Nairobi Metropolitan Area Commercial Office Report 2019 & Cytonn Weekly #14/2019

Real Estate

I. **Commercial Office**

Businesses continue to relocate their offices from the Central Business District (CBD) to upcoming business nodes in search of more exclusive locations, ample space, tranquility, and less congestion. During the week, I&M Bank announced that they will be relocating their head office from the Nairobi CBD to 1 Park Avenue building located in Parklands, come August this year. The new age building will be part of the real estate investment portfolio of the bank's property arm, I&M Realty. The 12,358 SQM building, whose cost remains undisclosed, will be partially owner-occupied while the rest of the space will be let out. According to the Nairobi Metropolitan Area Commercial Office Report 2019, Parklands area was one of the best performing areas in the commercial sector, recording a rental yield and occupancy rate of 8.4% and 86.0%, respectively, 0.3% points and 2.7% points above the market average of 8.1% and 83.3%, respectively, in FY'2018. This was mainly attributed to increased demand for office space by multinational companies given the supply of quality Grade A offices in the submarket, which in end enables developers to charge a premium on rentals.

The table below shows the FY'2018 performance of commercial office submarkets in Nairobi:

All values in Kshs unless stated otherwise

Nairobi Commercial Office Submarket Performance FY'2018

Commercial Nodes	Price Kshs/ SQFT FY 2018	Rent Kshs/SQFT FY 2018	Occupancy FY 2018(%)	Rental Yield (%) FY 2018
Gigiri	13,833	141	88.3%	**10.5%**
Karen	13,666	118	88.6%	**9.2%**
Westlands	12,050	110	82.1%	**9.0%**
Parklands	12,494	102	86.0%	**8.4%**
Kilimani	13,525	99	88.3%	**8.0%**
Upperhill	12,560	100	80.7%	**7.9%**
Nairobi CBD	12,425	89	88.3%	**7.6%**
Thika Road	12,517	86	81.5%	**6.7%**
Mombasa Road	11,400	79	65.6%	**5.8%**

All values in Kshs unless stated otherwise

Nairobi Commercial Office Submarket Performance FY'2018

Commercial Nodes	Price Kshs/ SQFT FY 2018	Rent Kshs/SQFT FY 2018	Occupancy FY 2018(%)	Rental Yield (%) FY 2018
Average	**12,719**	**103**	**83.3%**	**8.1%**

· Gigiri, Karen and Westlands recorded the highest rental yields at 10.5%, 9.2%, and 9.0%, respectively, attributed to increased demand by businesses and multinational companies due to proximity to CBD and other business nodes, high quality office space and relatively good infrastructure network,
· Thika Rd and Mombasa Rd, had the lowest returns with average rental yields of 6.7% and 5.8%, respectively attributed to traffic snarl-ups and low-quality office space

Source: Cytonn Research 2019

We expect local and multinational companies to continue focusing on high return areas such as Parklands, Westlands, Karen and Gigiri, with the aim of maximizing on returns in addition to leveraging on the high-quality office spaces in the areas. These will eventually result in the significant growth of the areas as commercial nodes, as firms seek to settle further from the congested Nairobi CBD.

II. **Listed Real Estate**

On 3rd April, 2019, the Nairobi Securities Exchange (NSE) admitted property development company, 'My Space Properties', under the Ibuka Incubator Programme, following a successful vetting of the subject company. The incubator experience is intended to give companies a realistic and practical feel of the listing process, as the interested firms have an opportunity to participate in a stage by stage, one on one, structured engagement with the Capital Markets Authority, the Nairobi Securities Exchange, Nominated Advisors (NOMADS), transaction advisors, lawyers, auditors, stockbrokers and investment banks, among other service providers, to allow for confidential Business-to-Business(B2B) discussions on their readiness for listing. My Space Properties plans to officially list after the incubation making it the second property developer to be listed in Kenya, the first one being Home Afrika Limited, which went public on 15th July 2013. We, however, note that listed real estate investment stocks have so far been performing poorly with low subscriptions and price declines, post listing;

i. Home Afrika was listed at an IPO price of Kshs 12.0 per share and has since lost 95.0% of its value to a price of Kshs 0.6 as at 5th April 2019,
ii. Stanlib Fahari i-REIT achieved only 29.0% subscription and is currently trading at Kshs 10.1 per unit, 49.5% below its listing price of Kshs 20.0 as at 27Th Nov 2015, and
iii. The Fusion D-REIT, in 2016, failed to list after attaining only 38.0% subscription, and thus failing to raise at least half of the initial gross proceeds it had targeted.

In our view, the main reasons listed real estate stocks have failed to gain momentum include inadequate investor knowledge and the poor performance of the same, for example with Home Afrika recording a 95.0% decline in the value of its share from its initial listing value. The development of a vibrant real estate capital market is necessary given;

i. the large amount of funding required for the reduction of the existing housing deficit in Kenya,
ii. the traditional sources of real estate funding, such as bank debt and private equity, are not sufficient to meet the financing demands required by real estate which is capital intensive, and
iii. the low credit lending to the private sector as the actual cost of credit remains high averaging at 16.7% due to additional administration fees, which raises the cost of development, thus making real estate development expensive for both developers and off-takers.

In order to improve the uptake and performance of listed real estate, the following needs to be done;

i. creation of awareness of the stocks thus enhance investor knowledge and confidence in the same,
ii. broad institutional support,
iii. simplify the process of incorporation to have a one stop shop solution,
iv. the new products may also require initially an industry initiative or government sponsorship, thus rather than each player trying to launch their own REIT, a few strong real estate and investment players should collaborate on a club deal that has broad support with the goal of not just economic viability but also proofing the REIT concept to the market,
v. bringing down the minimum amounts required for investments, as the current amounts, for example, the minimum of Kshs. 5 million for the Fusion D-REIT is very high and locks out most investors,
vi. most traditional money houses such as banks are not real estate specialists, yet REIT trustees are almost all banks, who are not historically good at alternative assets product innovation and development; the pool for REIT Trustees needs to be broadened, and
vii. improved corporate governance around issuance.

We expect the real estate sector to continue recording increased activities supported by the continued demand for office space in prime locations in addition to improved diversification of avenues aimed at raising capital by investors in the sector.