increase in 2016 as demand for them increases, they will also fetch higher rents and selling prices due to increase in land value.

Retail Sector

Retail developments have increased over the past few years driven by favorable demographic conditions. The average uptake of retail space is 75%. The rental prices of retail vary depending on the location, which influences the demand. In 2015, the rents paid by anchor tenants ranged from Kshs 50 to 100. Line shops rent rates also varied and they ranged from Kshs 150 to 400. The rental yields in the sector ranged from 6% to 11% depending on the type and location of developments. The high earners are the mixed-use developments (MUD?s) in the posh areas of Nairobi such as Kilimani. The notable trend was the entry of international retailers like Carrefour and the Game. In 2016 we expect to see a decrease in the rents as a result of increased supply. We expect more international retail and investment groups to enter the Kenyan market as they explore attractive emerging markets so as to tap into the growing middle class. We also expect to see an increase in the development of retail space in the counties as well owing to the population increase brought about by devolution.

Industrial Sector

Most industrial premises are owner built and hence uptake has not really been an issue. For the few constructed for commercial purposes, the uptake has been low, with low income of averagely 400 shillings per square metre per month verses 2100 shillings for offices and 4800 shillings for retail. The major factor-limiting uptake has however been substandard warehousing and buildings. This is

set to be corrected with more industrial parks being constructed in master planned cities and in dormitory towns, which have sufficient space. In 2016, we expect developers to construct more in the dormitory towns. We also expect land transactions to start taking off along the LAPPSET project as it continues to take shape. The rates and uptakes will also rise as demand for warehousing, logistical assembly parks and factory building rise with increased industrialization, improved infrastructure and the growing demand from the neighboring landlocked east Africa Countries. We also expect higher quality warehousing and factory building as the construction sector grows.

Hotel Sector

The industry?s performance is decreasing at a decreasing rate and this is an indication that the industry is recovering from its plunge in 2012. The performance was attributed to both internal and external shocks specifically, insecurity concerns, negative travel advisories. These resulted in a significant decline in bed occupancy, primarily due to reduced international tourists.

Despite the shortcomings, international hotels have increased their investment through brands such as The Simba Corporation, The Golf View Hotel, The Radisson Blu and the Grand Sapphire. There will see be additional 700 rooms in the next 1-2 years in Nairobi mainly from medium-priced hotels. In 2016, the Hospitality industry is expected to further improve citing reassurance of the security in the country hosted visits by the pope and the US president as well as the WTO Conference in December 2015.

The Hotel Industry in Kenya is highly dependent on the tourism industry. Other factors that boost the sector are: growth in the GDP translating into increased disposable income; increasing competition in the travel industry bringing down the air travel costs as well as incorporation of technology in the industry.

The Conferencing facilities saw a slowdown in 2015 hugely due to government cut in spending on conferencing. We expect growth in conferencing in 2016 due to increased appetite from the business traveler as the industry diversifies from overreliance on tourism.

Opportunities for hospitality industry are foreseeable as a result of:

- The expansion of BOMAS of Kenya to become the largest conference facilities in Africa
- Expansion of the Malindi Airport to allow landing of larger planes and hopefully international flights
- The proposed launch of direct flights to the USA by May 2016
- Growth in local tourism and business travel

Disclaimer: The views expressed in this publication, are those of the writers where particulars are not warranted- as the facts may change from time to time. This publication is meant for general information only, and is not a warranty, representation or solicitation for any product that may be on offer. Readers are thereby advised in all circumstances, to seek the advice of an independent financial advisor to advise them of the suitability of any financial product for their investment purposes.