Cytonn Real Estate Markets Review - 2016

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Executive Summary: During the year, real estate continued with its good performance recording high returns across all themes, with rental yields averaging 10.0% in retail, 9.4% in commercial office, 6.0% in residential and 5.8% in industrial. The sector had total average returns of 25.8% in 2016 (yield 7.8% + capital appreciation 18.0%).

Real Estate Market Review

The real estate sector continues to perform extremely well across all sectors supported by (i) the accumulated housing deficit from previous years, (ii) continued investment in infrastructure, (iii) growing businesses both SMEs and entry of global brands into the country, and, (iv) the growing middle class. The land and house prices gained during the year and below is the performance by sector:

I. Residential Sector

In 2016, we witnessed increased investment in residential real estate, with developers aiming to curb the huge housing deficit, which is approximated at 2 million units and growing at 200,000 units annually. Major residential developments launched this year include Alma, a Kshs 3 bn project by Cytonn Real Estate in Ruaka, Gem Juja, a Kshs 400 mn project by Urithi in Juja, Express Kenya with a Kshs 2 bn housing project in Industrial Area and the Kshs 300 bn Private Urban Renewal Project in Ngara and Pangani led by the Nairobi County Government.

In terms of performance, in completed houses, Karen and Runda were the best performing sub-markets in the high-end sector with returns of 12.7% and 11.3%, respectively. Apartments in the upper-middle income market have recorded slower uptake and price appreciation in areas such as Kilimani and Kileleshwa due to a possible oversupply of units. However, in satellite towns such as Ruaka and Kikuyu, residential units have continued to record high returns due to the increasing demand from the growing middle class and improving infrastructure in these areas.

The summary for the top-5 areas according to the income level is as follows;

(i) High End Market-Top 5 Areas

Location	Average Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Total Return
Karen	91.5%	92.8%	4.8%	7.9%	12.7%
Runda	100.0%	96.5%	5.3%	6.0%	11.3%
Roselyn	86.6%	91.6%	7.1%	3.7%	10.8%
Kitisuru	61.9%	61.9%	5.0%	2.0%	7.0%
Loresho	93.7%	93.6%	1.4%	2.7%	4.1%

Karen and Runda are the best performing markets with 12.7% and 11.3% returns, respectively. Property in Karen has high demand due to its upmarket state, proximity to major shopping hubs and improved access via the Southern Bypass, Langáta Road and Ngong Road, which is still undergoing expansion.

(ii) Upper Middle Income Market-Top 5 Areas

Location	Average Uptake	Average Occupancy %	Average Rental Yield	Average Price Appreciation	Total Return
Ridgeways	98%	90%	5.4%	12.7%	18.1%

Kilimani	79%	66%	3.9%	9.9%	13.8%
Riverside	53%	93%	4.2%	8.2%	12.4%
Spring Valley	75%	82%	3.6%	8.5%	12.1%
Lavington	98%	83%	4.6%	7.3%	11.9%
Westlands	89%	73%	5.3%	6.4%	11.6%
Kileleshwa	88%	52%	6.0%	4.7%	10.7%
Ridgeways and Kilimani were the best markets in the Upper Middle Income Segment with total returns of 18.1% and 13.8% per annum on average, respectively. Ridgeways boasts of a prime location with accessibility via the Northern Bypass and Kiambu Road and proximity to the UN, while Kilimani area attracts the middle class due to its proximity to main commercial hubs					

(iii) Lower Middle Income Market-Top 5 Areas

Location	Average Uptake	Average Occupancy %	Average Rental Yield	Average Price Appreciation	Total Return
Ruaka	93%	95%	5.0%	13.4%	18.4%
Kikuyu	66%	73%	6.1%	11.2%	17.3%
Imara Daima	87%	91%	5.2%	11.2%	16.4%
Dagoretti	88%	91%	5.7%	9.8%	15.6%
Donholm	85%	89%	5.8%	9.6%	15.4%
Ruaka and Kikuyu were the best performing markets in the lower middle income segment with total returns of up to 18% and 17.3% per annum. This is due to infrastructural development in both areas and the growing middle income population					

In the regional markets, the Kisumu residential market is slowly picking up with most developments having been completed in the last 5-years. Two bedroom apartments in high-end areas have the highest rental yields among residential units of 6.5%, as compared to those in low-end areas with yields of 4.8% and three bedroom units with yields of 5.0%. This is because they have higher rents, due to the exclusive locations, better amenities and security provided in high-end areas. They also have higher demand than three bedrooms in high-end areas, as they are relatively cheaper. The summary for Kisumu market is as follows;

Kisumu Residential Market Summary

Location	Type	Plinth Area	Monthly Rent	Average Price	Price Appreciation	Rental Yield	Total Return
Kisumu-Low End	2-Bed	76	30,600	5.9m	6.9%	4.8%	11.7%
Kisumu-High End	2-Bed	84	42,000	7.9m	6.6%	6.5%	13.1%
Kisumu-Low End	3-Bed	108	40,000	7.1m	5.8%	5.3%	11.1%
Kisumu-High End	3-Bed	120	62,500	13.5m	6.1%	5.6%	11.7%
Developments in Kisumu recorded average returns ranging from 11% to 13% with 2 bed units in the high end market having the highest returns due to high demand							

In the Coastal region, residential units have recorded slow uptake in the last 5-years. This can be attributed to the fact that most investors target short to medium-stay visitors to rent their units. However, due to insecurity and terrorist attacks in the period between 2011 and 2015, apartments recorded low occupancies and thus low returns. Some developments have lowered their prices so as to boost uptake. The summary for Mombasa market is as follows;

Mombasa Residential Market Summary

Location	Type	Plinth Area	Monthly Rent	Average Price	Price Appreciation	Rental Yield	Total Return
Mombasa-Mid End	2-Bed	114	68,000	13.6m	5.0%	6.0%	11.0%
Mombasa-High End	2-Bed	204	150,000	33.0m	(13.0%)	5.0%	(8.0%)
Mombasa-Mid End	3-Bed	166	76,000	15.5m	8.0%	5.0%	13.0%

Mombasa-High End 3-Bed	278	180,000	53.8m	1.0%	6.0%	7.0%
Developments in Mombasa recorded low returns due to price reduction to boost uptake, mostly in the high end market						

II. Commercial Sector

In 2016, commercial real estate continued on its upward trend, as was expected, though a slowdown was witnessed in some themes such as commercial office. Retail and Industrial themes continued picking up with most construction activity being witnessed in the industrial themes, amid a slight slowdown on retail construction over fears of oversupply. A summary of performance of the various commercial real estate themes is given below:

Offices

The commercial office market in Nairobi in 2016 remained largely stable, with occupancy at 88%, compared to 89% the previous year. The performance was constrained by the tough economic environment that has caused some businesses especially in the financial services sector to downsize, as well as multinationals such as Coca Cola, Standard Chartered and Tullow Oil to reduce their operations in the country. Despite these challenges, the market recorded a slight improvement performance, with rents increasing by 6% from Kshs 97 to Kshs 103 per square foot, prices also increased marginally by 2% from Kshs 12,800 to Kshs 13,000 per square foot translating to a slight increase in yield of 1.1% over the same period. Occupancy levels declined by 1% point from 89%, but remained high at 88%, though this is a 3% points decline from the 5-year high of 91% witnessed in 2011. This is attributable mainly to the tough economic environment and increased supply of office space, which has grown with a 5-year CAGR of 16% from 1.7 mn square feet in 2011 to 3.6 mn in 2016 in Nairobi alone.

Summary of Commercial Office Returns in Nairobi Over Time							
Year	**2011**	**2013**	**2015**	**2016**	**Δ (2013)**	**Δ (2015)**	**Δ (2016)**
Occupancy (%)	91	90	89	**88**	(1%)	(1%)	(1%)
Completions (Sqft)	1.7 mn	2.4 mn	5.4 mn	**3.6 mn**	50%	125%	(33%)
Asking Rents (Kshs/Sqft)	78	95	97	**103**	22%	2%	6%
Average Prices (Kshs/Sqft)	10,557	12,433	12,776	**13,003**	18%	3%	2%
Average Rental Yields (%)	**9.8%**	**10.0%**	9.3%	**9.40%**	**2.0%**	**-7.0%**	**1.1%**
Occupancy levels remain high at 88% indicating that demand for office space is still high							

In terms of submarket analysis in Nairobi, Gigiri, Parklands and Karen were the best performers in 2016 due to superior locations allowing them to charge premium rents. These locations for Gigiri, Parklands and Karen recorded rental yields of 12.9%, 10.4% and 10.3%, respectively. Mombasa Road was the worst performing submarket with rental yields of 8.9% on average. This is mainly due to poor location as a result of traffic congestions and its zoning for industrial use. Mombasa Road performance has however improved from 2015 earnings by 0.6% points, attributable to opening of quality spaces in the area such as in the Next Gen Mall, which opened in November.

Summary of Commercial Office Performance in Nairobi by Nodes				
Area	**Price Per Sqft "Kshs"**	**Rental Yields %**	**Rent Per Sqft "Kshs"**	**Occupancy %**
Gigiri	14,000	12.9%	150	90%
Thika Road	13,771	11.3%	104	80%
Parklands	12,500	10.4%	109	80%

Karen	15,063	10.3%	125	88%
Kilimani	13,676	9.5%	107	93%
Westlands	13,216	9.5%	104	92%
Upperhill	14,747	9.3%	113	90%
Nairobi CBD	11,750	9.0%	92	93%
Mombasa Road	11,098	8.9%	83	86%
Average	**13,313**	**10.1%**	**110**	**88%**
Gigiri is the best performing submarket due to prime location and high quality office space and are hence able to charge a premium above market				

For the key markets in the country, the summary of the performance is as below:

Summary of Office Returns in Kenya				
Area	**Average Rent Per Sqft Kshs**	**Average Price Per Sqft Kshs**	**Yield %**	**Occupancy %**
Nairobi	110	13,313	10.1%	88.0%
Kisumu	102	13,000	9.40%	91.0%
Mombasa	98	12,833	9.20%	85.0%
Average	**103**	**13,049**	**9.6%**	**88.0%**
Nairobi is the best performing market with high yields of up to 10.1%. This is attributable to the high demand for office given that it is the capital and hence the hub of businesses in the country				

Retail

In 2016, the retail market continued with its upward trend and high returns recording average rental yields of 10.0%, and an average annual occupancy of 89.3%. The rent charged averaged at Kshs 187 per square foot in Nairobi. In terms of submarkets, Karen, Westlands and Kilimani were the best performing markets due to prime locations near high-end population and companies and ease of access to these areas. The three areas recorded average rental yields of 12.5%, 12.3% and 10.6%, respectively. The worst performing submarkets were Eastlands and Mombasa Road which recorded average rental yields of 7.5% and 8.2%, respectively.

Summary of Retail Sector Performance by Nodes in Nairobi			
Location	**Rent / SQFT 'Kshs'**	**Occupancy (%)**	**Yield (%)**
Karen	216.7	96.3%	12.5%
Westlands	231.4	92.0%	12.3%
Kilimani	209.3	86.0%	10.6%
Kiambu Road	187.3	90.0%	10.1%
Thika Road	187.1	89.3%	10.0%
Ngong' Road	170.1	93.3%	9.7%
Satellite Towns	175.0	88.3%	9.3%
Mombasa Road	157.6	83.3%	8.2%
Eastland	148.2	85.0%	7.5%
Average	**186.9**	**89.3%**	**10.0%**
Karen is the best performing submarket, with a yield rate of 12.5% and an occupancy of 96.0%. This is attributable to the premium for class charged on their rents and lower competition from small scale retailers present in low end areas			

For the whole country, Mt Kenya and Nairobi were the best performers earning rental yields of 10.1% and 10.0%, respectively. Mt Kenya's performance is attributed to Mt. Kenya as a tourist hub and high purchasing power mainly from the local community and presence of military personnel in the region, while for Nairobi the key factor pushing its momentum is improved infrastructure and the high middle class population. Eldoret was the worst performing market with an average rental yield of 6.6%, which can be attributed to competition from small scale retailers in the region.

Summary of Retail Market Performance in Kenya By Regions			
Location	Rent / SQFT (Kshs)	Occupancy (%)	Yield (%)
Mt. Kenya	151.5	90.0%	10.1%
Nairobi	192.3	89.3%	10.0%
Kisumu	170.2	75.0%	9.4%
Mombasa	154.7	76.7%	7.2%
Eldoret	105.6	83.3%	6.6%
Average	154.9	82.9%	8.7%
Mt. Kenya is the best performing market with high yields of on average 10.1% attributable to high purchasing power in the regions mainly from the local community, tourists and military personnel in Nanyuki			

Industrial

In 2016, the industrial theme continued with its upward trend recording average yields of 5.8% on average, rent of Kshs 35 per square foot, sales price of Kshs 6,313 per square foot and a high uptake of 85.0%. In submarket analysis, Industrial Area was the best performing market with average rental yields of 7.2% and a high occupancy of 90%. This can be attribute to the high demand for warehousing space in the area due to presence of many manufacturing companies in the area. Baba Dogo and Ruiru also performed well with rental yields of 7.0% and 6.2%, respectively. Baba Dogo performed well due to proximity to Thika Road, making it easy to access from both the CBD. Ruiru performed well due to lower prices due to cheaper land prices. Athi River is the worst performing submarket with rental yields of 4.2% attributable to traffic congestions along Mombasa Road.

Summary of Industrial Market Performance in Nairobi by Nodes								
Area	Unit Height (Metres)	Occupancy (%)	Unit Plinth Sqft	Rent per sqft Kshs	Price per Sqft Kshs	Price Appreciation (%)	Rental Yield (%)	Uptake %
Industrial Area	10	90%	7,144	43	7,522	6.8%	7.2%	68%
Baba Dogo	10	88%	9,206	40	6,175	5.1%	7.0%	70%
Ruiru	8	89%	6,917	35	6,000	9.1%	6.2%	66%
Syokimau	7	92%	9,822	36	5,882	2.7%	5.7%	98%
Mombasa Road	9	82%	7,769	30	7,568	13.9%	4.8%	50%
Athi River	8	71%	7,916	23	4,735	6.9%	4.2%	44%
Grand Total	**9**	**85%**	**8,129**	**35**	**6,313**	**7.4%**	**5.8%**	**66%**
Industrial Area was the best performing market with average rental yields of 7.2% and a high occupancy of 90%. This can be attribute to the high demand for warehousing space in the area due to presence many manufacturing companies in the area								

During the year, the main transactions in the commercial real estate sector included:

1. The Launch of Kshs 5.6 bn Montave Towers, which is a mixed use development (MUD) of office, retail, and hotel space by a consortium of developers including Hass Consult and Abacus International Limited
2. The International Finance Corporation announced that it will invest in Kshs 1 bn equity in Africa Logistics Property (ALP) which intends to develop first grade warehousing in industrial parks that is Tatu City and Tilisi in Kiambu County
3. Ground breaking for Kshs 12.5 bn Infinity Industrial Park
4. Ground breaking for Kenya's first a construction supermarket in Nairobi expected to cost Kshs 10 bn
5. Launching of the Phase I of the Leather Industrial Park in Kinanie Athi River

III. Hospitality Sector

The year 2016 was a good year for the Hospitality sector in Kenya as evidenced by the 13.9% increase in tourist arrivals at Jomo Kenyatta International Airport (JKIA) and Moi International Airport between April and May 2016. In addition, the country hosted major global conferences, which resulted in full occupancies with hotels in Nairobi being the main beneficiaries. The main factors boosting the sector include i) Improved security and lifting of travel advisories, ii) Increased budgetary allocation to boost tourism, iii) hosting of major global conferences, and iv) improved facilities as seen through the increased number of hotels attaining 5-star rating.

The attractiveness of the sector especially for business tourism over the past few years can be evidenced by increased investment in the sector characterized by the launching/unveiling of a number of hotels in the year including i) The English Point Marina in Mombasa ii) Tune Inn in Westlands and; iii) The launch of Montave in Upperhill

For the serviced apartments segment, we also had new entrants with the notable ones being i) The 11-storey Soho Apartments in Kilimani by a Chinese developer worth Ksh 1.8bn earlier on in April and; ii) Opening of Serviced apartments in Riverside, Nairobi under the Best Western brand in December

In terms of performance, serviced apartments (specifically in Nairobi) outperformed the hotels countrywide despite the high hotel rates. This can be attributed to the high occupancy levels for serviced apartments averaging at 90% all year round compared to hotels' average of 33% countrywide. The resultant is the serviced apartments having a Total RevPAR of USD 127.00 against Hotels' Total RevPAR of USD 98.00

Summary of the Hospitality Industry Performance			
Type	**ADR (USD)**	**Total RevPAR (USD)**	**Occupancy Rate**
Hotel	212	98	33.0%
Serviced Apartments	141	127	90.0%
Average for the Hospitality Sector	**177**	**113**	**62.0%**

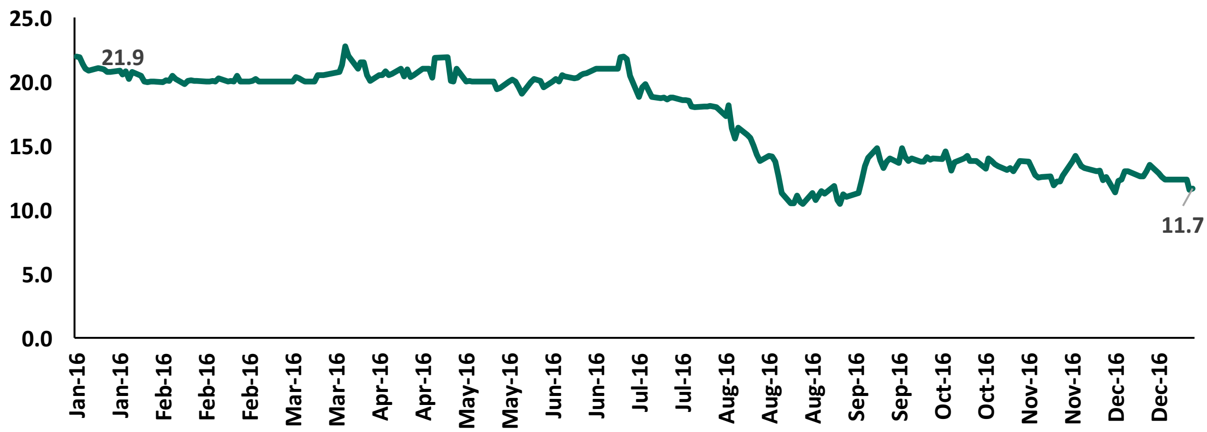
Some of the challenges faced by hotels is the recovery from insecurity challenges that have caused a decline in occupancy and revenues while increasing costs specifically in marketing and enhancing security. On the other hand, serviced apartments especially within Nairobi are thriving, recording high occupancy levels and high returns due to the high numbers of business travellers.

The opportunity in this sector thus lies in serviced apartments in Nairobi, 3 & 5-star rated hotels in Maasai Mara as well as 4 Star rated hotels in Nairobi offer the best investment opportunity. In order to address the likelihood of an oversupply, investors should differentiate their product offering especially in customer service to realize high occupancy levels.

IV. Listed Real Estate – REITS

During the year, the listed real estate market performed poorly with the only listed I-REIT in Kenya, Fahari I – REIT shedding 45% of its value, currently trading at Kshs 11 down from Kshs 20 at the time of the listing. This is a 50% decline from its price at the beginning of the year of Kshs 22. Fusion Capital also attempted to list a D-REIT FRED – Commercial, but is was undersubscribed raising only 37.8% from four investors out of the minimum requisite of 50% from at least seven investors and hence failed to list. The poor performance of listed real estate can be attributed (i) poor returns from the underlying assets (ii) opacity of the exact returns from the underlying assets, (iii) inadequate investor knowledge and lack of institutional support for REITS, and (iv) the negative sentiment currently engulfing the sector given the poor performance of Fahari and failure of FRED.

Fahari REIT Performance 2016



We remain cautiously optimistic on the performance of the Real estate sector. The increased focus by institutional developers in the sectors poses as significant growth in the sector but competition is expected to be stiff as clients and investors demand for quality developments. The returns remain attractive and is expected to hold.