Cytonn Weekly #15/2019

Real Estate

I. **Industrial Parks Sector**

During the week, Knight Frank, a real estate management firm, released a report titled 'Africa Horizons: A Unique Guide To Real Estate Investment Opportunities' that highlighted investment opportunities within Africa with key focus in trade and investment, residential, food and technology in 2019. According to the report, the (i) African Continental Free Trade Agreement, (ii) increase in middle-income households, and (iii) competition for multilateral cooperation in Africa are the key factors driving general investment in Africa. The major take outs from the report include:

- Foreign Direct Investment (FDI) - Kenya is among the Top 5 recipients of FDI in Africa thus driving domestic investment projects, according to EY Attractiveness Report 2018,
- Investment in Student Housing - The number of students in Kenya is growing exponentially and current hostels cannot keep up with demand. The latest Kenyan National Bureau of Statistics estimates from 2017 put the number of students at 520,893 and with expected growth of youth between the age bracket of 15 and 24-years by 15% to 1.5 mn by 2023, this is likely to increase and operators in the student accommodation market already run near to full capacity,
- Hospitality – The Kenyan hospitality industry recorded Revenue per available room (RevPAR) and occupancy rates of Kshs 6,462 and 52.0%, respectively, 20.1% and 9.0% points below the market average of Kshs 11,207 and 61%, respectively,
- Kenya is the logistics hub of East Africa supported by the significant new investments into the sector, including the rail link between Nairobi and Mombasa, and the Kenyan Government's focus on the manufacturing sector under the Big 4 Agenda,
- Increasing demand for storage facilities and sophisticated logistics properties in Nairobi driven by continued expansion of international retailers such as Shoprite and Carrefour,
- The report foresees a continued shift in activities from the existing industrial area due to challenges such as poor infrastructure and high land costs, to satellite towns such as Ruiru supported by increased demand for centralized warehouses by retailers,
- The most significant logistics and light manufacturing development to take advantage of this improved accessibility is Tatu Industrial Park, which has sold off 80% of its first phase. Other notable industrial and warehouse parks include Africa Logistics Properties (APL) North and Tilisi Logistics Park.

This report findings are in line with our Cytonn H1'2018 Markets Review, which indicates that the industrial sector recorded improved performance with rental yields and occupancy rates increasing by 0.7% and 11.8% points, respectively, to 6.1% and 89.1% in H1'2018, from 5.4% and 77.3% in H1'2017, respectively. This was attributed to increased investor confidence as a result of a stable political climate and primary focus on manufacturing by the government as part of the Big 4 Agenda, and increased demand for Grade A warehouses by distribution, fast-moving consumer goods (FMCG) and construction companies.

We have a positive outlook for the industrial sector in Nairobi. We expect continued growth in the industrial sector with development of industrial parks and warehouses in areas with low supply, adequate infrastructure and affordable land prices such as Ruiru and Athi River supported by the government's goal to increase the manufacturing sector's contribution to GDP from 9.2% in 2016 to 20.0% by 2022 through establishment of industrial parks, Special Economic Zones, and implementation of policies to boost processing of textiles, leather, oil, gas, construction material, foods, fish, iron and steel

II. **Retail Sector**

Kenya's retail sector has been vibrant over the past few years, attracting interest from renowned international retailers as well as the robust expansion of local retailers. The trend continues, and during the week, American pizza restaurant, Domino's Pizza opened their seventh outlet in Kenya at Shell Petrol Station on Argwings Kodhek Road in Kilimani, Nairobi. In our view the international retailer's expansion into Kenya is supported by;

i. Increased disposable income as a result of an expanding middle class thus creating demand for high-end restaurants and casual dining areas, with GDP per Capita growing at a rate of 7.9% p.a over the last 5-years, from Kshs 113,539 in 2013 to Kshs 166,314 in 2017,
ii. A positive demographic dividend, with a population growth rate of approximately 2.5% p.a. and a high urbanization rate of 4.3%, compared to the global average of 2.1%, hence an increase in demand for restaurants, and,
iii. Stable economic growth, with Kenya's GDP growth averaging at 5.4% over the last five-years and set to come in at 5.8% in 2018 and expected GDP growth between 5.7% and 5.9% in 2019, according to Cytonn Research, thus, creating an enabling environment for the retailers to make desirable profits.

In our view, the Kilimani area presents a viable opportunity for the business due to its: (i) good infrastructure network and security, (ii) proximity to other commercial hubs such as Nairobi CBD, Westlands and Upperhill with several firms that regularly seek premises for business meetings, (iii) positioning as an affluent neighbourhood hosting middle to high-income earners with relatively high purchasing power, and (iv) attractiveness to a number of international organizations such as International Committee of the Red Cross (ICRC), Oxfam, among others, hence hosting a large expatriate population, who comprise of the restaurant's target market. The continued expansion of retailers will lead to increased retail space uptake in the area thus improving the overall performance of the sector. For investors in retail real estate, Kilimani area, which includes Kileleshwa and Lavington, records an average rental yield of 10.4% and occupancy rate 90.8%, compared to the market average rental yield and occupancy rate of 8.4% and 76.8%, respectively according to Cytonn Q1'2019 Markets Review. This therefore portrays Kilimani as a viable investment destination for both retailers and retail real estate developers.

The table below shows the summary of Nairobi Metropolitan Area submarket performance in Q1'2019:

Summary of Nairobi's Retail Market Performance – Q1'2019

Location	Rent Kshs/SQFT Q1' 2019	Occupancy Q1' 2019	Rental Yield Q1' 2019
Westlands	218	85.0%	11.5%
Kilimani	173	90.8%	10.4%
Ngong Road	173	90.0%	9.8%
Karen	225	73.6%	9.3%

Summary of Nairobi's Retail Market Performance – Q1'2019

Location	Rent Kshs/SQFT Q1' 2019	Occupancy Q1' 2019	Rental Yield Q1' 2019
Eastlands	154	72.7%	7.7%
Kiambu Road	169	69.8%	7.5%
Thika road	168	70.8%	7.3%
Mombasa Road	153	66.0%	6.8%
Satellite Towns	135	72.2%	6.3%
Average	**174**	**76.8%**	**8.4%**

- ***Kilimani recorded an average rental yield and occupancy rate of 10.4% and 90.8%, compared to the market average of 8.4% and 76.8%, respectively***

Source: Cytonn Research 2019

We expect the real estate sector to continue recording increased activities supported by the continued entry of international retailers and expansion of local retailers in prime locations in addition to capitalise on favourable returns in other sectors such as industrial parks.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com