Nairobi Metropolitan Area Commercial Office Report

"*Tenant Driven Market*"

Cytonn

Date: April 7th, 2019

Table of Contents

I. Overview of Real Estate in Kenya

Cytonn

Introduction to Real Estate in Kenya

Our outlook for the sector is neutral as it is mainly constrained by high financing cost for both developers and off-takers

Factor	Characteristics
Macro-economic Contribution	• In Q3'2018, real estate recorded an average growth rate of 5.3%, a 0.7% points decline from 6.0% recorded in Q3'2017 according to the KNBS Q3 2018 GDP Bulletin. The sector's contribution to GDP remained at 8.7% in Q3'2018 and Q3'2017 • The slowdown in growth is attributed to reduced effective demand in the market, evidenced by the 3.0% decline in the residential sector occupancy rates in 2018, and the increased supply of mall space in the retail sector recording a growth of 4.8% y/y in Nairobi to 6.5 mn SQFT in 2018 from 6.2 mn SQFT in 2017
High Returns	• Real estate has consistently outperformed other asset classes in the last 5 years, generating average returns of 20.1% p.a., compared to an average of 8.7% p.a. in the traditional asset classes • The sector recorded rental yields of 8.1% in the commercial office sector, 9.0% in the retail sector, 4.7% in the residential sector, 8.0% in mixed use developments (MUDs) and 7.4% in serviced apartments in 2018
Recent Developments	• The real estate sector has seen entry of more institutional and international players in the market. For instance, Milost a US based company bought a stake into Kings Pride Properties and India's Tata Housing Development Company announced a Ksh 15 bn joint venture cash call with the National Housing Bank and an unnamed real estate firm, • The Government kicked off the affordable housing initiative as part of the Kenyan Government's Big 4 Agenda, launching of projects such as the Pangani Estate in Nairobi
Market Outlook	• Our outlook for the sector is neutral as it is mainly constrained by real estate space surplus in the market and limited access to financing for both developers and off takers • The real estate sector has pockets of value such as housing for lower-middle to low-income earners in the residential sector, serviced apartments and Mixed-Use Developments (MUDs)

Introduction to Real Estate in Kenya –RE Contribution to GDP

Real Estate and construction sectors contribution to GDP declined slightly to 14.5% in Q’3 2018 from 15.1% in 2017

	2000	2010	2017	Q3 2018
Agriculture	31.3 %	23.7 %	16.8 %	18.9 %
Manufacturing	17.0 %	11.5 %	9.3 %	9.6 %
Wholesale & Retail Trade	16.5 %	7.1 %	7.7 %	8.7 %
Hospitality & Tourism	16.5 %	1.7 %	1.5 %	1.3 %
Real Estate & Construction	10.5 %	12.6 %	15.1 %	14.5 %

Source: KNBS

2. Nairobi's Commercial Office Report

Executive Summary

The Commercial Office Sector performance improved marginally in 2018, recording rental yields of 8.1%

- We carried out a research on the commercial office theme in Nairobi. The report aims to inform on the supply and performance of the commercial office sector in Nairobi in 2018
- In 2018, 4.3mn SQFT of office space was delivered in Nairobi with an average occupancy level of 83.3%. This resulted in a supply of 9.0mn SQFT against a demand of 3.8mn SQFT and thus an oversupply of 5.2mn SQFT. The oversupply was 10.8% higher than in 2017 at 4.7mn SQFT. Assuming current occupancy levels persist, we expect a 7.6% increase in oversupply to 5.6mn SQFT in 2019
- On performance, average occupancy rates increased by 0.7% points from 82.6% in 2017 to 83.3% in 2018 with rental yields increasing by 0.2% points from 7.9% in 2017 to 8.1% in 2018
- In the submarket analysis, Gigiri and Karen had the highest returns with average rental yields of 10.5% and 9.2%, respectively with Thika Rd and Mombasa Rd having the lowest returns with average rental yields of 6.7% and 5.8%, respectively. Grade B office spaces had the highest rental yields at 8.4%, Grade A offices had an average rental yields of 8.1%, while Grade C offices had the lowest average rental yields of 7.9%. Grade B offices were the most common in the market with a market share of 58.1%
- We have a negative outlook for investments in the commercial office market in Nairobi, given the increase in supply and expected stagnation in performance. We thus recommend for investment in the sector only for the long run and in specific pockets of value; These are
    i. Differentiated concepts such as serviced offices with yields of on average 13.5%, higher than conventional office space yields of 8.1% and
    ii. New markets such as in county headquarters most of which have low quality office spaces and in short supply and emerging commercial zones such as Gigiri
- We expect market performance to stagnate in 2019 constrained by the oversupply and the low credit supply inhibiting both development and offtake finance

Nairobi's Commercial Office Report – "*Tenant Driven Market*"

The opportunity lies in differentiated concepts such as serviced offices and new markets such as County Headquarters

Value Area	Summary	Effect on The Office Market
Oversupply	• In 2018, the market had a supply of 9.0mn SQFT against a demand of 3.8mn SQFT resulting in an oversupply of 5.2mn SQFT. We expect the oversupply to increase by 7.6% to 5.6mn SQFT in 2019	• Asking rents increased marginally by 1.6% to an average of Kshs 103 per SQFT from Kshs 101 per SQFT in 2017, while asking prices increased by 0.6% to Kshs 12,719 in 2018 from Kshs 12,649 in 2017, attributable to the oversupply of 5.2 mn SQFT office space as at 2018
Returns	• Rental yields and occupancy rates increased slightly by 0.2% points and 0.7% points, respectively to 8.1% and 83.3% in 2018 from 7.9% and 82.6%, respectively in 2017 due to the increased demand driven by increased economic activities • The best performing nodes in the office sector were Gigiri and Karen with rental yields of 10.5% and 9.2%, respectively, with Thika Road and Mombasa Road having the lowest yields at 6.7% and 5.8%, respectively	• The yields were still attractive at 8.2% compared to market average at 7.4% • The oversupply will, however constrain performance further with yields expected to soften to average at 8.0%
Opportunity & Outlook	• We have a negative outlook for the commercial office theme in Nairobi and thus investment should be geared to the long-term horizon for gains when the market picks • Investments should be made in zones with low supply and high returns such as Gigiri and in differentiated concepts such as serviced offices recording a rental yield of up to 13.5% to boost returns	• Reduced development activity in the markets with high supply such as Upperhill and low returns such as the CBD • A buyers market as the office market undergoes correction, therefore giving tenants bargaining power

The opportunity lies in differentiated concepts such as serviced offices and new markets such as County Headquarters

A. Introduction

Key Factors **Driving** Office Market in Kenya

Nairobi as a Regional Hub, Devolution, and growth of SMEs are some of the factors driving the Office Market

Factor	Characteristics
Nairobi as a Regional Hub	• In 2019, Nairobi was ranked #6 in JLL's City Momentum Index, notably as the only city outside Asia Pacific region to rank top 20. The rise in rank from #10 in 2018 is attributable to infrastructural investment and the robust start-up culture. This is set to attract foreign direct investments. As per the EY Attractiveness Report 2018, Kenya recorded a 68% increase in inward investment projects • Recently, Mauritius Commercial bank and Nairobi Overseas Centre by Enterprise Singapore, opened offices in Nairobi signaling the robustness of Nairobi's commercial scene
Devolution	• Demand for office spaces has persistently increased over time due to Devolution. The emergence of devolved governments has thus led to increased need for office spaces in counties to cater for County Governments and businesses that are expanding to county headquarters therefore leading to increased development of commercial office spaces • Notable developments in counties include upcoming Jesus House of Praise building in Meru, Pension Towers in Eldoret, and The County Mall in Nyeri, with notable developers showing interest in counties including AMS properties in Kisumu, Fusion Capital in Meru and Cytonn Investments in Nyeri,
Growth of Small and Medium Sized Enterprises (SMEs)	• SMEs contributed to approximately 45% of Kenya's GDP, 80% of employment in Kenya and constituted 98% of businesses locally according to a CNBC News Report 2014 and are thus a key driver for the commercial office sector. The start-up culture also led to Nairobi's ranking as #6 Most Dynamic City in the World by JLL

Challenges Affecting Office Sector

Access to finance, increase in supply, and insufficient infrastructure will affect the office Market

Factor	Characteristics
Accessibility to Finance	• Lack of proper funding for developments has resulted in use of expensive debts in the funding structure that affect the supply of office spaces due to its capital intensive nature • Banks have reduced credit advancement to small and medium sized companies as a result of the interest rates cap that stands at 13.0% (CBR rate at 9.0%), hence private sector credit growth came in at 4.4% in October 2018, compared to a 5-year (2013-2018) average of 14.0% • Despite the capping of interest rates, the actual cost of credit is still high averaging at 18.0% due to additional administration fees, which then raise the cost of development, thus making development expensive for both developers and off takers
Supply	• Due to the relatively high returns in the office market, and demand from multinational firms, developers nonetheless focus heavily on construction of office buildings with the supply as of 2018 coming in at 9.0 mn SQFT against a demand of 3.8 mn SQFT, hence an oversupply of 5.2 mn SQFT. This signals a competitive market for developers while the bargaining power rests with tenants who have a wide variety of office spaces to choose from
Infrastructure	• Insufficient trunk infrastructure such as roads, sewer and water connection in some areas in Nairobi, due to rapid increase in developments and population hence straining the infrastructure in place • For example Nairobi has a 50% sewer coverage, 17% in Kiambu, and 15% in Machakos, a clear indication of insufficient infrastructure hence increasing cost of development as it is translated to developers as they try provide these infrastructures in their developments

B. Highlights in the Commercial Office Sector

Highlights in the Commercial Office Sector - 2018

High Court ruled held that Value Added Tax is not payable on residential and commercial land transactions

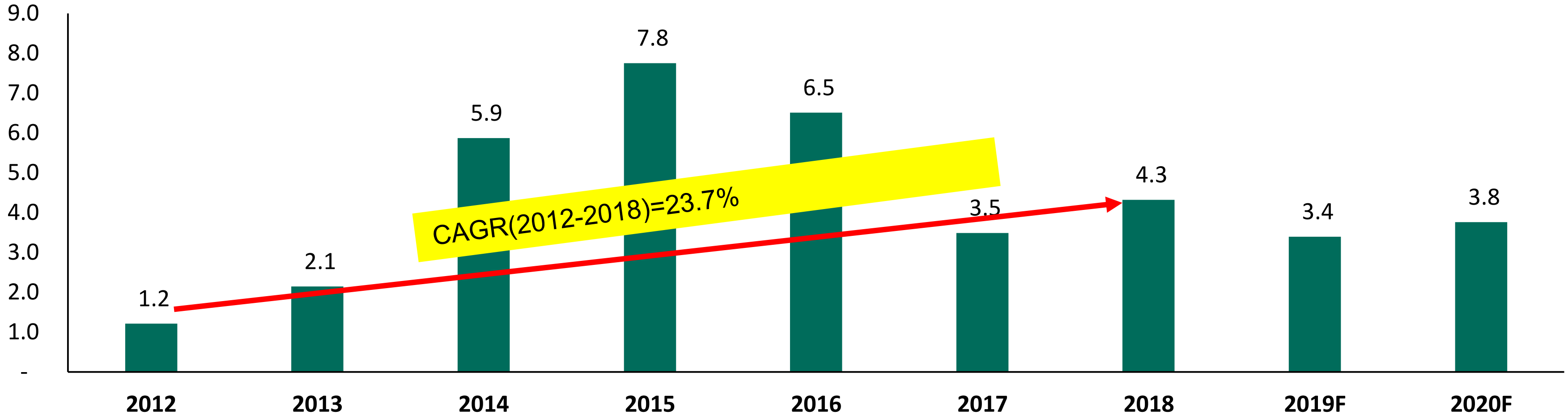
Highlight	Details
New Developments	• New office buildings were officially opened for occupation such as Britam Tower (349,240sqft) and Prism Towers (482,000sqft) in UpperHill, One Africa Place (138,004sqft) and The Promenade (215,999sqft) in Westlands and Victoria Towers (85,002sqft) in Two Rivers along Limuru Road • The market witnessed the start of construction of more office blocks with various offices such as Garden City Business Park and U.S Embassy Annex breaking ground in 2018
Business Relocations	• Coca Cola, a multi-national beverage company, announced that it was relocating the company's headquarters for the East and Central Africa Region from Upperhill office to newly built office facility in 90 James Gichuru office in Lavington, Nairobi • The European Union (EU) delegation to Kenya announced its headquarters' relocation from Union Insurance House along Ragati Road in Upperhill to Dunhill Towers along Waiyaki Way in Westlands. Other relocations during the year included Centum who relocated from International House in the CBD to South Tower in Two Rivers
Office Property Sales & Acquisitions	• The Ethics and Anti-Corruption Commission's (EACC), Kenya's Anti-Corruption Agency acquired the Integrity Centre Building, along Valley Road, Nairob for a value of Kshs 1.5 bn from Tegus Limited. The building which is built on 1.2 acres was purchased by Tegus Limited in 2003 at Kshs 400 mn, thus providing a return of 30.3% p.a. over 5-years • Other office properties put up for sale included Emperor Plaza, and Kenya Methodist University (KEMU) Hub, in Nairobi CBD, for Kshs 750 mn and Kshs 1.7 bn, respectively,
Statutory review	• The High Court ruling held that Value Added Tax is not payable on transactions for the sale or purchase of land regardless of whether the buildings constructed on the land are residential or commercial. The ruling declared that the charge of VAT on commercial land was in contravention of Clause 8 of Section B of the Value Added Tax Act, which exempted the sale, renting, leasing, hiring, and letting of land or residential premises from VAT. The ruling stands pending the hearing and determination of the Appeal

C. Commercial Office Supply in Nairobi

Commercial Office Space Supply-Nairobi

Oversupply is expected to result in reduced office development, leading to a market correction as the forces of demand and supply come into play

Office Completions (Mn SQFT)

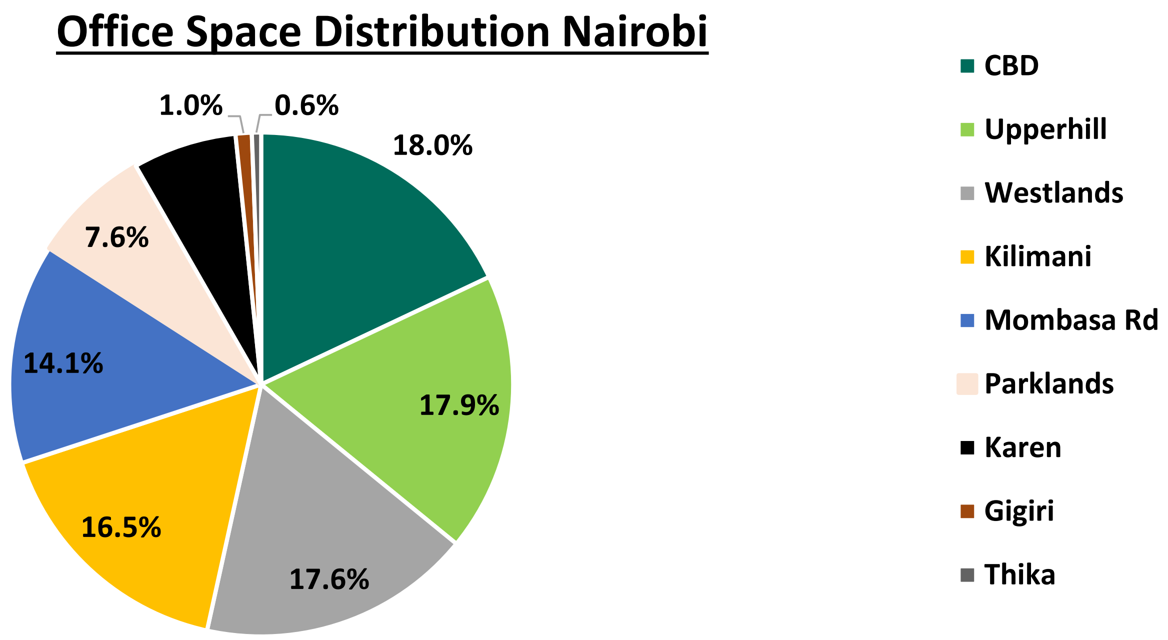


- The total office stock in Nairobi increased by approximately 4.3 mn SQFT in 2018, 23.9% higher than in 2017, due to completion of office complexes such as Prism Towers (482,000 SQFT) in UpperHill, One Africa Place (138,004 SQFT) and The Promenade (215,999 SQFT) in Westlands and Victoria Towers (85,002 SQFT) in Two Rivers along Limuru road
- Office space supply has grown at 23.7% CAGR between 2012 and 2018, driven by demand from growing SMEs and multinationals setting up operations in the country being the regional hub for East Africa
- Over the next two years, office space completions are expected to decline by a 2-year CAGR of 6.0% due to market correction as the forces of demand and supply come into play

Source: Nairobi Building Approvals Data from Nairobi City

Commercial Office Space Supply – Nairobi Continued…

CBD, Upperhill and Westlands had the largest supply, with market shares of 18.0%, 17.9% and 17.6%, respectively with a cumulative market share of 53.5%



- In 2018, the CBD, Upperhill and Westlands had the largest supply of office space in Nairobi with a market share of 18.0%, 17.9% and 17.6%, respectively out of the total office supply and a cumulative market share of 53.5%, while Gigiri and Thika Road had the lowest supply with a market share of 1.0% and 0.6%, respectively
- Westlands and Kilimani have grown as business nodes as firms move away from the CBD and Upperhill due to traffic congestion and in search of better quality space, hence the high supply

Source: Cytonn Research

D. Commercial Office Market Performance

Commercial Office Market Performance Summary

The performance of the commercial office space in Nairobi improved in 2018, recording 0.2% points and 0.7% points y/y increase in average rental yields and occupancy rates

Year	2011*	2013*	2015*	2016*	2017*	2018	y/y Δ 2017	y/y Δ 2018
Occupancy (%)	91.0%	90.0%	89.0%	88.0%	82.6%	**83.3%**	(5.4%)	**0.7%**
Asking Rents (Kshs/SQFT)	78	95	97	97	101	**103**	4.2%	**1.6%**
Average Prices (Kshs/SQFT)	10,557	12,433	12,776	12,031	12,649	**12,719**	5.1%	**0.6%**
Average Rental Yields (%)	8.1%	8.3%	8.1%	8.5%	7.9%	**8.1%**	(0.6%)	**0.2%**

Rental yields for FY'11 to FY'17 restated to include average market occupancy rates. The average rental yield for offices published in our previous reports assumed 100% occupancy rates

- The performance of the commercial office space in Nairobi improved marginally in 2018, recording a 0.2% points and 0.7% points y/y increase in average rental yields and occupancy rates to 8.1% and 83.3% from 7.9% and 82.6%, respectively, in 2017. The positive performance was largely driven by:
    - Political stability that led to improved macroeconomic environment , with the GDP growing at 6.0% in Q3'2018, higher than the 4.7% recorded in Q3'2017, and expected to close at 5.8% for the year 2018, and
    - The positioning of Nairobi as a regional hub and thus increased entrance of multinationals creating demand for commercial offices.
- Asking rents increased marginally by 1.6% to an average of Kshs 103 per SQFT from Kshs 101 per SQFT in 2017, while asking prices increased by 0.6% to Kshs 12,719 in 2018 from Kshs 12,649 in 2017. We attribute the slow rise in rents and prices to the oversupply of 5.2 mn SQFT of office space as at 2018

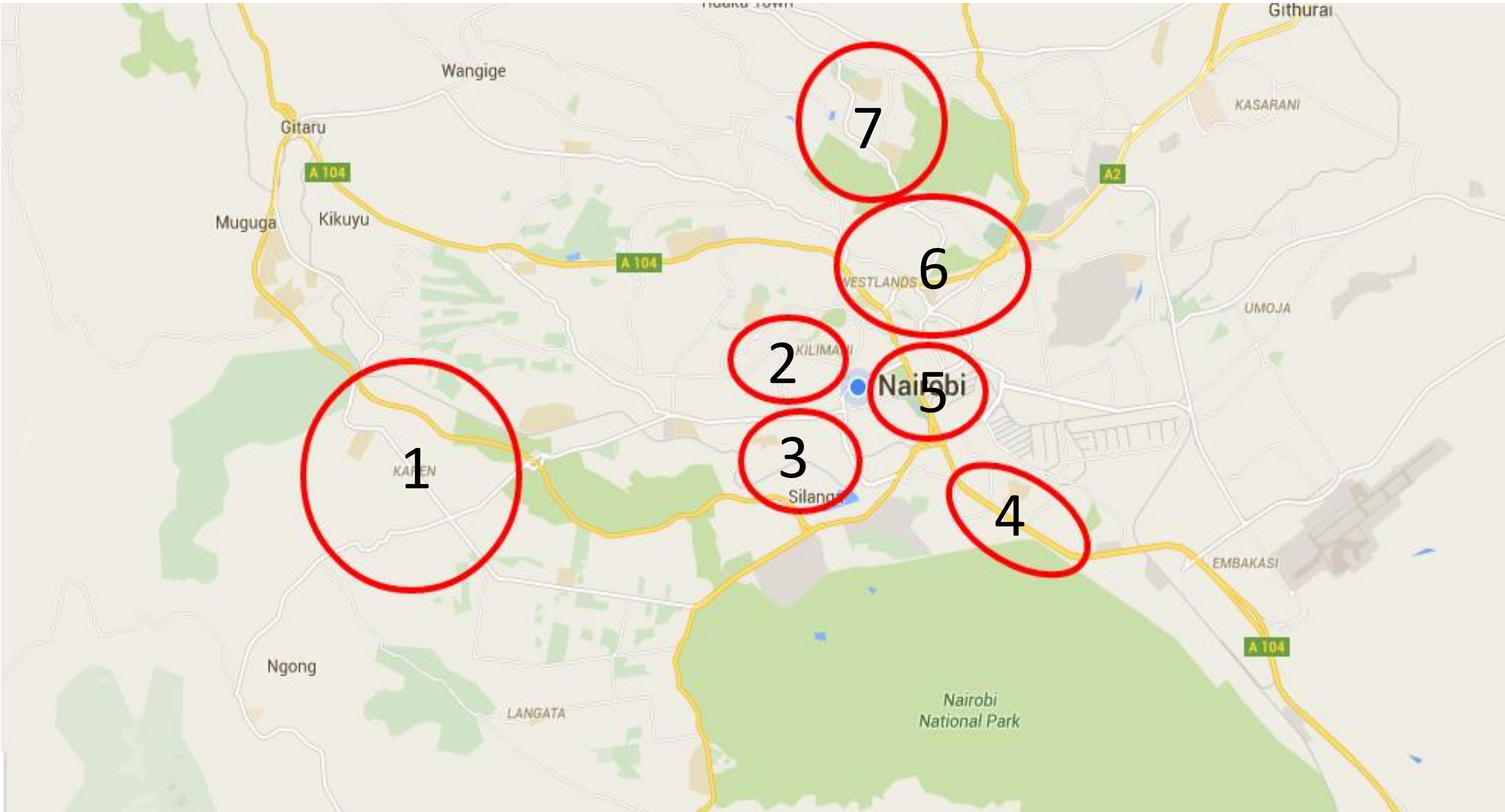
Source: Cytonn Research

i. Performance by Nodes

Cytonn

Nairobi Office Market

The key nodes of focus are in Karen, Kilimani, Westlands, Msa Rd, Nairobi CBD, Parklands and Gigiri



Key: 1. Karen 2. Kilimani 3. Upper Hill 4. Mombasa Road 5. CBD 6. Westlands 7. Gigiri

Nairobi Office Market Performance

Gigiri and Karen were the best performing nodes with average rental yields of 10.5% and 9.2%, respectively

Commercial Nodes	Price Kshs/ SQFT FY 2018	Rent Kshs/SQFT FY 20178	Occupancy FY 2018(%)	Rental Yield (%) FY 2018	Price Kshs/ SQFT FY 2017	Rent Kshs/SQFT FY 2017	Occupancy FY 2017(%)	Restated Rental Yield (%) FY 2017	Δ Rent Y/Y	Δ Occupancy Y/Y (% points)	Δ Rental Yields Y/Y (% points)
Gigiri	13,833	141	88.3%	10.5%	13,750	138.3	81.4%	9.8%	1.9%	6.9%	0.7%
Karen	13,666	118	88.6%	9.2%	13,167	113.0	89.2%	9.2%	4.7%	(0.6%)	0.0%
Westlands	12,050	110	82.1%	9.0%	12,872	103.0	88.5%	8.5%	6.5%	(6.4%)	0.5%
Parklands	12,494	102	86.0%	8.4%	12,729	103.0	85.7%	8.3%	(0.9%)	0.3%	0.0%
Kilimani	13,525	99	88.3%	8.0%	12,995	99.0	82.0%	7.5%	(0.1%)	6.3%	0.5%
Upperhill	12,560	100	80.7%	7.9%	12,901	101.0	84.5%	7.9%	(1.2%)	(3.8%)	(0.1%)
Nairobi CBD	12,425	89	88.3%	7.6%	12,286	88.0	84.1%	7.2%	0.9%	4.2%	0.4%
Thika Road	12,517	86	81.5%	6.7%	11,500	82.0	73.6%	6.3%	5.3%	7.9%	0.4%
Msa Road	11,400	79	65.6%	5.8%	11,641	82.0	74.2%	6.3%	(4.0%)	(8.6%)	(0.5%)
Average	12,719	103	83.3%	8.1%	12,649	101.0	82.6%	7.9%	1.6%	0.7%	0.2%

Source: Cytonn Research

- Location and quality of office space continue to be the main factors determining office performance in Nairobi with Gigiri and Karen recording the highest yields of 10.5% and 9.2%, respectively
- Areas affected by traffic snarl ups, low quality office space and are not necessarily primary business nodes such as Mombasa Rd, Thika Rd and Nairobi CBD had the lowest returns with average rental yields of 5.8%, 6.7% and 7.6%, respectively

Nairobi Office Market Performance, Continued…

Offices in prime locations, with low supply and high quality offices had the highest returns with on average rental yields of more than 9.0%, these include, Gigiri, Karen and Westlands

Gigiri

- Gigiri recorded an average rental yield of 10.5% in 2018, a 0.7% points increase from the 9.8% recorded in 2017. The increase was mainly as a result of increased demand by multinational companies who are looking for serene environment (not too populated with offices), security and quality Grade A offices. The area, is still attractive for investments mainly driven by the low supply of office space, currently accounting for 1.0% of office space in Nairobi Metropolitan area

Karen

- In 2018, Karen performance flattened retaining an average rental yields of 9.2%, with the area recording higher rental charges of Kshs. 118 per SQFT, 14.6% above the market average at Kshs. 103 per SQFT, due to the premium charged for quality offices and the prime location. The area still presents attractive returns given the availability of development land at relatively low prices of on average Kshs 55.8 mn an acre facilitating development of Grade A offices with ample spaces attractive to multinational companies

Westlands

- In 2018, Westlands recorded average rental yields of 9.0%, a 0.5% points increase from the 8.5% recoded in 2017. The node's attractive performance is mainly as a result of high demand by business and multinational companies due to ease of access, high quality office space and as it is a prime business district housing the headquarters of several multinationals including Google and Squared. Investments in the node, should however, be made sparingly as the node has a high supply with the 3rd largest market share at 17.6%, only behind CBD and Upperhill and with several developments in the pipeline such as Le' mac 85,000 SQFT, The Address 243,000 SQFT, and Global Trade Centre (GTC) 678,000 SQFT thus developing in the market has significant market risk

Nairobi Office Market Performance, Continued…

Kilimani and Upperhill will witness a decline in development activities due to high office space supply in the nodes

Parklands

- Parklands recorded an average rental yield of 8.4% in 2018, a 0.1% points increase from the 8.3% recorded in 2017. The area's positive performance is mainly driven by its proximity to the CBD and Westlands, ample infrastructure and favourable zoning regulations facilitating densification. In the short to medium term we expect to continue witnessing an increase in development activities in the area

Kilimani

- Kilimani is increasingly replacing Upperhill and Westlands as the business address of choice boosted by its proximity to CBD and an upper middle income neighbourhood, improved infrastructure, relatively lower land prices, relaxed zoning regulations and sufficient accommodation facilities. In 2018, the area recorded a rental yield of 8.0%, 0.5% points higher than in 2017 at 7.5%. Going forward, we expect returns in the market to soften as result of the increase in supply with a notable building in the pipeline being Xinhua Tower and accounting for 16.5% of the market share

Upperhill

- Upperhill's performance remained flat, with rental yields averaging at 7.9%. The market is undergoing a price correction that saw the rents reduce by 1.2% y/y. The reduction is attributable to the fact that the area is losing its appeal due to traffic congestion and an oversupply of office space even as developers expand to seemingly more attractive nodes such as Karen and Gigiri. We expect the downward pressure on rents and yields to persist in Upperhill given that the area has an oversupply of approximately 1.7mn SQFT

Nairobi Office Market Performance, Continued…

Mombasa Rd, Thika Rd and Nairobi CBD had the lowest returns with average rental yields of 5.8%, 6.7% and 7.6%, respectively

Nairobi CBD

- Previously the main business district, it is transforming to playing a retail and educational function with offices moving out of the zone in search of better environments and better quality office spaces. This has resulted in a rental yield of 7.6%, 0.5% points lower rental yield compared to the market average at 8.1% due to lower monthly rental charges to boost occupancy rates

Thika Road

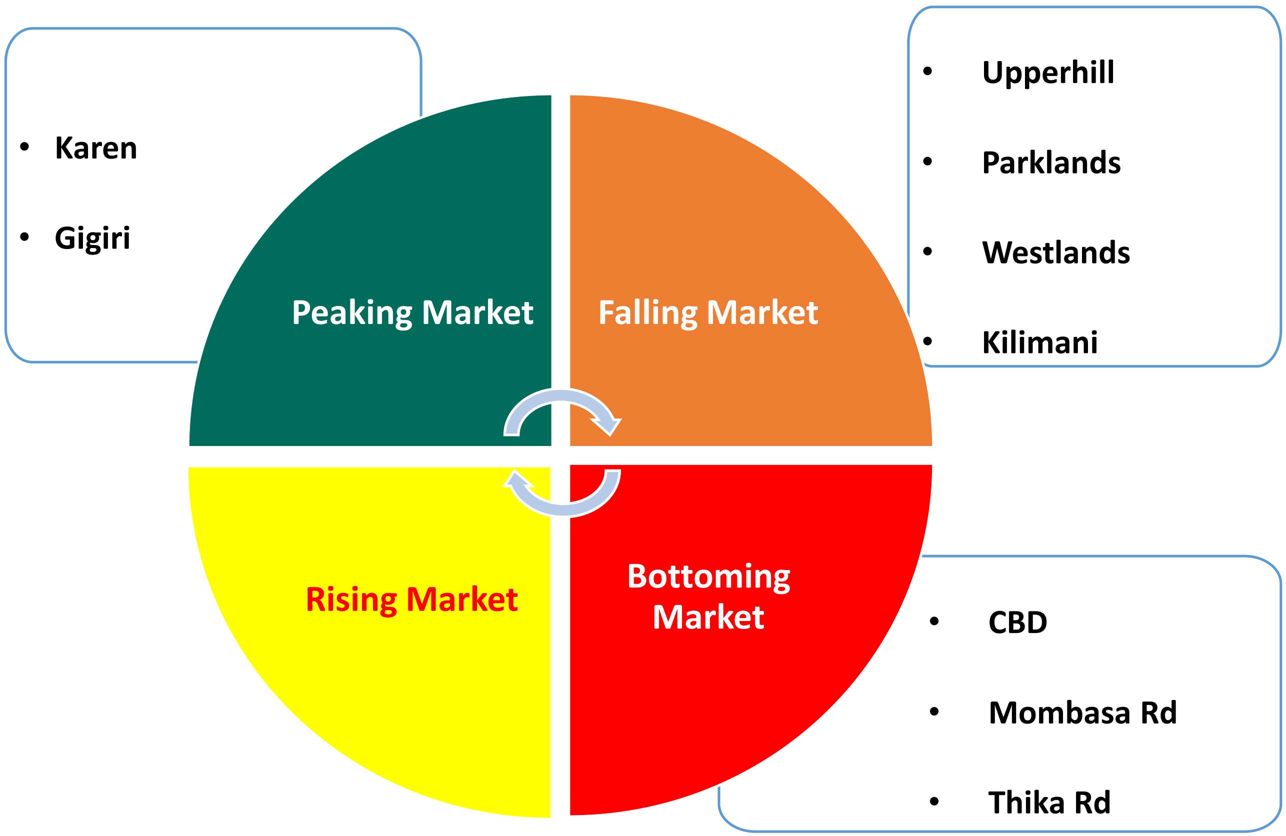
- A fairly new office zone, the node suffers from low quality office space and perception of being a middle income residential area and hence low rents which averaged at Kshs 86 Per SQFT per month with an average rental yield of 6.7%. Thika road is however positioning itself as an upcoming office node, with high quality office space such as the incoming Garden City Business Park expected to boost the profile of the area and consequently lead to better returns

Mombasa Road

- As has been the case in the past, Mombasa Road recorded the lowest rental rates in the market averaging at Kshs 79 per SQFT resulting in average yields of 5.8%. The area attracts low rents due to traffic congestion and its zoning for industrial use, though newly built high quality office space such as in the Next Gen Mall can attract higher yields and occupancy rates

Nairobi Office Market 2018 Summary

The market is a buyers market with Karen and Gigiri being at the peaking phase, Upperhill, Westlands, Parklands and Kilimani in the falling phase and the CBD, Thika Rd and Mombasa Rd bottoming out



Rising Market:
- Strong demand
- High pricing
- Limited Supply

Peak Market
- Strong demand spurs new supply
- Strong pricing above replacement costs
- Supply underway

Bottoming Market
- Stagnant demand
- High Vacancies
- Very low pricing

Falling Market
- Low demand
- Vacancies and supply
- Low Pricing

The market is fully a buyers market with seven out of the nine nodes being buyers/ tenants market and only two being developers market

Source: Cytonn Research using JLL Clock

ii. Performance by Grades

Cytonn

Classification of Offices in Nairobi

Kenya has various types of offices according to the global classification

GRADE A

- Ideally Grade A buildings should occupy more than 200,000 square feet. Very few buildings in Nairobi meet this threshold. Therefore for our research, we have used office buildings with a total area ranging from 100,000-300,000 square feet that are pace setters in establishing rents and that generally have ample natural good lighting, good views, prestigious finishing and on-site undercover parking
- Grade A buildings provide state of the art technical services such as high quality elevators, fittings and automation systems. They provide ample parking at a minimum ratio of 3:1000

GRADE B

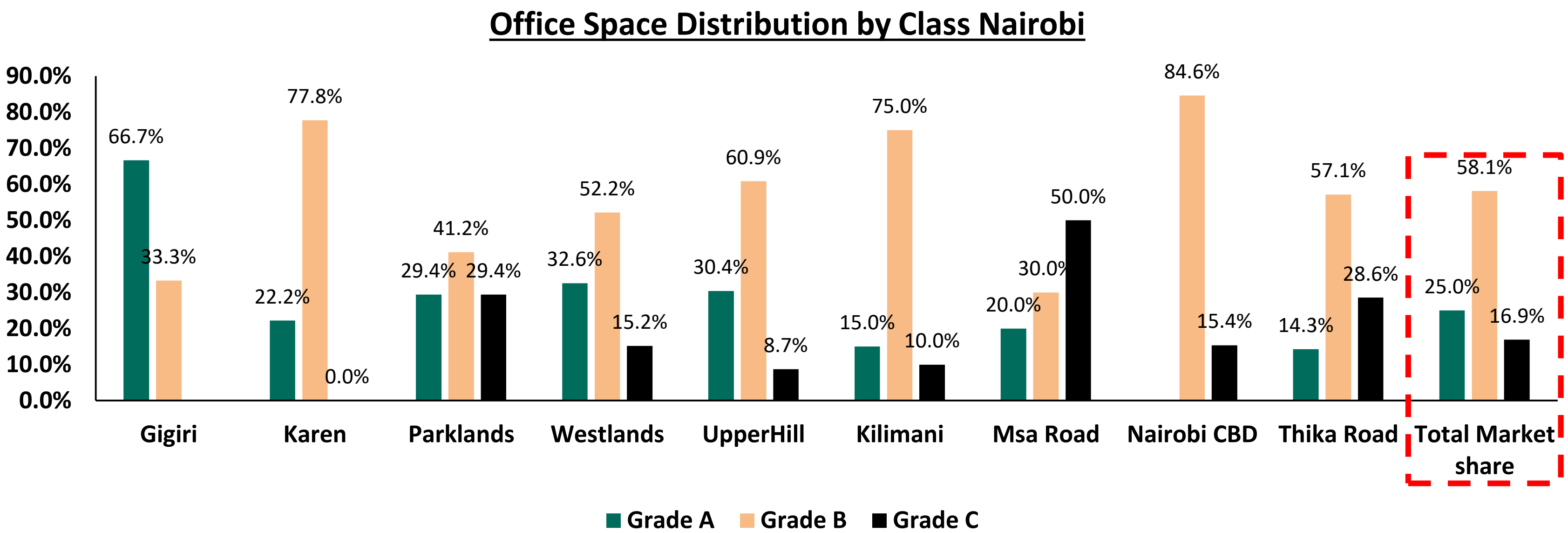
- For our research, we have used buildings with a total area ranging from 50,000 to 100,000 square feet. They have good (but lower than grade A) technical services and ample parking space

GRADE C

- These are buildings of any size, usually older and in need of renovation, they lack lobbies and may not have on site parking space. They charge below average rental rates

Distribution of Various Classes of Offices

Grade B offices are the most common, accounting for 58.1% of commercial offices in Nairobi



- **The market has witnessed an increase in Grade A office supply** with offices such as FCB mihrab (298,000 SQFT) and Prism towers (482,000 SQFT) coming into the market and therefore increasing the market share of Grade A offices from approximately 24.0% to approximately 25.0% of our sample size

- **From our sample, Grade B office spaces still account for a majority office spaces** in Nairobi with a market of 58.1%

- **For the individual nodes, Gigiri has the highest percentage of its offices being Grade A at 66.7%.** Nairobi CBD had the highest percentage of its offices being Grade B at 84.6% and no Grade A office space, while Mombasa Road had the highest percentage of its offices being Grade C at 50%

Performance of the Various Offices by Class

Grade B office spaces had the highest rental yields at 8.4% attributable to a 0.8% points increase in occupancy

Office Grade	Price 2018 Kshs/ SQFT	Rent 2018 (Kshs/SQFT)	Occupancy 2018 (%)	Yield 2018(%)	Price Kshs/ SQFT	Rent 2017 (Kshs/SQFT)	Occupancy 2017(%)	Yield 2017(%)	Δ Rent Y/Y	Δ Occupancy Y/Y (% points)	Δ Rental Yields Y/Y (% points)
Grade A	13,006	113	74.3%	8.1%	13,053	112	81.5%	8.4%	0.7%	(7.2%)	(0.3%)
Grade B	12,615	102	85.9%	8.4%	12,804	99	85.1%	7.9%	3.0%	0.8%	0.5%
Grade C	11,022	86	87.6%	7.9%	11,929	84	83.1%	7.0%	2.4%	4.5%	0.9%
Average	**12,215**	**100**	**82.6%**	8.1%	**12,595**	**98.3**	**83.2%**	**7.8%**	**2.0%**	**(0.6%)**	**0.3%**

- The performance of the commercial sector, improved with occupancy for Grade B increasing by 0.8% points to 85.9% and 4.5% points for Grade C to average at 87.6%. Grade A offices however recorded a 7.2% points decline in occupancy rates due to increased Grade A supply in the market and competition from Grade B that charge 10.8% cheaper rental rates and offer competitive facilities and amenities
- Commercial offices recorded an average rental yield of 8.1% at an average occupancy of 82.6%, monthly rental charges of Kshs 100 per SQFT and price per SQFT of Kshs. 12,215
- Grade B office spaces had the highest rental yields at 8.4% attributable to a 0.8% points increase in occupancy coupled by its higher rental rates of Kshs 102 per SQFT, 1.7% above the market average of Kshs 100 per SQFT in 2018
- The yields for Grades B and C increased by 0.5% and 0.9% points, respectively each to average at 8.4% and 7.9%. Grade A office yields however declined by 0.3% points from 8.4% to 8.1%, due to decline in occupancy rates, given that they are new in market hence occupancy rates haven't stabilized and they charge high rental rates, 12.5% above the market thus tenants preferring Grade B

iii. Performance by Nodes & Grades

Cytonn

Performance by Nodes and Grades

Gigiri, Karen and Parklands presents an investment opportunity in commercial office across Grade A, B and C respectively

Commercial Office Performance in 2018 by Nodes and Grades						
Typology	Grade A		Grade B		Grade C	
Location	Rental Yield (%)	Occupancy (%)	Rental Yield (%)	Occupancy (%)	Rental Yield (%)	Occupancy (%)
Gigiri	12.0%	90.0%	7.6%	85.0%		
Karen	9.1%	84.5%	9.2%	89.7%		
Parklands	8.6%	87.6%	7.7%	81.9%	8.9%	90.2%
Westlands	8.4%	74.8%	9.6%	83.6%	8.2%	92.7%
UpperHill	7.7%	66.0%	7.9%	85.8%	8.3%	96.0%
Kilimani	6.3%	69.5%	8.4%	90.7%	6.2%	92.0%
Msa Road	4.7%	62.5%	6.9%	73.3%	5.4%	60.0%
Thika Road	3.6%	40.0%	6.9%	86.6%	7.8%	94.5%
Nairobi CBD			7.5%	88.0%	8.3%	89.9%

- For Grade A offices, in 2018, Gigiri and Karen offered the highest returns with average rental yields of 12.0% and 9.1%, respectively, as they enjoy a superior location characterized by serene environment and low-rise developments
- For Grade B, Westlands and Karen offer the highest rental yield of 9.6% and 9.0%, respectively, and hence offer an investment opportunity in the market
- For Grade C, Parklands, Upperhill and Nairobi CBD offers the best investment opportunity with average rental yields of 8.9%, 8.3% and 8.3%, respectively

IV. Parking Data

Cytonn

Parking Analysis

Parking bays in Nairobi has an average yield of 8.0% at 100% occupancy rate

Node	Min Rent Per Bay	Max Rent per Bay	Average Rent per Bay
Nairobi CBD	5,000	13,000	9,667
Karen	5,000	10,000	7,944
Parklands	5,000	12,500	7,971
Gigiri	10,000	10,000	10,000
UpperHill	6,000	12,000	8,457
Westlands	7,500	13,500	10,750
Kilimani	5,000	11,000	8,045
Thika Road	6,000	10,000	8,500
Msa Road	4,000	10,000	6,300
Average Rent	**5,944**	**11,333**	**8,626**
Highest Sale Price			**2,000,000**
Lowest Sale Price			**1,000,000**

- Tenants are charged parking fees of Kshs 8,626 per bay per month on average
- Rates range from as low as Kshs 4,000 in low quality grade C offices in locations such as Mombasa Rd to highs of Kshs 13,500 in areas such as Westlands
- Offices in the Central Business District (CBD) had high parking rates as the area generally has inadequate parking space
- The highest sale price for parking recorded was Kshs 2.0mn, the lowest Kshs 1.0mn with an average of Kshs 1.3mn per unit
- Parking thus has an average yield of 8.0% at 100% occupancy in Nairobi

E. Office Space Opportunity

Office Space Opportunity – Methodology

GAP Analysis used to estimate over/undersupply situation in the market, supply is subtracted from demand and if a positive figure the market is undersupplied with a negative figure indicating an oversupply

- To gauge the supply situation in Nairobi, we used the **Gap Analysis**
- Gap analysis is a tool that measures the under or oversupply situation of an office market using demand and supply dynamics
- **Demand** is calculated by adding up net absorption (space taken up in a market in a year) by the space required to replenish depreciated office stock
- We used a depreciation rate of 2% p.a for office buildings
- **Supply** is calculated by summing up the completed office stock in a given year and the vacant stock from the previous year
- To get the over/undersupply in the market, the supply is subtracted from the demand
- If it is a positive figure then the market has an under supply that is demand is more than supply and if it is a negative figure then the market has an oversupply that is supply is more than demand
- **Based on building plan approvals data, in 2018, the market had a supply of 9.0mn SQFT against a demand of 3.8mn SQFT resulting in an oversupply of 5.2mn SQFT assuming a 2 year lag between building approvals and completion of construction**

Office Space Opportunity

Based on building approvals data we had an oversupply of 5.2mn SQFT in 2018

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Stock (Mn Sqft)	6.7	7.7	9.7	15.4	22.9	28.9	31.8	35.5	38.2	41.2	44.1	47.0
Completions (Mn Sqft)		1.2	2.1	5.9	7.8	6.5	3.5	4.3	3.4	3.8	3.8	3.8
Vacancy Rate (%)	9.0%	9.0%	10.0%	10.0%	11.0%	12.0%	16.8%	16.7%	16.7%	16.0%	15.0%	14.0%
Vacant Stock (Mn Sqft)	0.6	0.7	1.0	1.5	2.5	3.5	5.3	5.9	6.4	6.6	6.6	6.6
Occupied Stock (Mn Sqft)	6.1	7.1	8.8	13.9	20.3	25.4	26.5	29.6	31.8	34.6	37.5	40.4
Net Absorption		**1.0**	**1.7**	**5.1**	**6.5**	**5.1**	**1.0**	**3.1**	**2.2**	**2.8**	**2.9**	**2.9**
Demand		1.1	1.9	5.3	6.8	5.6	1.6	3.7	2.9	3.5	3.7	3.8
Available Supply, AS(T)		1.7	2.6	6.5	8.8	8.4	6.3	9.0	8.6	9.3	9.5	9.4
Under(Over)supply		**(0.5)**	**(0.8)**	**(1.2)**	**(2.1)**	**(2.9)**	**(4.7)**	**(5.2)**	**(5.6)**	**(5.8)**	**(5.7)**	**(5.6)**

Demand= Net absorption + space required to replace depreciated stock

Over(Under)supply= Demand - Available supply

Source: KNBS, NCG Completions data, Cytonn Research

Office Space Opportunity

Cautious investments can be made in the commercial office theme for long term gains. Opportunity in the sector is in serviced offices, in zones with low supply and in new markets such as county headquarters with low supply of office space

Concept/Market Niche	Characteristics
Differentiated Concepts	• These include; Green buildings which are gaining traction in the market, smart offices, semi-fitted offices as well as offices with design incorporating affirmative action will increase the occupancy rates of the building and hence the returns to the investor
Serviced Offices	• This is a new concept in the market that is experiencing rapid growth. They also have attractive returns with average rental yields of 13.5% against an average of 8.1% for conventional offices • They will thus not only increase an investor's returns, but also diversify his portfolio
Low Supply Zones	• Despite the oversupply in the market, some zones still have relatively low supply and high returns such as Gigiri with a market share of 1.0% and a rental yield of 10.5% and are hence a good investment opportunity
New Markets	• Devolution has created opportunity for development of office space in county headquarters most of which have low quality office spaces and in short supply • Relaxation of zoning regulations is also paving way for development of office spaces in previously residential zones such as Thika road, Parklands and Gigiri

Cautious investments can be made in the commercial office theme for long term gains when the market picks up in 3-5 years. Investments should be geared towards zones with low office supply ,differentiated concepts such as green buildings, smart offices and serviced offices

F. Office Market Conclusion and Outlook

Cytonn

Office Market Conclusion and Outlook

We have a negative outlook for the commercial office theme in Nairobi and thus investment in the commercial office theme should be geared to the long-term horizon for gains when the market picks up

Nairobi Commercial Office Outlook				
Measure	**2017 Sentiment**	**2018 Sentiment**	**2018 Outlook**	**2019 Outlook**
Supply	• We had an oversupply of 4.7 mn SQFT of office space in 2017, which impacted the performance negatively, lowering commercial office rental yields and occupancy rate to 7.9% and 82.6%, respectively from 8.5% and 88.0% recorded in 2016	• We had an oversupply of 5.2 mn SQFT of office space in 2018, and it is expected to grow by 7.6% to 5.6 mn SQFT in 2019, compared to 10.8% in 2018, due to decreasing supply with completions expected to decrease by 21.4% from 4.3mn sqft to 3.4mn sqft in 2019.	Negative	Negative
Demand	• There was reduced demand for office space in Nairobi evidenced by the 4.8% y/y decline in occupancy mainly attributable to a tough operating environment characterized by low credit supply and political uncertainty as a result of the protracted electioneering period.	• There was increased demand for office space in Nairobi evidenced by the 0.7% y/y increase in occupancy mainly attributable to political stability that has led to increased economic activities, positioning of Nairobi as a regional hub and thus increased entrance of multinationals and Improving macroeconomic environment, with the GDP growing at 6.0% in Q3'2018, higher than the 4.7% recorded in Q3'2017, and expected to close at 5.8% for the year 2018.	Neutral	Neutral
Office Market Performance	• The performance of office market softened, with yields reducing by 0.6 % points to 7.9% in 2017 from 8.5% in 2016, and occupancy rates reducing by 5.4% points from 88.0% in 2016 to 82.6% in 2017	• The performance of office market improved with yields increasing by 0.2% points to 8.1% in 2018 from 7.9% in 2017, and occupancy rates increased by 0.7% points from 82.6% in 2017 to 83.3% in 2018,	Neutral	Neutral
General Outlook and Opportunity	• **We have a negative outlook for the commercial office theme in Nairobi and thus investment in the commercial office theme should be geared to the long-term horizon for gains when the market picks up** • **Investments should be made in zones with low supply and high returns such as Gigiri and in differentiated concepts such as serviced offices and green buildings to boost returns**			

Cytonn