Nairobi Commercial Office Report

"In Transition to a Buyers' Market"

24th April 2017

Table of Contents

Cytonn REAL ESTATE

I. Introduction to Cytonn Investments

What We Stand For

Our Mission

We deliver innovative & differentiated financial solutions that speak to our clients' needs

Our Vision

To be Africa's leading investment manager by consistently exceeding clients' expectations

Our Values

People
Passionate and self-driven people who thrive in a team context

Excellence
Delivering the best at all times

Client Focus
Putting clients' interest first at all times

Entrepreneurship
Using innovation and creativity to deliver differentiated financial solutions

Accountability
We take both corporate and personal responsibility for our actions

Integrity
Doing the right things

Table of Contents

SECTION

I

Overview of The Firm

Strategy is straightforward – just pick a general direction and implement like hell

— Jack Welch

About Us

Cytonn Investments is an alternative investment manager with presence in East Africa, Finland and the US. We provide investors with exposure to the high growth East Africa region. Our investors include global and local institutional investors, individual high net-worth investors and the diaspora. We also service retail investors through our Cytonn Co-operative

FACT FILE

77	Over Kshs. 77 billion under mandate	**3**	Three offices across 2 continents	**300**	Over 300 staff members	**12**	12 investment ready projects

A unique franchise differentiated by:

Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

Committed Partners

Strong global and local partnerships in financing, land and development affiliate

Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

WE SERVE FOUR MAIN CLIENTS SEGMENTS:

- Retail segment through Cytonn Co-operative membership
- High Net-worth Individuals through Cytonn Private Wealth
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional clients

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

Our Business

Where We Operate

Our Business Lines

Investments
Alternative investment manager focused on private equity and real estate

Real Estate
We develop institutional grade real estate projects for investors

Diaspora
We connect East Africans in the diaspora to attractive investment opportunities in the region

Technology
We deliver world-class financial technology solutions

Co-operative
Provides access to attractive alternative investment opportunities for members

Our Solutions

To unearth the attractive opportunity that exists in alternative markets in Africa, we offer differentiated investment solutions in four main areas:

HIGH YIELD SOLUTIONS

Our expertise in the alternative markets enables us to offer investors high yielding investments. Our robust credit analysis coupled with our quick dealing capabilities, our extensive research coverage and our innovative structuring helps to ensure consistent and above market returns to investors.

REAL ESTATE INVESTMENT SOLUTIONS

Our comprehensive real estate capabilities enable us to find, evaluate, structure and deliver world-class real estate investment products to our investors in the East African region. Our capabilities include fundraising, market research and acquisition, concept design, project management and agency and facility management.

PRIVATE REGULAR INVESTMENT SOLUTIONS

Attractive returns in the alternative segments have typically been accessible to institutional and high net-worth investors. Our regular investment solutions provide access to the alternative investments to members of the Cytonn Co-operative.

PRIVATE EQUITY

We seek to unearth value by identifying potential companies and growing them through capital provision, partnering with management to drive strategy and institutionalizing their processes. Our areas of focus are Financial Services, Education, Renewable Energy and Technology Sectors.

Our Products

We serve three main types of clients namely, high net-worth individuals, institutions and retail, each with diverse needs. Below are the suitability criteria for the various products.

	INSTITUTIONAL CLIENTS	HIGH NET WORTH INDIVIDUALS (HNWI)	RETAIL CLIENTS
Cash Management Solutions	●	●	
Regular Investment Plan • Education Investment Plan • Regular Investment Solution • Co-op Premier Investment Plan • Land Investment Plan	●	●	●
Real Estate Development • Real Estate Developments • Sharpland	●	●	●

Our People

> If you could get all the people in an organization rowing the same direction, you could dominate any industry, in any market, against any competition, at any time.
>
> **— Patrick Lencioni**

Board of Directors

To ensure that we remain focused on the clients' interests, we have put in place proper governance structures. We have a board of directors consisting of 10 members from diverse backgrounds, each bringing in unique skill-sets to the firm.

Non-Executive Director

Chairman

Prof. Daniel Mugendi Njiru, PhD

Non-Executive Director

Madhav N. Bhalla, LLB

Non-Executive Director

Antti-Jussi Ahveninen, MSc

Non-Executive Director

Nasser J. Olwero, MPhil

For bios, visit www.cytonn.com

Non-Executive Director

James M. Maina, MA

Non-Executive Director

Michael Bristow, MSc

Non-Executive Director

Rose Kimotho, M.B.S.

Executive Director

Managing Partner

Edwin H. Dande, CPA, MBA

Executive Director

Senior Partner

Elizabeth N. Nkukuu, CFA, MBA

Executive Director

Partner

Patricia N. Wanjama, CPS (K), MBA

For bios, visit www.cytonn.com

Governance

> If you have leadership without governance you risk tyranny, fraud and personal fiefdoms. If you have governance without leadership you risk atrophy, bureaucracy and indifference.
>
> **— Mark Goyder**

INVESTMENTS & STRATEGY COMMITTEE

The committee oversees and provides strategic investment direction, including the implementation and monitoring process.

The committee consists of five directors with three non-executive directors namely: James Maina (Chairman), Antti-Jussi Ahveninen, Madhav Bhalla, Edwin Dande and Elizabeth Nkukuu.

AUDIT RISK & COMPLIANCE COMMITTEE

The committee establishes and oversees risk and compliance, including the implementation and monitoring process.

The committee consists of four directors with two non-executive directors namely: Madhav Bhalla (Chairman), Nasser Olwero, Edwin Dande and Patricia Wanjama.

GOVERNANCE, HUMAN RESOURCES & COMPENSATION COMMITTEE

The committee establishes, oversees and implements governance structure, human resource policies and firm wide compensations.

The committee consists of four directors with three non-executive directors namely: Antti-Jussi Ahveninen (Chairman), Prof. Daniel Mugendi, Michael Bristow and Edwin Dande.

TECHNOLOGY & INNOVATION COMMITTEE

The committee establishes, oversees and implements technical expertise and innovative processes as a driver towards competitiveness.

The committee consists of three directors, with two non-executive directors namely: Nasser Olwero (Chairman), Michael Bristow and Patricia Wanjama.

Summary Deal Show Case

AMARA RIDGE

SITU VILLAGE

THE ALMA

NEWTOWN

II. Overview of Real Estate in Kenya

Introduction to Real Estate in Kenya

Real estate sector expected to continue growing on the back of developments such as lower financing costs, and the entry of institutional developers to the market

Macro-economic Contribution

- The real estate sector contributed to 8.4% of Kenya's GDP in 2016, and grew by 8.8% in 2016 from a 7.2% growth in 2015. This is according to the KNBS Economic Survey 2017
- A relatively stable political environment, as well as favourable macroeconomic conditions leading to sustained GDP Growth and a stable exchange rate have led to positive development in the sector

High Returns

- Real estate has consistently out performed other asset classes in the last 5 years, generating returns of over 25% p.a., compared to an average of 10% p.a. in the traditional asset classes
- Residential units in Kenya in the last five years have generated an average rental yield of 5.0%, while commercial space have generated an average yield of more than 9.0% p.a

Recent Developments

- The real estate sector has seen entry of more institutional developers such as Saccos, private equity firms and funds such as Taaleri and Actis and foreign institutions such as AVIC of China
- Government initiatives such as digitising of the lands ministry, issuing of title deeds, waiving of the NCA, NEMA and title searching fees as well as a 15% tax cut for large scale developers are creating a conducive investment climate for real estate investment and lowering construction costs

Market Outlook

- We expect continued growth in Real Estate sector on the back of improved macroeconomic conditions, sustainable high returns, and a changing operational landscape as developers strive to satisfy the high housing deficit
- Key challenges include: high land and infrastructure development costs and in 2017 the political environment will pose a challenge with investors adopting a wait and see attitude and hence reducing transactions volume in the industry

Cytonn REAL ESTATE

Introduction to Real Estate in Kenya – RE Contribution to GDP

Real Estate and construction sectors contribution to GDP has been increasing from 10.5% in 2000 to 12.6% in 2010 to 13.8% in 2016

	2000	2010	2016
Agriculture	31.3%	23.7%	23.1%
Manufacturing	17.0%	11.5%	10.4%
Wholesale & Retail Trade	16.5%	7.1%	7.4%
Hospitality & Tourism	16.5%	1.7%	0.9%
Real Estate & Construction	10.5%	12.6%	13.8%

Source: KNBS

III. Nairobi's Commercial Office Report

Executive Summary

The Commercial Office theme is oversupplied by approximately 3.2 mn sqft. Average rental yields are 9.3% and occupancy of 88% with prices recording a 6% decline from 2015 to average at Kshs 12,031

- 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 subsector in Nairobi in 2016

- In 2016, Nairobi had a total supply of 28.9mn square feet (sqft) of office space which is growing with a 6 year CAGR of 34.0%. Completions have been growing with a 5 year CAGR of 52.6% and currently we approximate an oversupply of 3.2mn sqft of office space which is expected to grow by 21.0% to 3.9mn sqft in 2018

- On performance, average occupancy rates declined by 3% points from 91% in 2011 to 88% in 2016 with asking sales prices declining by 6.0% to average at Kshs 12,031 from Kshs 12,776 in 2015. The rents and yields stagnated remaining at average Kshs 97 per sqft and 9.3%, respectively

- In submarket analysis, Parklands and Karen had the highest average yields of 10.0% and 9.7%, respectively with Mombasa Rd and Thika Rd having the lowest returns with average rental yields of 8.5% and 8.8%, respectively. Grade A offices had the highest average rental yields of 10.0%, with Grade C offices having the lowest average rental yields of 8.6%. Grade B offices are the most common in the market with a market share of 60% and are also the most popular with the highest average occupancy rates of 90.6% on average

- The market is thus in transition to a buyers' market and to gain value investors will thus have to seek specific pockets of value with regards to:
    i. Supply - Invest in Grade A offices, zones with low supply like Gigiri and Green Offices which are now gaining traction
    ii. Returns – It is a buyers' market and hence ideal for long term investors seeking the high return in real estate at 25% which can be realised in Grade A office with high yields and high rental yields returns sub markets of Parklands and Karen at 10.0% and 9.7%, respectively
    iii. Differentiation – Differentiated concepts such as serviced office, mixed use development and devolved units headquarters

- We expect market performance stagnation constrained by the oversupply, slow down in growth of financial services and SME sectors as well as upcoming election which will slow down demand

Nairobi's Commercial Office Report - *"In Transition to a Buyers' Market"*

Performance in the Commercial Office theme is constrained by increased supply with investment opportunity being in Grade A office space, zones with low supply, differentiated concepts and serviced offices

Value Area	Summary	Effect on The Office Market
Oversupply	• There is a supply of 6.3mn square feet against a demand of 3.1mn sqft resulting in an oversupply of 3.2 mn sqft of office space in 2017 expected to grow by 21% to 3.9 mn sqft in 2018	• This has resulted in softening of the performance of the office market with occupancy and prices declining by 1% and 6% points, respectively, while rents and yields remained unchanged from 2015 levels
Returns	• Returns in the office market remained unchanged with average rental yields of 9.3% at an average occupancy rate of 88% • The best performing markets were Parklands and Karen with CBD, Mombasa Road and Thika Road having the lowest rental yields	• This resulted in a decline in completions with only 6.5mn square feet of office space being delivered in 2016 a 14% decline from the 7.6mn delivered in 2015
Opportunity & Outlook	• The market is in transition to a buyers market with only Parklands, Gigiri and Karen being developers markets • The opportunity is in Grade A offices which are in low supply, in markets with low supply such as Gigiri, differentiated concepts and serviced offices	• There has been a slowdown in office space construction that is likely to continue • We expect to witness increased construction of Grade A office spaces and in locations with low supply • Serviced offices as a trend will also continue growing in popularity

The market is in transition to a buyers' market with only Parklands, Gigiri and Karen being developers markets

a) Introduction

Introduction: Key Factors Driving Office Market in Kenya

Growth of professional services and SME's, devolution and Nairobi as a regional hub are some of the factors driving office market

Nairobi as a Regional Hub

- Nairobi was ranked the most dynamic city in Africa and 10th in the world, by JLL City Momentum Index 2017 due to innovation and technology adoption and it has attracted international investors creating demand for office space
- They Include Johnson & Johnson ,Wrigley's and Volkswagen who are keen to tap into the growing economy. They create demand for grade A office space

Growth of Professional Services

- The growth of companies in financial services, professional services and the devolved government units has created demand for office space
- Kenya is becoming a service driven economy and moving away from dependence on agriculture and the manufacturing sectors with the financial serviced sector growing with by 2.7% between 2011 and 2016

Growth of SME's

- The informal sector is estimated to constitute 98% of business in Kenya, contributing to 84% of jobs as per the 2017 KNBS Economic Survey
- There is an increase in the number of SME'S due to ease in business registration that takes a maximum of 2 weeks
- All these new companies require office space and hence drive the demand for office space

Devolution

- Decentralisation has opened up major towns across the 47 counties attract government institutions, private investors and entrepreneurs across all the county headquarters
- The urbanisation rate has increased hence attracting financial institutions to the county level to tap into the unbanked population
- This has therefore created need for office space to host all the investors and government headquarters

International Players

- Kenya has seen increase from International institutions entry into the country with foreign direct investments(FDI) growth rate at 47%, that saw 84 projects in diverse sectors initiated in 2015
- The foreign investors are therefore creating a demand for Grade A offices around key commercial nodes such as Westlands hosting company like Delloite and KPMG among others

Introduction: Factors Affecting Supply of Office Space

Low land supply has negatively affected office space development, but improved infrastructure and relaxation of zoning regulations is leading to the development of new office nodes in places such as Gigiri and Karen

Availability of Land

- Availability of land for development has been low within traditional commercial office zones such as the CBD and Westlands resulting in relatively high land prices
- This has resulted in relaxation of zoning regulations and hence increased commercial developments in previously residential areas such as Karen, Gigiri and Kilimani

Access to Funds

- Lack of proper funding for developments has resulted in excessive debt funding which is in limited supply and hence resulted in stalling of projects and extended project time frames. The above affect the supply of office spaces most of which are capital intensive and hence require high capital outlays
- The Banking Amendment Act 2015 and more prudent lending by banks has also resulted in a decline in credit supply in the market and more stringent borrowing terms which will hinder development of office space

Competition

- Many developers have focussed on construction of offices hence increasing stock to 7.75 mn sqft in 2015 that led to vacancy in most developments hence the supply decreasing to 3.49mn in 2017 mainly in commercial nodes such as upper hill, Westlands and Kilimani
- Due to supply of undifferentiated developments, the developers are likely to face high vacancy rates as tenants shift to Grade A offices in less congested areas such as Gigiri

Infrastructure

- Improved infrastructural developments of roads, power distribution especially in the Counties, revision of zoning and ICT infrastructure and penetration allowing for home office concept. This impacts supply both negatively and positively

Introduction: Factors Affecting Demand for Office Space

Location, quality and accessibility significantly affect the demand for office space in Kenya

Location	• Businesses are setting up offices in upcoming business nodes such as Karen and Parklands traditionally zoned as residential nodes with the aim of getting more space, convenience and a high quality business environment
Rent and Rates	• Rental and rates charged for office spaces form a basis for office occupancy in various commercial nodes • The prime areas attract a premium for the conducive environment hence attracting multinational companies while SME'S are opening offices in areas such as CBD that attract less rates
Quality	• Grade A offices with prime amenities i.e. adequate parking space, fast lifts, ample natural good lighting, good views and prestigious finishing attract tenants and willing to pay a higher premium • Currently there are few Grade A offices in Nairobi, hence the available ones have recorded high occupancy rates above 90% • There has also been increased demand for Green Buildings with emphasis on environmental sustainability and affordable running costs beside creating a healthier user environment
Accessibility	• Businesses are relocating to more accessible areas. For example during Q1'2017, several companies relocated from CBD that is characterised by high traffic to newer office zones. For instance Kenya Investment Authority (KenInvest) moved to UAP Old Mutual Tower in Upperhill from its headquarters in Railways, CBD while Ecobank moved to Fortis Office Park, Off Waiyaki Way in Westlands from Ecobank House in the CBD

Commercial Office Market Performance Summary

Increased supply is constraining performance in the sector with occupancy rates and prices declining by 1% and 6%, respectively, from 2015 to 2016 as rents and prices remained unchanged

Year	2011	2013	2015	2016	Δ (2013)	Δ (2015)	Δ (2016)
Occupancy (%)	91.0%	90.0%	89.0%	**88.0%**	(1.0%)	(1.0%)	(1.0%)
Completions (Sqft)	1.7 mn	2.1 mn	7.6 mn	**6.5mn**	23.5%	261.9%	(14.5%)
Asking Rents (Kshs/Sqft)	78	95	97	**97**	21.8%	2.1%	0.0%
Average Prices (Kshs/Sqft)	10,557	12,433	12,776	**12,031**	17.8%	2.8%	(5.8%)
Average Rental Yields (%)	**9.8%**	**10.0%**	9.3%	**9.3%**	**2.0%**	**(7.0%)**	0.0%

Source: KNBS, NCC, Cytonn Research

- The commercial office sector is softening after exponential growth in the past five years. This is as there was increased supply with completions increasing with a 46% CAGR between 2013 and 2016 alone
- This has resulted in reduced occupancy rates with occupancy rates declining from 91% in 2011 to average at 88% in 2016
- The average prices growth rates have been on a downward trend declining from an 18% growth between 2011 and 2013 to a 3% growth between 2013 and 2015 with a 6% decline in asking in prices being witnessed in 2016
- The yields have also declined with the average yield being 9.3% in 2016 a 7% decline from the highest average yield of 10.0% in 2013

b) Trends in the Commercial Office Theme in Nairobi

Trends in Kenya's Office Sector

Serviced offices are increasing in popularity as they provide ready to use office spaces and save on time, costs and office administration logistics

Serviced Offices

- Serviced offices are fully equipped and managed offices let usually for short periods of time of up to an hour
- They relieve the interested party of the Costs of setting up a dedicated office and office administration logistics
- Some of the providers of serviced office services in Kenya include ESBC, Regus, Bloom, Horizons Offices
- In Kenya, the serviced offices industry is fairly young with only a 0.35% market share of office space with the highest concentration in Westlands and Upperhill
- **We carried out a research on serviced offices and from our analysis they offer attractive returns with yields of 13.4% on average at 66% occupancy against conventional office spaces with yields of 9.3% despite a higher occupancy of 88%**

Semi-fitted Offices

- In order to attract buyers and tenants, developers are now selling/letting semi-fitted offices as opposed to previous trends where tenants were required to do their own fittings
- Some of the fitting that is done includes tiling, cabling, painting, partitioning, ceilings and kitchen fittings
- This is attractive to tenants and buyers as it reduces the cost of office set-up

Green Office Building

- Offices increasingly employing green building standards to enable energy and resource-efficiency from the design and construction stage to operation and maintenance stages
- This has been known to reduce operational costs in the long run and improve employee productivity while reducing environmental degradation
- Use of green building designs and operations is a fairly new trend in Kenya. Some of the building that have employed the technology include Pope Paul VI Learning Resource Centre at The Catholic University of East Africa, UNEP Nairobi building, Strathmore University building and Vienna Court in Milimani

Smart Offices

- Offices buildings are incorporating use of technology to set themselves apart. These offices use technology to enhance efficiency and optimize productivity through automating routine and everyday tasks
- Some of these include, smart lights that use sensor devices, thermostats, smart switches and use of applications to automate processes

Trends in Kenya's Office Sector

There's increase of Mixed Use Developments so as to diversify revenue streams instead of relying only on income from office space

Mixed-Use Developments

- Offices buildings are integrating the product mix to incorporate retail, residential, hospitality and other functions in order to create multiple revenue streams thus diversify risk, especially at a time when office vacancy rates are increasing
- Some of the developments that have diversified their office space include UAP and Crowne Building in Upperhill, incorporating a retail aspect and a hotel, respectively
- Other upcoming MUDs include Hass Towers and Montave both with office, retail and residential functions

New office districts

- There has been growth and expansion of New office districts in Kenya as firms move away from the Nairobi Central District in search of more space, convenience and high quality business environment
- Parklands, Riverside, Kilimani, Gigiri, Karen and Thika Road are some of the new frontiers in office space provision and we have seen firms such as ICEA Lion relocating to Chiromo Drive

Home - Offices

- Firms are increasingly using home-offices to reduce set-up and operational costs. This involves conversion of residential houses to offices or remotely working from home through equipping them with office equipment
- This is ideal for start-up companies and departments that do not involve interaction with clients
- Residential houses that have been converted to offices are common in Westlands, State-house Avenue and Gigiri

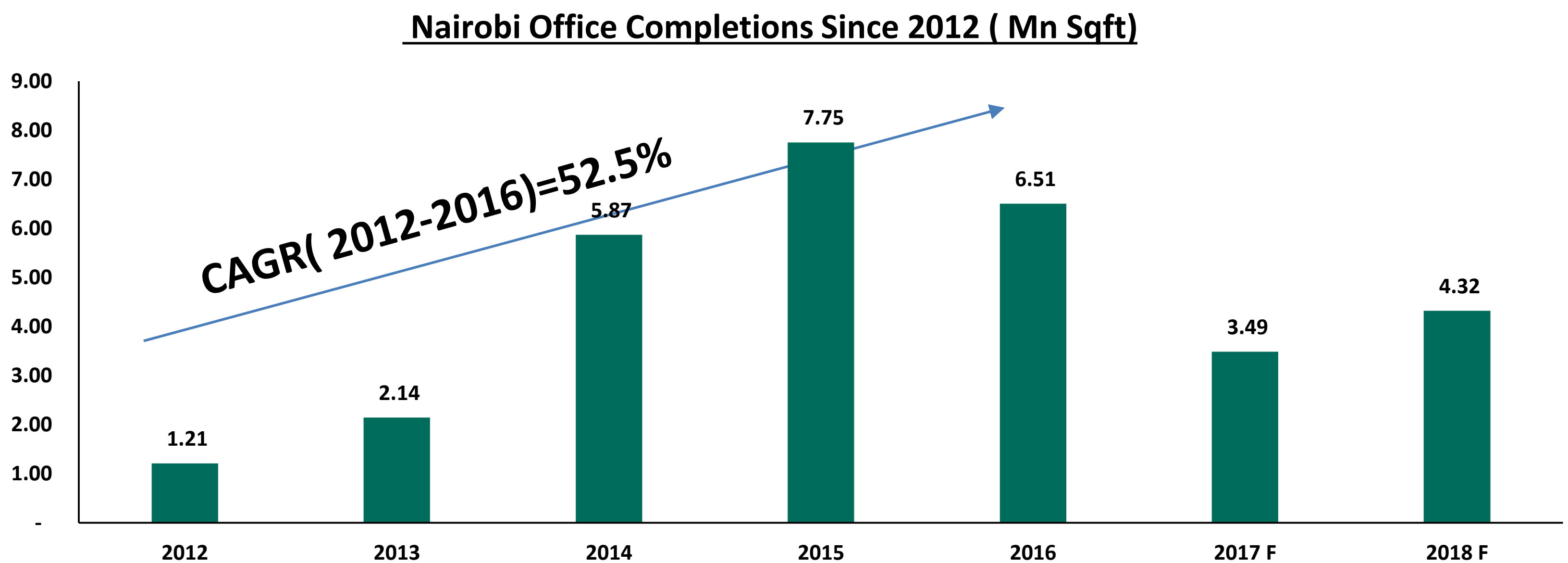
Affirmative Action in Office Design

- Developers and property managers are employing means to favour disadvantaged employees through office design
- These include enabling access for the disabled using ramps, elevators, railings and disability-friendly lavatories
- Also, firms are creating nursery space and mother rooms (Mutter Zimmers). This enables employed mothers to work and still have the comfort of attending to their children in close range
- Firms are also making space for play areas for employees to unwind during breaks for instance Safaricom offices

c) Commercial Office Supply in Nairobi

Office Space Supply-Nairobi

Net completion of office buildings in Nairobi is increased with a 5-year CAGR of 52.5% between 2012 and 2016 driven by demand for office space. Supply expected to reduce in 2017 and 2018 as the market responds to the increased supply



- The supply of office space increased steadily between 2012 and 2016 driven by demand growing businesses, SMEs and multinational firms reaching a total supply of 28.9mn sqft. However, office completions are expected to reduce in 2017 and 2018 as seen through the reduced office building approvals
- This is attributable to increasing vacancy rates indicating that office demand has slowed down in the last 2 years. The trend can be observed as multi-national firms such as HSBC and Atlas Development have been leaving the country citing a harsh investment climate. This is likely to continue as even local companies eg banks have been downsizing to cut on costs

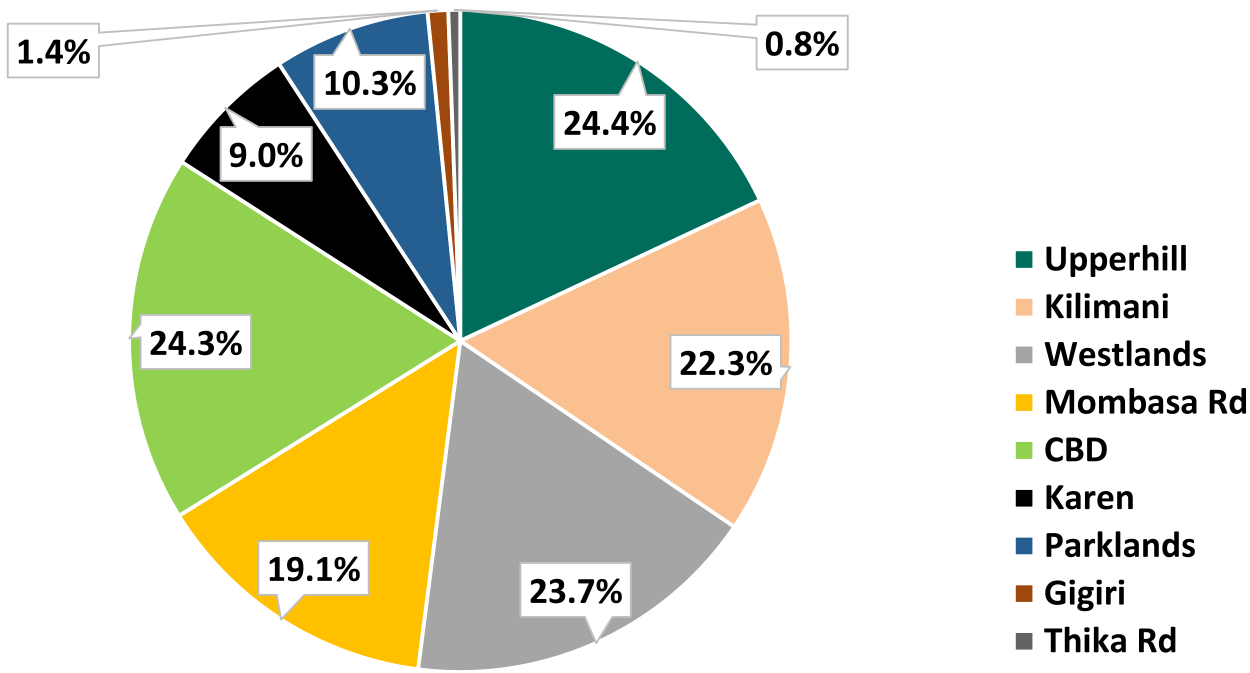
Source: County Government of Nairobi Completions Data, Cytonn Research

Cytonn REAL ESTATE

Office Space Supply-Nairobi

Upperhill, CBD and Westlands have the largest supply, with market shares of 24.4%, 24.3% and 23.7%, respectively with a total market share of 72.4%

Office Space Distribution



- Currently Upperhill, CBD and Westlands have the largest office space supply with market share of the total office space supply in Nairobi of 24.4%, 24.3% and 23.7%, respectively, while Gigiri and Thika Road have the lowest supply with market share of the total office space of 1.4% and 0.8%, respectively
- Upperhill, Westlands and Kilimani have grown as business nodes as firms move away from the CBD in search of better quality space and hence the high supply

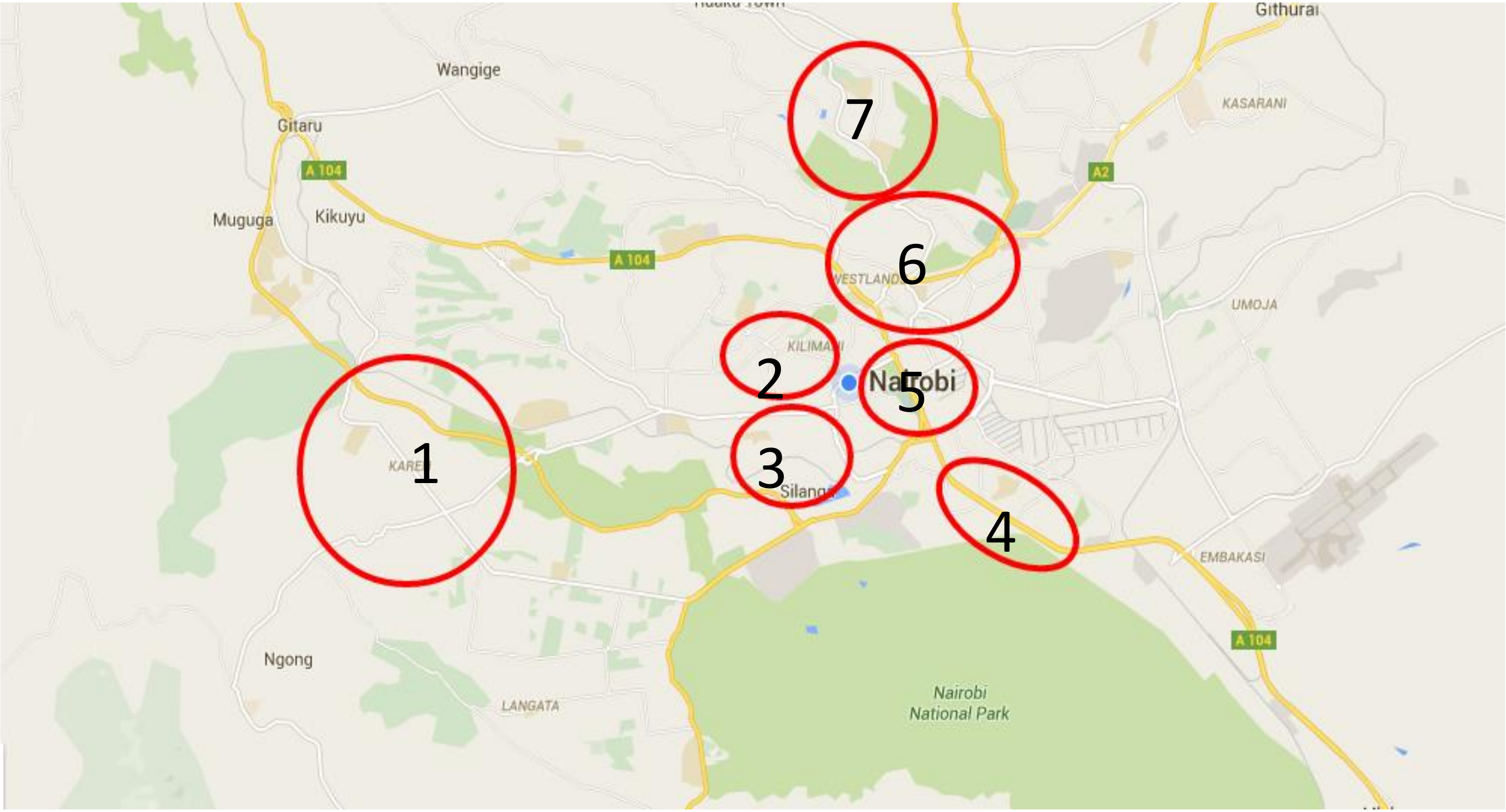
Source: Cytonn Research

d) Commercial Office Market Performance

i. Performance by Nodes

Nairobi Office Market

Demand out of the CBD leads to rising developments in other areas such as Karen and Kilimani



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

Nairobi Office Market Performance

Parklands and Karen are the best performing office markets with yields of 10.0% and 9.7% respectively, mainly as they are located in prime locations hence have a premium on the rents

Area	Price(Kshs/Sqft)	Rents (Kshs/Sqft)	Occupancy(%)	Rental yields 2015 (%)	Rental Yields 2016(%)
Parklands	11,771	102	80.0%	10.0%	10.0%
Karen	13,500	107	90.0%	10.1%	9.7%
Kilimani	12,667	99	90.5%	9.5%	9.3%
Westlands	12,482	102	92.1%	9.3%	9.2%
UpperHill	12,529	102	89.8%	9.0%	9.0%
Nairobi CBD	11,750	92	92.7%	9.3%	9.0%
Thika Road	11,700	91	80.3%	8.3%	8.8%
Mombasa Road	10,720	80	86.1%	8.3%	8.5%
Grand Total	**12,053**	**100**	**88.9%**	**9.2%**	**9.2%**

Source: Cytonn Research

- Parklands and Karen are the best performing office markets with yields of 10.0% and 9.7% respectively, mainly as they are located in prime locations hence have prime rents

- Mombasa Road and Thika Rd have the lowest yields averaging at less than 9.0%. This is attributable to their locations with Mombasa Rd being affected by traffic congestion and its zoning for industrial use while Thika Rd is largely a lower middle income residential zone which has low quality office space hence lower prices and rents

Source: Cytonn Research

Cytonn REAL ESTATE

Nairobi Office Market

Upperhill, Kilimani and Karen have an average yields of more than 9.0% p.a

Upperhill

- Africa's fastest growing business district experienced an influx of supply in 2016 with 190,000 square meters of space being added through openings such as the UAP Old Mutual, Fourth Ngong Towers and Flamingo Towers. The increase in supply resulted in occupancy rates declining by 5.3% to average at 90% from a 95% average in 2015. Despite this yields remained steady averaging at 9.0% but with incoming supply through buildings such as the Montave and Hass Towers we expect the prices and rents to stagnate and eventually cool off

Kilimani

- Predominantly a residential zone, the area has become increasingly commercialized with a number of office spaces coming in up in 2016 notable ones being Kose Heights and Royal Square. The proximity of the area to CBD as well good infrastructure and sufficient accommodation has made it an ideal office zone. In 2016 the occupancy rates increased by 4.5% from 2015 but a 5.7% decline in rents lead to yields declining by 0.2% points to average at 9.3% from 9.5% average in 2015

Karen

- Due to the relaxation of zoning regulations, Karen is becoming more and more commercialized resulting in increased office space. In 2016, approximately 13,000 square meters of office space was added to the market. Due to its prime location and high quality office space provided, it attracted high rents and occupancy of Kshs 107 per sqft and 88%, respectively. It earns high yields of on average 9.7%

Mombasa Road

- Similar to 2015 Mombasa Road recorded the lowest rental rates in the market averaging at Kshs 80 per sqft resulting in average yields of 8.5%. The area attracts low rents due to traffic congestions and zoning for industrial use though newly built high quality office space such as in Next Gen mall can attract higher yields and occupancy rates

Nairobi Office Market, continued…

Parklands sub-market the best performing with an average yield of 10.0%

Parklands

- Like Kilimani, the area previously residential is becoming increasingly commercialized and in 2016, approximately 27,000 square metres of office space was supplied. Its proximity to Westlands, the CBD and sufficient amenities being the main pull factors. It has high returns with the average rental yield being 10.0%. There is an influx of supply however which may result in lower returns in 2017

CBD

- Previously the main business district, it is being relegated to playing a retail function with offices moving out of the zone in search of better environments and better quality office spaces. This has resulted in a 6% decline in occupancy rates from 99% to 93%. The rental yield averaged at 9.0% in 2016

Westlands

- Westlands has had the highest number of completions in the last five years. With average prices of Kshs 12,500 per sqft. The average asking rents is Kshs 102 per square foot with the average yields being 9.2%

Cytonn REAL ESTATE

Nairobi Office Market 2016 Summary

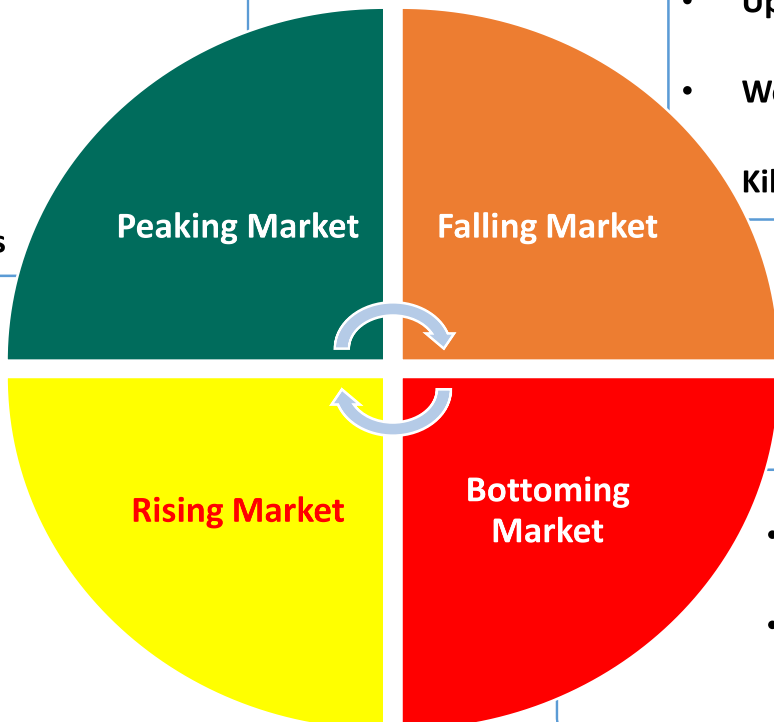
In 2016, the market has gone full circle with the only developers markets being Karen, Gigiri and Parklands. Upperhill, Westlands and Kilimani are in the falling phase with the CBD and Mombasa Rd bottoming out

Developers Market

- **Karen**
- **Gigiri**
- **Parklands**

Tenants Market

- **Upperhill**
- **Westlands**
- **Kilimani**



- **CBD**
- **Mombasa Rd**

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

In 2016, CBD and Mombasa Rd have fallen to bottoming markets from falling markets in 2015, Upperhill, Westlands and Kilimani have transitioned to falling markets after peaking with Karen, Gigiri and Parklands growing to peaking markets from rising markets in 2015

Source: Cytonn Research using JLL Clock

Cytonn REAL ESTATE

ii. Performance by Grades

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 120,000-300,000 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 70,000 to 120,000 square feet. They have good (but lower than grade A) technical services and ample parking space

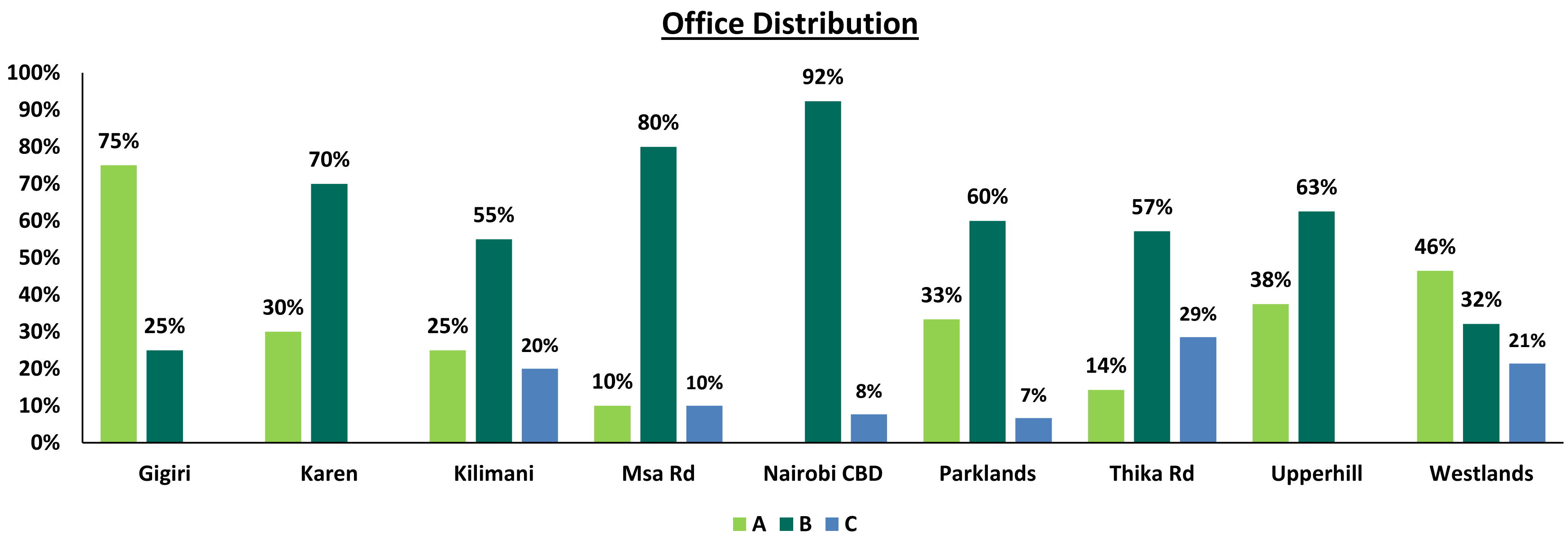
GRADE C

•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

Cytonn REAL ESTATE

Distribution of Various Classes of Offices

Grade B offices are the most common, accounting for 60% of commercial offices in Nairobi



- Office space distribution remains unchanged from last year with Grade B office space accounting for the bulk of office space in the city. From our sample size this was approximately 60%
- There was no grade A office space in the CBD with Mombasa Rd having only 10% of the office space as Grade A
- Gigiri has the highest concentration of Grade A office space at 75% which are also of the highest quality in the market

Performance of the Various Offices by Class

Grade A Offices have the highest returns with average rental yields of 10.0%

Grade	Price(Kshs/Sqft)	Rents(Kshs/Sqft)	Occupancy (%)	Rental Yields(%)
Grade A	12,889	112	85.7%	**10.0%**
Grade B	11,959	98	90.6%	**9.2%**
Grade C	11,245	82	87.5%	**8.6%**
Average	**12,031**	**97**	**88.0%**	**9.3%**

Source: Cytonn Research

- Grade A Offices have the highest yields, rents and prices as they are offered at a premium
- Grade B offices are the most popular in the market at an average occupancy rate of 90.7% compared to 85.7% and 87.5% for grades A and C, respectively. This is as they are more affordable than grade A offices being 7% cheaper and have better facilities than grade C
- Grade C offices continue to have high occupancy as they serve the low end businesses that cannot afford to pay the higher charges levied in grade A and B offices

iii. Performance by Nodes & Grades

Performance by Nodes and Grades

Westlands and Karen have the highest returns for Grade A office spaces with yields of more than 10%, Parklands has the highest returns for Grade B office spaces with yields of on average 10.2% with Kilimani having the highest returns from Grade C office spaces with yields of on average 9.0%

	GRADE A		GRADE B		GRADE C	
Area	**Yield**	**Occupancy**	**Yield**	**Occupancy**	**Yield**	**Occupancy**
Kilimani	9.2%	81.2%	9.4%	93.2%	**9.0%**	**95.3%**
Upperhill	9.3%	60.0%	8.8%	94.0%	7.7%	81.7%
Parklands	9.8%	80.0%	**10.2%**	**83.3%**	9.1%	60.0%
Westlands	**10.3%**	**94.2%**	8.8%	94.0%	7.9%	91.5%
Karen	**10.4%**	**90.0%**	9.6%	90.0%	-	-
Mombasa Rd			8.2%	85.3%	9.0%	87.6%
Thika Rd			9.0%	91.5%	8.7%	58.0%
CBD			9.0%	93.0%	8.5%	90.0%

Source: Cytonn Research

- Among the Grade A offices, those in Parklands and Westlands have highest yields averaging at more than 10.0% and an average occupancy of above 90%
- Parklands has the highest returns for Grade B offices with average rental yields of 10.2%
- Out of the Grade C offices, those in Kilimani and Mombasa Rd have the highest returns with average rental yields of 9.0% for both and high occupancy levels of more than 85%

iv. Parking Data

Parking Analysis

Average rent per bay per month in Nairobi is Kshs 8,621

Area	Highest Fee	Lowest Fee	Average Fee Per Bay
Upperhill	10,000	6,500	9,200
Karen	10,000	6,500	10,000
Kilimani	14,000	3,000	7,900
Parklands	10,000	3,500	7,788
Westlands	12,500	5,000	8,048
CBD	12,000	10,00	10,500
Mombasa Rd	8,000	3,500	5,625
Thika Rd	8,000	6,000	6,667
Average Fee per Parking Bay			**8,216**
Highest Sale Price			**2,500,000**
Lowest Sale Price			**850,000**

Source: Cytonn Research

- Tenants are charged parking fees of Kshs 8,000 per bay on average with the rates ranging from as low as Kshs 3,500 in low quality grade C offices in poor location such as Mombasa Rd to highs of Kshs 12,500 in high quality grade A office spaces in prime locations such as Westlands
- Parking bay sale prices in Nairobi range from Kshs 850,000 per bay to 2.5 million per bay, with open parking bays charging lower while covered bays charge a premium
- Offices in the CBD have high parking rates as the area generally has inadequate parking space

Cytonn REAL ESTATE

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 estimate the supply situation in Nairobi, we used Gap Analysis
- Gap analysis is a tool that measures the under or over supply 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 its 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 approvals given in 2017, the market will have a supply of 6.3mn sqft against a demand of 3.1 mn sqft translating to an oversupply of 3.2mn sqft**

Office Space Opportunity

Based on approvals data we will have an oversupply of 3.2mn sqft of office space in 2017

Year	2011	2012	2013	2014	2015	2016	2017	2018
Stock (Mn Sqft)	6.7	7.7	9.7	15.4	22.9	28.9	31.8	35.5
Completions (Mn Sqft)		**1.2**	**2.1**	**5.9**	**7.8**	**6.5**	**3.5**	**4.3**
Vacancy Rate (%)	9.0%	9.0%	10.0%	10.0%	11.0%	12.0%	12.0%	13.0%
Vacant Stock (Mn Sqft)	0.6	0.7	1.0	1.5	2.5	3.5	3.8	4.6
Occupied Stock (Mn Sqft)	6.1	7.1	8.8	13.9	20.3	25.4	28.0	30.9
Net Absorption		**1.0**	**1.7**	**5.1**	**6.5**	**5.1**	**2.6**	**2.9**
Available Supply, AS(T)		1.7	2.6	6.5	8.8	8.4	6.3	7.4
Gap, GAP(T)		**(0.5)**	**(0.8)**	**(1.2)**	**(2.1)**	**(2.9)**	**(3.2)**	**(3.9)**

Gap= Net absorption + space required to replace depreciated stock - Available supply

Source: KNBS, NCG Completions data, Cytonn Research

Cytonn REAL ESTATE

Office Space Opportunity

It is a good time to invest for long tem gains. Opportunity in the sector is in Grade A office space, in serviced offices, in zones with low supply and in new markets such as county headquarters with low supply of office space

Grade A Office Space

- Grade A Office space offer an attractive investment opportunity due to:
- Low supply – Grade A offices have a market share of 10% compared to 60% for grade B office space
- High Returns – They have the highest returns in the market with average rental yields of 10.0% against a market average of 9.3% and are hence an attractive investment opportunity

Differentiated Concepts

- Such as 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 9.3% for conventional offices
- They will thus not only increase an investors returns, but also diversify his portfolio

Low Supply Zones

- Despite the oversupply in the market, some zones still have relatively low supply such as Gigiri with a market share of 1.8% 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 Parklands and Gigiri

It is a good time to invest in the commercial office theme for long term gains when the market picks up in 3-4 years. Investments should be geared towards zones with low supply such as Grade A offices, zones with high returns such as Parklands and differentiated concepts such as green buildings, smart offices and serviced offices

f) Office Market Conclusion and Outlook

Office Market Conclusion and Outlook

Opportunity for investment in the theme lies in specific pockets of value such as in Grade A office spaces in Gigiri, Mixed Use Developments encompassing a commercial office component and in serviced offices

Measure	Sentiment
Supply	• We have an oversupply of 3.2 mn sqft of office space in 2017 and it is expected to grow by 21% to 3.9 mn sqft in 2018
Office Market Performance	• Increased supply is constraining performance with occupancy rates and yields declining as rents and prices experience slower growth rates • Based on supply pipeline the trend may continue before the market picks up. Despite this the sector offers attractive returns in selected markets of up to 10% yields with 90% occupancy
Serviced Offices Performance	• Serviced offices offer attractive returns with yields of on average 13.4% at 50% occupancy. They are also in low supply accounting for only 0.35% of the office space supplied in Nairobi and are hence a good investment opportunity
Outlook	• We expect to witness reduced development activity as the market reacts to the stagnating prices and returns • For 2017 we also expect the prices to remain at 2016 levels or decline as the office market is transitions from a developers market to a buyers market
Opportunity	• It is a good time to invest in the commercial office theme for long term gains when the market picks up in 3-4 years. Investments should be geared towards zones with low supply, high returns and differentiated concepts • Such as grade A office space, serviced offices and new markets such as county headquarters

Thank You!

For More Information

- Free Real Estate Market Research: www.cytonnreport.com
- Follow on Twitter @CytonnInvest
- On Facebook: Cytonn Investments
- Contact: RDO@Cytonn.com

Cytonn REAL ESTATE

Appendix

The Team

Investments and real estate research team responsible for Kenya's Retail Report

Elizabeth N. Nkukuu,
Partner & CIO

Johnson Denge,
Real Estate Services Manager

Shiv Arora,
Head - Private Equity Real Estate

Nancy Murule,
Research Analyst

Juster Kendi
Research Analyst

Patricia Wachira,
Research Analyst

George Evans Muriithi,
Research Analyst

Cytonn REAL ESTATE