NMA Mixed Use Developments Report 2019 & Cytonn Weekly#45/2019

Focus of the Week

Last year, we released the NMA Mixed-Use Developments (MUDs) Report 2018 that highlighted the performance of Mixed-Use Developments within the Nairobi Metropolitan Area in 2018. According to the report, MUDs performed better in 2018 recording average rental yields of 8.0%, 0.5% points higher than single-use themes average of 7.5%. Other than the retail sector, which recorded average rental yields of 8.5%, 1.0% lower than single-use retail, commercial office and residential themes within MUDs performed better with rental yields averaging at 8.2% and 5.6%, 0.3% and 0.6% points higher than single-use office and residential units which had market averages of 7.9% and 5.0%, respectively.

This week, we update our report based on research conducted in eight nodes within the Nairobi Metropolitan Area, comparing Mixed-Use Developments' performance against the market performance of the residential, commercial office, and retail sectors as of September 2019. The report shall cover the following:

i. Overview of Mixed-Use Developments (MUDs),
ii. Mixed-Use Developments Performance Summary in 2019, and
iii. Mixed-Use Developments Investment Opportunity and Outlook.

Section I: Overview of Mixed-Use Developments (MUDs)

A Mixed-Use Development (MUD) refers to a real estate development containing more than one real estate theme. Such a development would have two or more uses, that is, residential, retail, office, and hospitality, all in one location, and whose functions are to some degree physically and structurally integrated. These real estate developments can range from a single building to an entire neighborhood and aim to offer a variety of benefits such as housing, workplaces and other amenities within the same location. Mixed-Use Developments are designed to not only incorporate various types of real estate themes together but also complement them. Some of the major factors supporting the growth of Mixed-Use Developments include:

1. **Relatively Higher Developer Returns**: Over the past two years, rental yields in sole use office and retail properties have been on a downward trajectory owing to an oversupply in the majority of the commercial nodes within Nairobi. This downturn in performance has resulted in less speculative investment leading to an upturn in the new trend of mixed-use developments MUDs which promise better-diversified portfolio and returns from a project mix comprising of sectors that perform differently in the market,
2. **Demographic Growth:** According to the World Bank, Kenya's urban population grows at an average annual rate of 4.3%. This is in comparison to the Sub-Saharan and global rates of 4.1% and 1.2%, respectively. The rapid population growth calls for innovative real estate solutions that promote operational synergies and accommodate the population pressures with themes that complement each other,

3. **Foreign Investments:** Nairobi's status as one of the top dynamic cities in the world, evidenced by rankings in JLL's City Momentum Index Reports, continues to attract foreign investors with interests in emerging niches such as Mixed-Use Developments. For instance, Actis, a UK-based private equity firm is behind Garden City, along Thika Road, Aviation Industry Corporation of China (AVIC) is behind the upcoming Global Trade Centre in Westlands and also has ownership stake in Two Rivers Mall, the largest Mixed-Use Development in East and Central Africa, while UK-based Kiloran Development Group is behind the upcoming Beacon Mall, along Mombasa Road, and,
4. **Growth of the Middle Class:** Kenya's middle class continues to grow which means increased disposable income and demand for convenient lifestyles such as the ability to live, work and play in an environment that meets business, residential and social demands of modern lifestyles. This has created a niche for developers to connect workstations and residences promoting productivity and peak functionality to end buyers.

However, Mixed-Use Developments tend to face various challenges such as:

i. **High Development Costs:** This is owing to the size and intricacies involved in incorporating various real estate themes together. This is coupled by soaring land prices in Nairobi and other urban areas, with a price per acre within Nairobi County standing at Kshs 134 mn as at September 2019, driven by high demand due to population pressures and infrastructural improvements, and,
ii. **Inadequate Infrastructure:** The rapid growth of urban populations against the backdrop of inadequate infrastructure means overreliance on insufficient infrastructures such as sewer systems and roads. Thus, Mixed-Use Developments tend to procure own forms of infrastructure such as water, sewerage systems, and reliable electricity, which means incurring huge costs.

Section II: Mixed-Use Developments Performance Summary in 2019

A. **Summary of Thematic Performance in MUDs in Comparison to General Market Performance**

Mixed-Use Developments recorded average rental yields of 7.3%, 0.4% points higher than the respective single use retail, commercial office and residential themes with 6.9% in 2019. In 2019, retail, offices and residential spaces in MUDs recorded rental yields of 8.4%, 7.9% and 5.4%, respectively, compared to the single-use average of 8.0%, 7.7%, and 5.0%, respectively. This is attributed to increasing popularity for differentiating the mixed-use concepts due to convenience as a result of incorporated working, shopping and living spaces. However, MUDs recorded a 0.1% point y/y decline in performance to 7.3% in 2019 from 7.4% in 2018 attributed to a decline in effective demand and constrained consumer spending due to a tough financial environment as a result of the interest rates capping law that has since been repealed.

The table below shows the performance of single-use and mixed-use development themes between 2018 and 2019:

Thematic Performance of MUDs in Key Nodes 2018-2019

	MUD Themes Average		Single-Use Themes Average			
	Rental Yield % 2019	**Rental Yield % 2018**	**Rental Yield % 2019**	**Rental Yield % 2018**	**Δ in y/y MUD Rental yields**	**MUD vs Single-Use Rental Yield 2019**
Retail	8.4%	8.5%	8.0%	9.5%	(0.1%)	0.4%
Offices	7.9%	8.2%	7.7%	7.9%	(0.3%)	0.2%
Residential	5.4%	5.6%	5.0%	5.0%	(0.2%)	0.4%
Average	**7.3%**	**7.4%**	**6.9%**	**7.5%**	**(0.1%)**	**0.4%**

***Market performance is as at Q3'2019**
• Mixed-Use Developments recorded average rental yields of 7.3%, 0.4% points higher than the respective single-use retail, commercial office and residential themes with 6.9% in 2019
• MUDs recorded a declined performance a 0.1% point y/y to 7.3% in 2019 from 7.4% in 2018 attributed to a decline in effective demand and constrained consumer spending due to a tough financial environment

Source: Cytonn Research 2019

B. Mixed-Use Developments Performance per Node

Kilimani was the best performing node recording average rental yields of 9.1% with the retail and office spaces recording rental yields of 9.6% and 8.4%, respectively, 1.2% points and 0.5% points higher than the sector average of 8.4% and 7.9%, respectively. The performance is driven by high occupancy rates in addition to premium rental rates charged as the area serves a prime commercial and affluent neighbourhood with areas such as Kileleshwa and Lavington, hosting a large portion of Nairobi's high-end and upper-middle-class population.

Limuru Road was ranked second with average rental yields of 8.0%, largely driven by its attractiveness as a retail destination with malls such as Two Rivers. Mombasa Road and Eastlands were the worst performing areas recording rental yields of 5.7% and 5.5%, respectively attributed to low rental charges as a result of competition from informal Mixed-Use Developments.

The table below shows the performance of Mixed-Use Developments by node in 2019:

NMA Mixed-Use Developments Market Performance by Nodes 2019

	Retail Performance				Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price/SQM**	**Rent/SQM**	**Ann. Uptake %**	**Rental Yield %**	**Avg. MUD yield**
Kilimani	17,702	172	82.6%	9.6%	13,770	126	74.8%	8.4%					9.1%
Limuru Rd	22,500	223	72.0%	8.6%	13,500	130	72.0%	8.3%	177,935	842	25.0%	5.7%	8.0%
Karen	23,333	163	85.0%	7.3%	13,380	137	86.0%	10.6%	215,983	821	26.7%	4.6%	8.2%
UpperHill	15,552	127	71.3%	7.0%	12,673	100	78.7%	7.4%					7.4%
Westlands	15,876	172	72.8%	9.6%	12,917	113	68.7%	7.1%	204,603	810	31.0%	4.8%	7.4%
Thika Rd	26,250	200	84.5%	8.3%	13,890	128	71.0%	8.0%	161,910	640	30.1%	4.8%	6.0%

NMA Mixed-Use Developments Market Performance by Nodes 2019

	Retail Performance				Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price/SQM**	**Rent/SQM**	**Ann. Uptake %**	**Rental Yield %**	**Avg. MUD yield**
Msa Rd	19,200	150	68.0%	6.4%	13,200	100	52.0%	4.7%	171,304	722	23.0%	5.1%	5.7%
Eastlands	20,000	132	72.0%	5.7%	12,000	100	68.0%	6.8%	81,717	350	20.0%	5.5%	5.5%
Average	**18,846**	**167**	**77.3%**	**8.4%**	**13,227**	**118**	**73.4%**	**7.9%**	**167,909**	**689**	**26.5%**	**5.0%**	**7.3%**

**** Mixed-Use Developments in Kilimani and Upper Hill areas had no residential spaces***
• Kilimani was the best performing node recording average rental yields of 9.1% with the retail and office spaces recording rental yields of 9.6% and 8.4%, respectively, 1.2% and 0.5% points higher than the sector average of 8.4% and 7.9%, respectively
• Mombasa Road and Eastlands were the worst performing areas recording rental yields of 5.7% and 5.5%, respectively attributed to low rental charges as a result of competition from informal Mixed-Use Developments

Source: Cytonn Research 2019

C. Performance of Real estate Themes in MUDs versus Single-themed Developments' Performance

In our Mixed-Use Development analysis, we looked into the performance of the retail, commercial office and residential themes:

i. Retail Sector

Retail spaces in Mixed-Use Developments recorded average occupancy rates and rental yields of 77.3% and 8.4%, respectively, 2.2% points and 0.4% points higher than the single use retail market average of 75.1% and 8.0% in 2019, respectively. The better performance of retail spaces in Mixed-Use Developments is attributed to the convenience of the spaces as one-stop centres for consumers living and working in the area.

Kilimani and Westlands are the best-performing nodes in both single and Mixed-Use Development recording rental yields of 9.6% and 9.4%, respectively in mixed-use development themes. This is mainly attributed to the nodes serving the upper middle income and high-end population. Mombasa Road and Eastlands were the worst performers recording rental yields of 6.4% and 5.7%, respectively, a 2.0% and 2.7% points, lower than the MUD average of 8.4%, attributed to low rental charges as property managers look to attract smaller retailers.

The table below provides a summary of the performance of retail spaces in MUDs against market performance:

(All Values in Kshs Unless Stated Otherwise)

Performance of Retail in MUDs versus Single- Use Market Performance 2019

	MUD Performance			Single-Use Retail Performance			
Location	**Rent/ SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Kilimani	172	82.6%	9.6%	170.4	87.2%	9.9%	(0.2%)

Performance of Retail in MUDs versus Single- Use Market Performance 2019

	MUD Performance			Single-Use Retail Performance			
Location	**Rent/ SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Westlands	170	72.8%	9.4%	203.6	84.6%	9.2%	(0.5%)
Limuru Rd	223	72.0%	8.6%	166.0	61.7%	6.8%	1.8%
Thika Rd	200	84.5%	8.3%	165.4	73.5%	7.5%	0.9%
Upper Hill	127	71.3%	7.0%				
Karen	163	85.0%	6.8%	207.9	77.0%	9.1%	(2.3%)
Msa Rd	150	68.0%	6.4%	148.1	64.0%	6.3%	0.1%
Eastlands	132	72.0%	5.7%	145.0	74.5%	7.5%	(1.8%)
Average	**166**	**77.3%**	**8.4%**	**168.6**	**75.1%**	**8.0%**	**0.4%**

**** Single-Use retail performance is as at Q3'2019***
• Kilimani and Westlands are the best-performing nodes in both single and Mixed-Use Developments recording rental yields of 9.6% and 9.4%, respectively in mixed-use development themes
• Mombasa Road and Eastlands were the worst performers recording rental yields of 6.4% and 5.7%, respectively

Source: Cytonn Research 2019

ii. **Commercial Office Space**

Commercial office spaces in MUDs performed better than single-use office spaces recording rental yields of 7.9%, 0.2% points more than the former at 7.7% as at Q3'2019. The improved performance is attributed to the better quality of space and additional amenities offered in mixed-use developments compared to single-use office spaces. Karen and Kilimani were the best-performing office spaces in MUDs recording average rental yields of 10.6% and 8.4%, respectively, while Mombasa Road was the worst-performing recording occupancy rates and rental yields of 52.0% and 4.7%, respectively.

The table below shows the performance of office spaces in MUDs against the Single-Use commercial market in 2019:

(All Values in Kshs Unless Stated Otherwise)

Performance of Commercial Offices in MUDs versus Single- use Market Performance 2019

	MUD Performance				Single-Use Office Performance				
Location	**Price/SQFT**	**Rent/ SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/ SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Rental Yield Difference**

Performance of Commercial Offices in MUDs versus Single- use Market Performance 2019

	MUD Performance				Single-Use Office Performance				
Location	**Price/SQFT**	**Rent/ SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/ SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Rental Yield Difference**
Karen	13,380	137	86.0%	10.6%	13,665	111	84.6%	9.0%	1.6%
Kilimani	13,770	126	74.8%	8.4%	12,680	91	81.2%	7.2%	1.3%
Limuru Rd	13,500	130	72.0%	8.3%	13,833	116	79.6%	9.2%	(0.9%)
Thika Rd	13,890	128	71.0%	8.0%	12,600	88	80.9%	6.6%	1.5%
Upper Hill	12,673	100	78.7%	7.4%	12,397	98	81.5%	7.6%	(0.2%)
Westlands & Parklands	12,917	113	68.7%	7.1%	12,369	101	80.7%	8.5%	(1.4%)
Msa Rd	13,200	100	52.0%	4.7%	11,400	73	68.7%	5.7%	(1.0%)
Average	**13,227**	**118**	**73.4%**	**7.9%**	**12,638**	**96**	**80.5%**	**7.7%**	**0.2%**

Limuru Road includes Gigiri area
**** Single-Use office performance is as at Q3'2019***
• Commercial office spaces in MUDs recorded rental yields performed better with offices in MUDs recorded better rental yields recording 7.9%, 0.2% points more than the single-use office market average of 7.7%
• Karen and Kilimani were the best-performing office spaces in MUDs recording average rental yields of 10.6% and 8.4%, respectively

Source: Cytonn Research 2019

iii. Residential Space

Residential units in Mixed-Use Developments recorded average rental yields of 5.4% in 2019, 0.4% points more than the single use residential market rental yields of 5.0% as at Q3'2019. Residential units in MUDs also recorded average price and rent per SQM of Kshs 157,909 and Kshs 689, respectively, above the single- use market average of Kshs 112,003 and Kshs 540, respectively. Thika Road was the best performing area recording rental yields of 6.4% driven by higher uptake of 30.1% compared to the average uptake of 26.5% attributed to increased demand for units in the area boosted by affordability in comparison to the upper markets.

The table below summarizes the performance of residential spaces in MUDs against the single- use market in 2019:

(All Values in Kshs Unless Stated Otherwise)

Performance of Residential Units in MUDs versus Single- Use Market Performance 2019

	MUD Performance				Single-Use Residential Performance				
Location	**Price/SQM**	**Rent/SQM**	**Uptake %**	**Rental Yield %**	**Price/SQM**	**Rent/SQM**	**Uptake %**	**Rental Yield %**	**Rental Yield Difference**
Thika Rd	124,045	640	30.1%	6.4%	79,478	433	17.6%	5.8%	0.6%

Performance of Residential Units in MUDs versus Single- Use Market Performance 2019

	MUD Performance				Single-Use Residential Performance				
Location	**Price/SQM**	**Rent/SQM**	**Uptake %**	**Rental Yield %**	**Price/SQM**	**Rent/SQM**	**Uptake %**	**Rental Yield %**	**Rental Yield Difference**
Limuru Rd	177,935	842	25.0%	5.7%	98,979	507	20.4%	4.9%	0.8%
Eastlands	81,717	350	20.0%	5.5%	79,802	362	24.0%	5.5%	0.0%
Msa Rd	171,304	722	23.0%	5.1%	80,290	368	22.1%	4.9%	0.2%
Westlands	204,603	810	31.0%	4.8%	145,299	806	24.2%	4.8%	(0.0%)
Karen	215,983	821	26.7%	4.6%	188,172	763	20.9%	4.2%	0.4%
Average	**157,090**	**689**	**26.5%**	**5.4%**	**112,003**	**540**	**21.5%**	**5.0%**	**0.4%**

**** Single-Use residential performance is as at Q3'2019***
• Residential spaces in Mixed-Use Developments recorded rental yields of 5.4% in 2019, 0.4% points more than the single-use residential market rental yields of 5.0%
• Thika Road and Limuru Road were the best performing areas recording rental yields of 6.4% and 5.7%, respectively

Source: Cytonn Research 2019

Section III: Mixed-Use Developments Investment Opportunity and Outlook

The table below summarizes our outlook on Mixed-Use Developments (MUDs), where we look at the general performance of the key sectors that compose MUDs i.e. retail, commercial office and residential and investment opportunities that lies in such the themes:

Mixed-Use Developments (MUDs) Outlook

Sector	2019 Sentiment and Outlook	2019 Outlook
Retail	• Retail spaces performance in Mixed-Use Developments (MUDs) was relatively higher compared to the single-use market average by 0.4% points recording average rental yields of 8.4% compared to the market's yield of 8.0% as at Q3'2019 • Average occupancy rates for the spaces in MUDs was higher by 2.2% points averaging at 77.3% compared to the single-use retail market average of 75.1% attributed to the preference of spaces in MUDs as a result of traffic gained from consumers who prefer convenient areas that allow for work, shopping and residence • However, we attribute the decline in the performance of MUDs to 8.4% in 2019 from 8.5% in 2018, to competitive rates offered by single-use retail spaces.	**Neutral**
Office	• Commercial office spaces in MUDs performed better than single-use office spaces recording rental yields of 7.9%, 0.2% points higher than the office market average of 7.7% as at Q3'2019 • Performance of office MUDs, however, declined y/y by 0.3% points to 7.9% in 2019 from 8.2% in 2018 attributed to a tough operating environment and oversupply of office space within the Nairobi Metropolitan Area by 5.2 mn SQFT • For investors, incorporation of serviced offices will give better returns with yields of 13.5% compared to the unserviced offices market average of 7.9% as at Q3'2019	**Neutral**
Residential	• Residential units in Mixed-Use Developments recorded average rental yields of 5.4% in 2019, 0.4% points higher than the single- use market rental yields of 5.0% as at Q3'2019. • Uptake of residential units in MUDs came in at 26.5%, 5.0% points higher than the single-use market average of 21.5% as at Q3'2019 mainly attributed to higher demand for residential units in MUDs as a result of ease of access to amenities such as shopping, working spaces and entertainment areas as opposed to stand-alone residential spaces • For investors, we recommend residential units within MUDs as they are performing better with average rental yields of 5.4%, compared to 5.0% for those within purely residential developments	**Positive**
Outlook	**The outlook for Mixed-Use Developments (MUDs) is neutral mainly due to attractive returns compared to single-use themes. However, the sector remains constrained mainly due to oversupply of space by 2.8 mn SQFT and 5.2 mn SQFT in the retail and office sectors. The investment opportunity within the Nairobi Metropolitan Area is in areas with high returns such as Kilimani and Limuru Road recording rental yields of 9.1% and 8.5%, respectively.**	

Source: Cytonn Research 2019

Despite the 0.1% point drop in rental yields performance to 7.3% in 2019 from 7.4% in 2018, MUDs still offer an attractive investment as the development provides diversified revenue streams for property owners and improves the overall return on investment. We expect investors' returns to be dependent on the composition of mixed-use concepts due to sectors such as retail and office having an oversupply of 2.8 mn SQFT and 5.2 mn SQFT, respectively as at 2018. We recommend Kilimani and Limuru Road as the major investment zones given the relatively high rental yields of 9.1% and 8.5%, respectively, above the market average of 7.3%. The investment strategy for mixed-use developments lies in incorporating differentiated concepts such as serviced apartments and offices which provide attractive returns of 6.4% and 13.5%, respectively, compared to the unserviced

apartments and office space yields of 5.1% and 7.9%, respectively, as at Q3'2019.