Cytonn Annual Market Outlook – 2018

5th February, 2018

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I. Overview of the Firm

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

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

82	Over Kshs. 82 billion worth of projects under mandate	**6**	Six offices across 2 continents	**275**	Over 275 staff members	**10**	10 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

We collect funds from our clients → **We invest them in high growth opportunities** → **We deliver the best possible returns**

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, Hospitality 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**

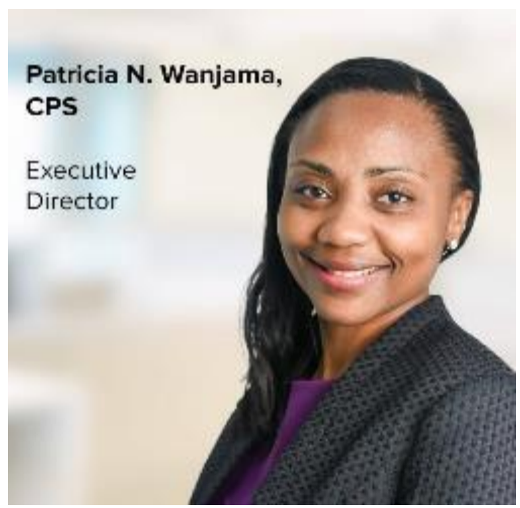
We are focused on one agenda:

THE CLIENT

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 11 members from diverse backgrounds, each bringing in unique skill-sets to the firm.

Board of Directors, continued…



Governance Committees

We have four main board committees to ensure all of Cytonn's functions are done in a fair and transparent manner:

Investments and Strategy Committee

The committee oversees and provides strategic investment direction, including the implementation and monitoring process. The members are:-

- James Maina (Chair)
- Antti-Jussi Ahveninen, MSc
- Madhav Bhalla, LLB
- Edwin H. Dande, MBA
- Elizabeth Nkukuu, CFA

Audit, Risk and Compliance Committee

The committee establishes and oversees risk and compliance, including the implementation and monitoring process. The members are:-

- Madhav Bhalla, LLB (Chair)
- Nasser Olwero, Mphil
- Madhav Bhandari, MBA
- Dr. Nancy Asiko Onyango, DBA
- Patricia N. Wanjama, CPS

Governance, Human Resources and Compensation Committee

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

- Antti-Jussi Ahveninen, MSc (Chair)
- Prof. Daniel Mugendi Njiru, PhD
- Michael Bristow, MSc (Chair)
- Rose Kimotho, M.B.S
- Edwin H. Dande, MBA

Technology and Innovation Committee

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

- Nasser Olwero, Mphil (Chair)
- Michael Bristow, MSc
- Rose Kimotho, M.B.S
- Patricia N. Wanjama, CPS

II. Global and Regional Markets Outlook

Global Market Summary

India and China have the highest expected 2017 & 2018 GDP growth rates of major economies at 6.7% and 6.8%, for 2017, and 7.4% and 6.5% for 2018, respectively

World GDP Growth Rates

	Region	2014a	2015a	2016a	2017e	2018f
1.	India	7.2%	7.6%	7.1%	6.7%	**7.4%**
2.	China	7.3%	6.9%	6.7%	6.8%	**6.5%**
3.	Middle East, North Africa	2.7%	2.3%	5.0%	2.6%	**3.5%**
4.	Sub-Saharan Africa	5.1%	3.4%	1.4%	2.6%	**3.4%**
5.	United States	2.4%	2.6%	1.5%	2.2%	**2.3%**
6.	Euro Area	1.1%	2.0%	1.8%	2.1%	**1.9%**
7.	United Kingdom	3.1%	2.2%	1.8%	1.7%	**1.5%**
8.	Brazil	0.1%	(3.8%)	(3.6%)	0.7%	**1.5%**
9.	South Africa (SA)	1.6%	1.3%	0.3%	0.7%	**1.1%**
10.	Japan	0.0%	0.5%	1.0%	1.5%	**0.7%**
	Global Growth Rate	**3.4%**	**3.2%**	**3.2%**	**3.6%**	**3.7%**

Source – International Monetary Fund (IMF)

Cytonn INVESTMENTS

Factors That Will Affect Global Markets in 2018

Robust trade growth, stable commodity prices & tightened monetary policy in the horizon

Monetary Policy Stance

- The US Fed is expected to continue unwinding its quantitative easing program, as well as the expectation of three further rate hikes in 2018
- The ECB plans to reduce its quantitative easing program by reducing the monthly bond buying program to EUR 30.0 bn from EUR 60.0 bn as from January 2018, with the option to extend the stimulus package beyond September

Global Trade

- The World Trade Organization (WTO) upgraded their outlook for world trade growth in 2017 to 3.6% from their 2.4% expectation in April 2017, citing a resurgence in Asian trade flows as intra-regional shipments picked up, and as import demand in North America recovered after stalling in 2016
- Trade growth is expected to remain robust in 2018, albeit less so than in 2017 as per WTO, due to (i) a higher base effect from a thriving 2017, compared to a weak year in 2016, and (ii) controlled fiscal expansion in China, to prevent the economy from heating

Stable Commodity Prices

- Global commodity prices have registered gains in 2017, with crude oil, metals & minerals, and energy registering gains of 15.7%, 13.5%, and 11.5%, respectively, while agriculture experienced a decline of 2.1%, as per the World Bank Commodity Prices Index. According to the World Bank, oil prices are forecast to rise to USD 56.0 a barrel in 2018 from USD 53.0 a barrel in 2017 as a result of steadily growing demand and a sustained cap on oil production by OPEC countries and Russia, despite increased US shale oil output

Global Market Outlook

The US & Eurozone economies are expected to remain strong in 2018, while China grows at a steady pace, supported by positive structural reforms

United States

- The Fed is expected to raise interest rates three times in 2018, supported by a relatively stronger US economy, with unemployment levels at 4.1% and inflation edging towards the 2.0% target
- The stock market is expected to do well supported by strong earnings growth, as consumer sentiment improves

Euro-Zone

- The ECB plans to reign in on its quantitative easing program by reducing the monthly bond buying program to EUR 30.0 bn from EUR 60.0 bn as from January 2018, with the option to extend the stimulus package beyond September 2018
- The region's growth is estimated to come in at 1.9% in 2018, but still at strong levels, from an expectation of 2.1% in 2017, following tightened monetary policy indications

China

- The Chinese economy is expected to grow by 6.5% in 2018, with the country having embraced monetary and fiscal stimulus measures in a bid to support the country's growth. However, despite this strong growth, China's increasing debt levels and dependency on credit to fuel growth continues to pose a major financial stability threat to the global economy

Regional Macroeconomic Outlook

The Sub Saharan Africa Region is expected to grow by 2.6% in 2017 according to the International Monetary Fund, and 3.4% in 2018 as commodity-driven economies recover with recovery of global prices

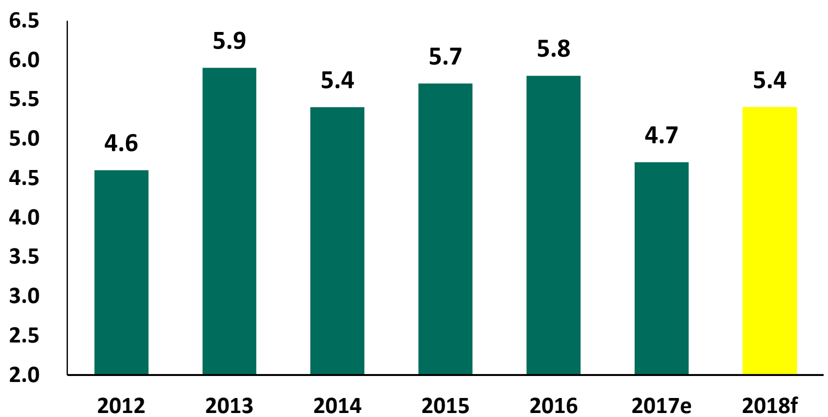
- Sub Saharan Africa (SSA) is expected to register economic growth of 3.4% in 2018, higher than the 2.6% expected in 2017 and 1.4% recorded in 2016
- This is due to expectations of improved growth in commodity driven countries such as Nigeria and Angola which are expected to grow by 0.8% and 1.5% in 2017 and by 1.9% and 1.6% in 2018, up from (1.6%) and (0.7%) registered in 2016, as oil prices and production improve, and Nigeria continues to strengthen its agricultural sector
- South Africa's GDP growth is also still expected to improve to 0.7% in 2017 and 1.1% in 2018 from 0.3% in 2016, despite political uncertainty that has led to decreased investor confidence in the country
- Average growth in South Africa and Nigeria for the first three quarters of 2017 came in at 1.4% and 0.4%, respectively, indicating a positive improvement towards full year projections
- Other countries expected to drive growth in 2017 are Ethiopia, at 8.5% according to the IMF and Ghana at 7.9%, according to the Bank of Ghana,
- The two countries are expected to grow by 8.5% and 8.9% in 2018, once again driving growth

Source – IMF

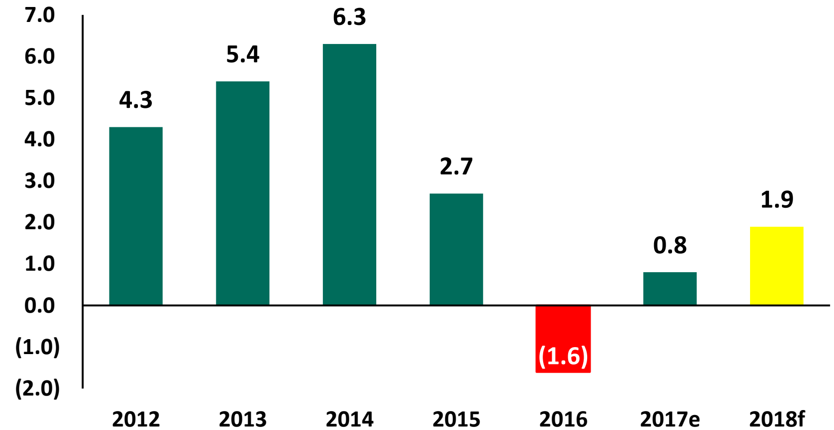
GDP Growth – Select SSA Countries

Sub Saharan Africa is expected to grow by 3.4% in 2018, with the main countries expected to drive growth being Nigeria, Ethiopia, Ghana and Kenya

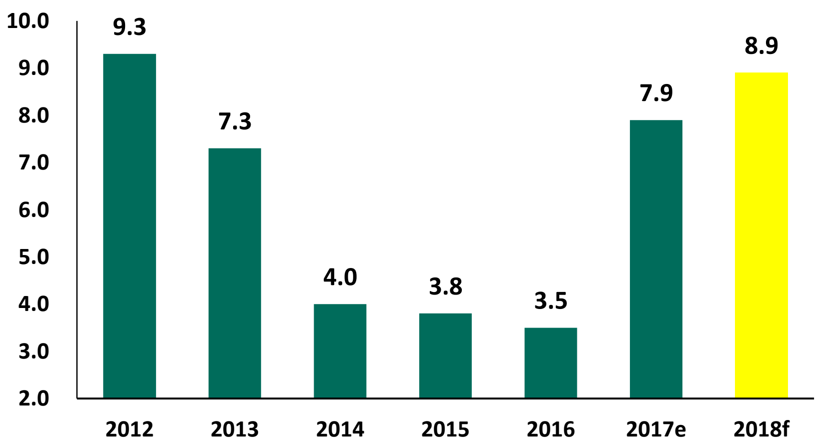
Kenya



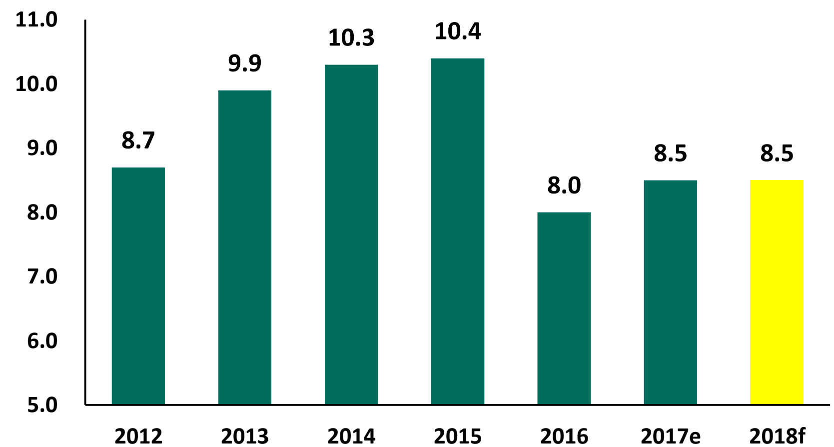
Nigeria



Ghana



Ethiopia

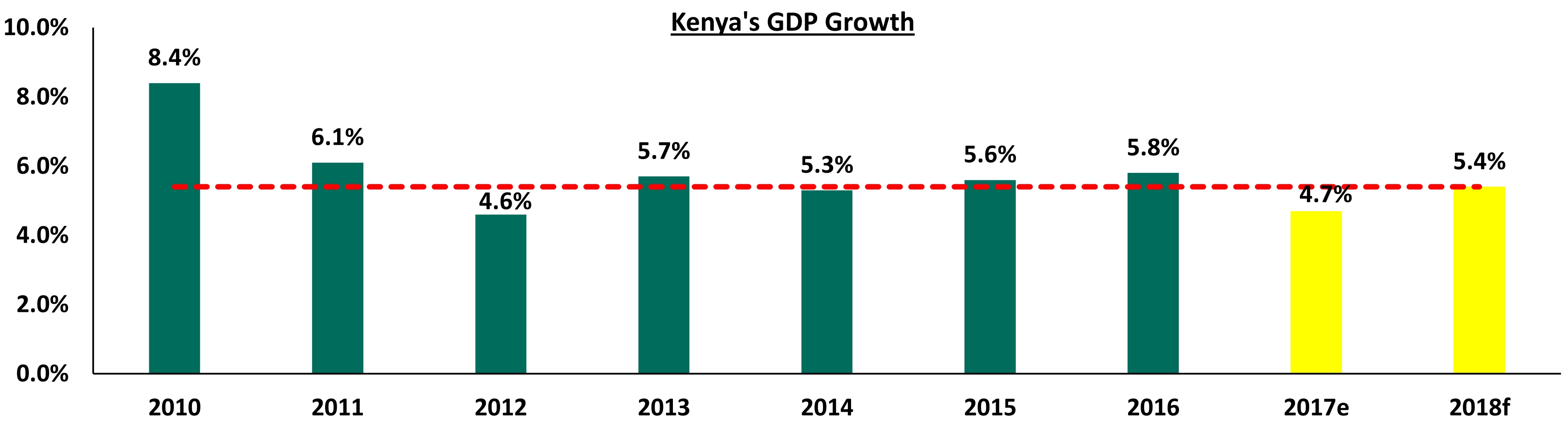


INVESTMENTS

III. Kenya Macroeconomic Outlook

Kenya – GDP Growth

2017 GDP is expected to grow by 4.7% supported by growth in RE & recovery of the tourism sector



- GDP growth in **2016** came in at 5.8% supported by strong performance in key sectors such as Real Estate and the continued recovery of tourism
- **2017** GDP has averaged 4.7% for the first 3 quarters and we expect it to come in between 4.5% - 4.8% supported by (i) strong growth in the real estate sector, (ii) the recovery of the tourism sector, and (iii) the continued growth of the construction sector
- Growth to be slower than for 2016 given the expectation of slow growth in agriculture and financial & insurance sectors given (i) the effects of the 2016/17 drought on agriculture, and (ii) bank margin reduction following the cap
- We expect **2018** GDP growth between 5.3% - 5.5%, driven by (i) recovery of the agriculture sector, (ii) continued strong growth in the real estate and tourism sectors, (iii) public infrastructural investments boosting growth in the construction sector, and (iv) growth in the manufacturing sector

Sectors That Will Shape Economic Growth in 2018

We expect GDP growth in 2018 to be driven by recovery of the agriculture sector, continued strong growth in the real estate and tourism sectors, and growth in construction and manufacturing sectors

Agriculture

- Growth in agriculture is set to recover with improving weather conditions and driven by the government's efforts towards food security through re-engineering and mechanization

Manufacturing

- The manufacturing sector is set to grow rapidly with the government's plan to re-vamp industries and encourage further growth in agro-processing, to increase contribution to a government set target of 15.0% of GDP from 10.2% currently

Real Estate

- Real estate will continue to exhibit strong growth in 2018 driven by private sector investments and government plans to build 500,000 new homes in the next 5 years

Construction

- Growth in construction will mainly be driven by government spending on projects such as phase II of the SGR, development of ports, LAPSSET, airport upgrades and energy projects

Accommodation & Food Services

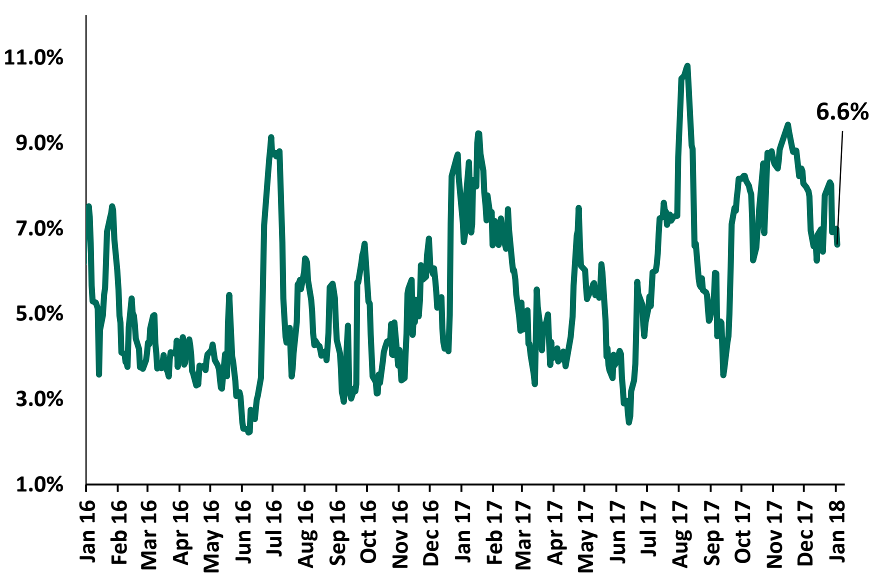
- Tourism is one of the sectors of focus, exhibiting double digit growth in 2017. We expect this to continue in 2018 driven by better security and budgetary allocation towards recovery of the sector

Source – President Inaugural Speech 2017, Budget Statement 2017/2018

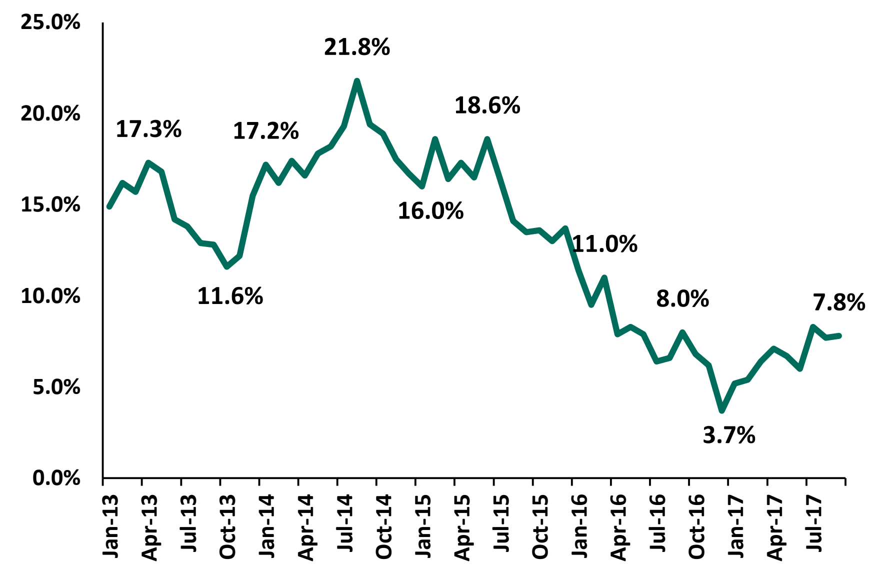
Market Liquidity and Money Supply

We expect liquidity to be better distributed in the money market in 2018 as the Central Bank works to introduce the use of pooled securities as collateral for interbank transactions

Interbank Rates (%)



Money Supply Growth (M3) (y/y)

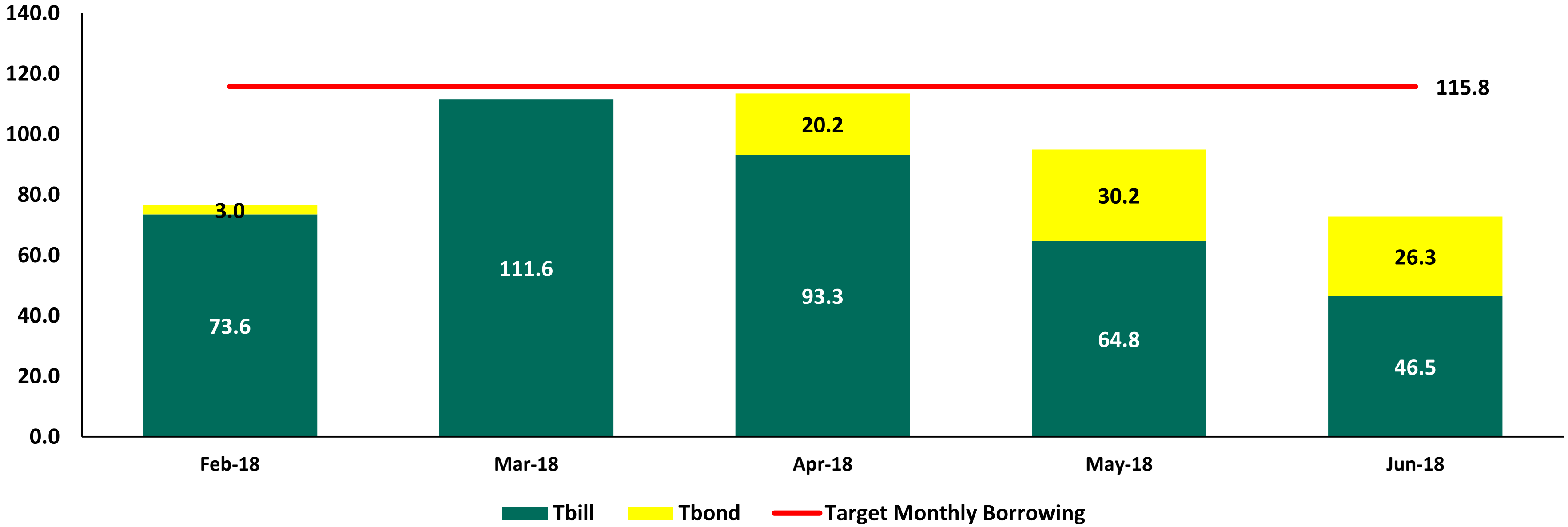


- In 2017, the interbank rate averaged 6.3%, higher than 4.7% in 2016, indicating lower liquidity levels in the money market, in line with money supply growth which has declined to a 2017 average of 6.7% in 9 months to September compared to 8.6% recorded in the same period in 2016. Liquidity remained skewed towards larger banks
- The CBK was active in the money market through Kshs 486.2 bn worth of reverse repos
- In 2018, with the CBK exploring the use of pooled securities under the control of a central counterparty as collateral for interbank money market transactions, we expect that this will serve to redistribute and improve liquidity in the money market

Source – Central Bank of Kenya

Government Debt – FY 2017/18

The government will have to borrow Kshs 115.8 bn locally on a monthly basis to meet both its domestic borrowing target of Kshs 410.2 bn and maturity obligations worth Kshs 469.5 bn



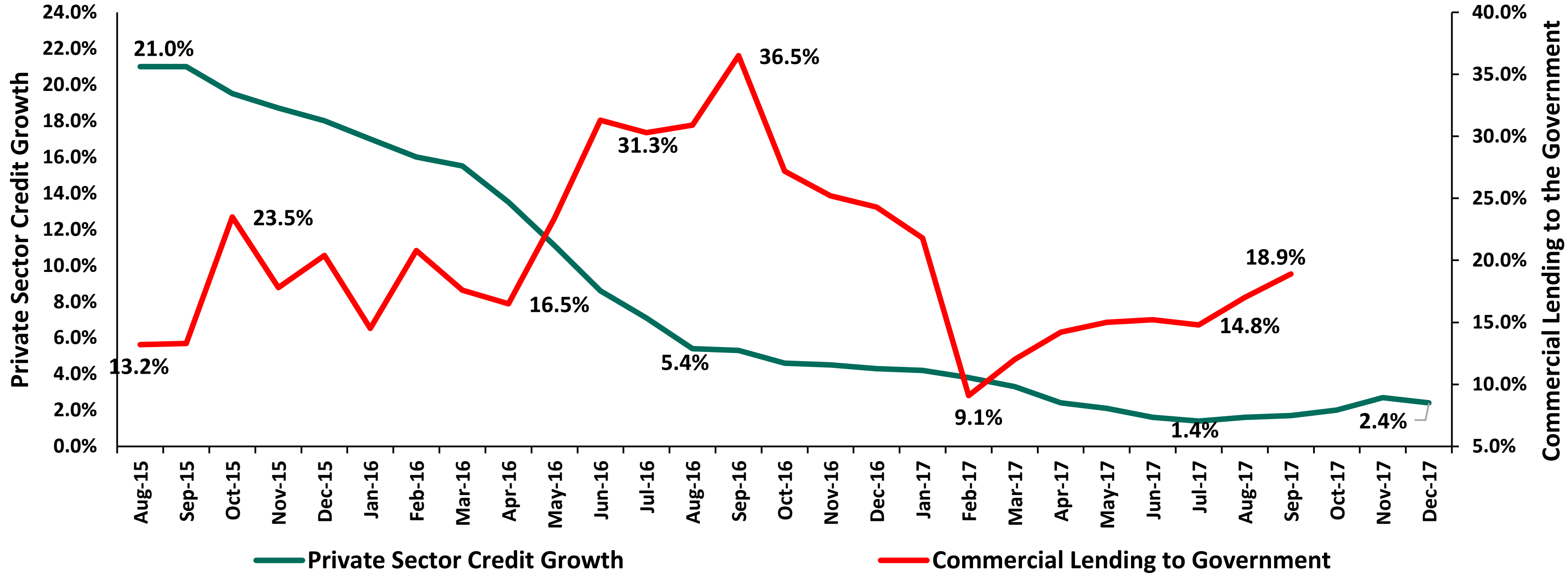
- Government is behind its target on its domestic borrowing schedule, having borrowed Kshs 185.0 bn against a pro-rated target of Kshs 244.5 bn
- T-Bill Total Maturities = Kshs 389.7 bn
- Bonds Total Maturities = Kshs 79.8 bn
- Domestic borrowing target = Kshs 410.2 bn
- Target monthly borrowing = Kshs 115.8 bn

Source – Central Bank of Kenya

Private Sector Credit Growth

Private sector credit growth is expected to remain low in 2018

Private Sector Credit Growth vs Commercial Lending to the Government



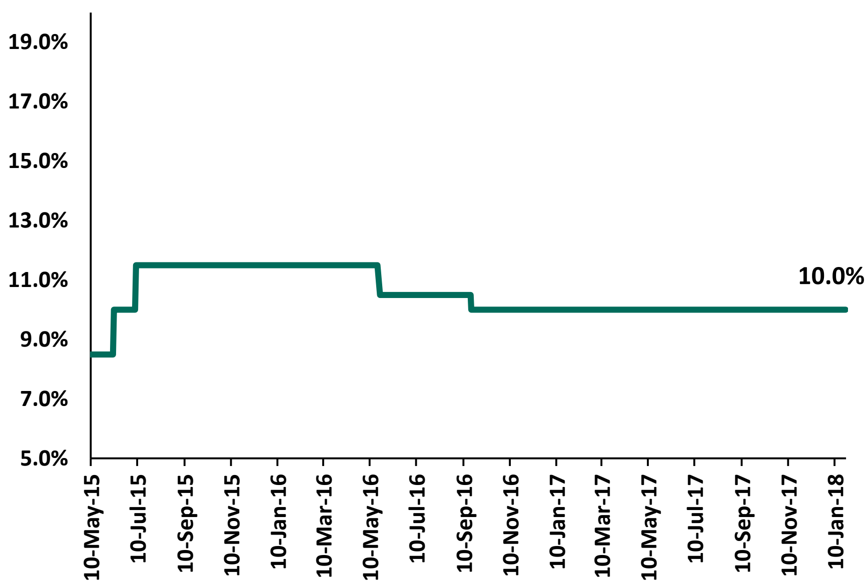
- Private sector credit growth remained low throughout 2017, averaging 2.4% in 2017, compared to a 5-year average of 14.0% as commercial lending to the government increased
- In 2018, with banks embarking on implementation of IFRS 9 that will require them to be more prudent in terms of provisioning, we expect private sector credit growth to remain below the government target of 18.3% and interest rates to remain stable as long as the interest rate cap is in place; with banks channelling additional funds towards the government, thereby crowding out the private sector

Source – Central Bank of Kenya

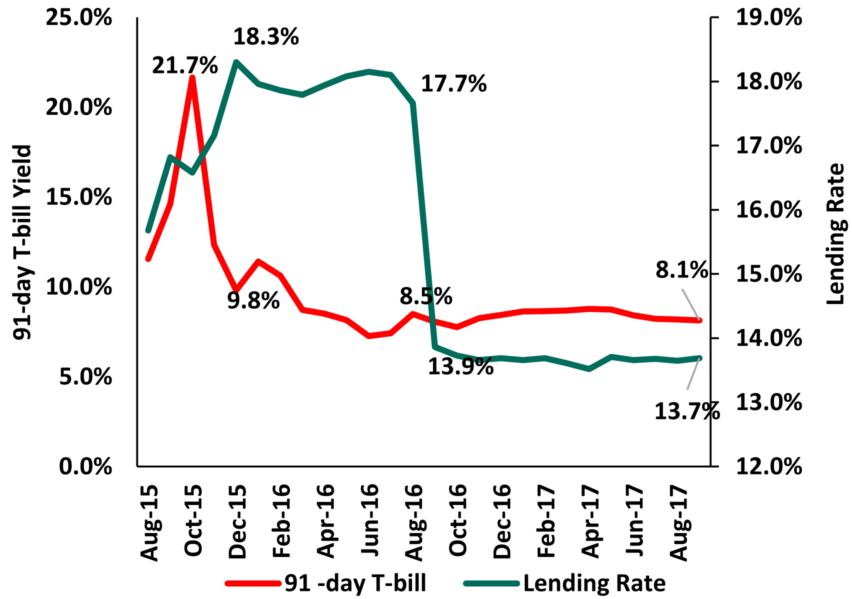
Interest Rates and Monetary Policy

We expect interest rates to remain stable in 2018, with the interest rate cap still in place

Kenya
Central Bank Rate



Interest Rates:
Lending Rates vs 91-day T-bill



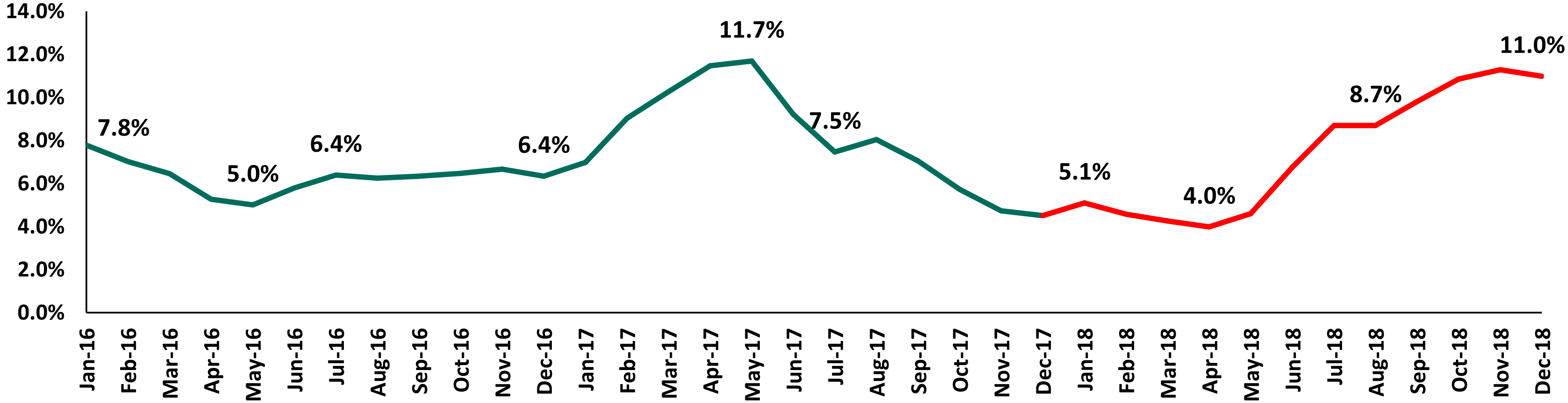
- Interest rates remained stable since the passing of the interest rate cap in September 2016
- In 2018, with the interest rate cap still in place, we expect that interest rates will maintain their stability
- The CBR was held at 10.0% throughout 2017 as the currency remained relatively stable, only depreciating by 0.7% and the economy remaining resilient, despite a decline in private sector credit growth, which averaged 2.4%
- In 2018, with expectations of a stable macroeconomic environment, a stable shilling, inflation averaging within the government target range and the interest rate cap still in place, we expect the CBR to be maintained at 10.0%

Source – Central Bank of Kenya

Inflation Forecast

Kenya inflation rate is expected to average 7.5% in 2018, with pressure mainly from electricity and fuel prices that are expected to rise

Kenya's Inflation Rate Forecast 2018

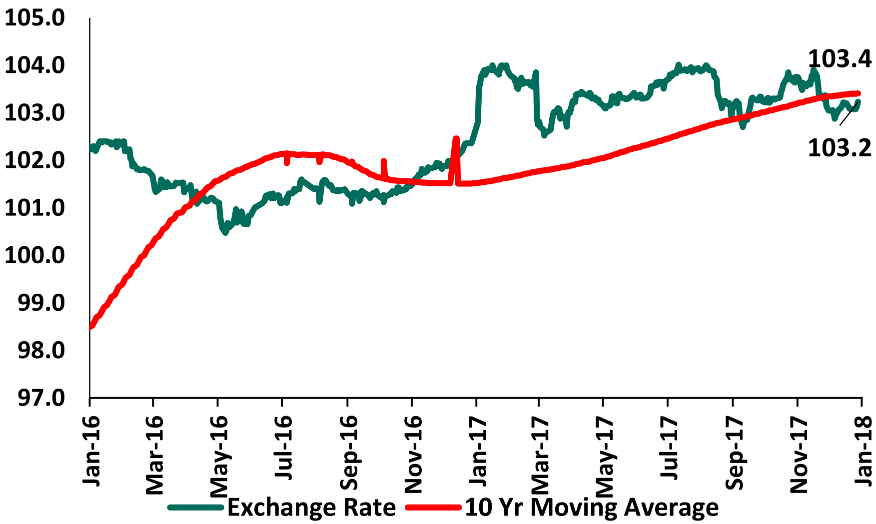


- Kenya's Inflation rate stood at 8.0% for the year 2017 up from 6.3% in 2016, mainly due to a rise in prices for Food and Non-alcoholic beverages by 8.0% y/y
- Going forward, we expect inflationary pressure from (i) rising electricity prices as the Kenya Power Company recovers the Kshs 8.1 bn in backdated bills from consumers, and (ii) expected recovery of global oil prices that will result in higher local fuel pump prices and higher transport prices
- This, however, is expected to be countered by a base effect especially in H1'2018, due to the high rates witnessed in a similar period in 2017, and the increased maize flour prices in January, when the maize subsidy ended on December 31st 2017, should be cushioned by declining prices of other food basket items as a result of improved weather conditions
- 2018 average inflation is expected to come in at 7.5%, just at the upper bound of the government target range of 2.5% - 7.5%

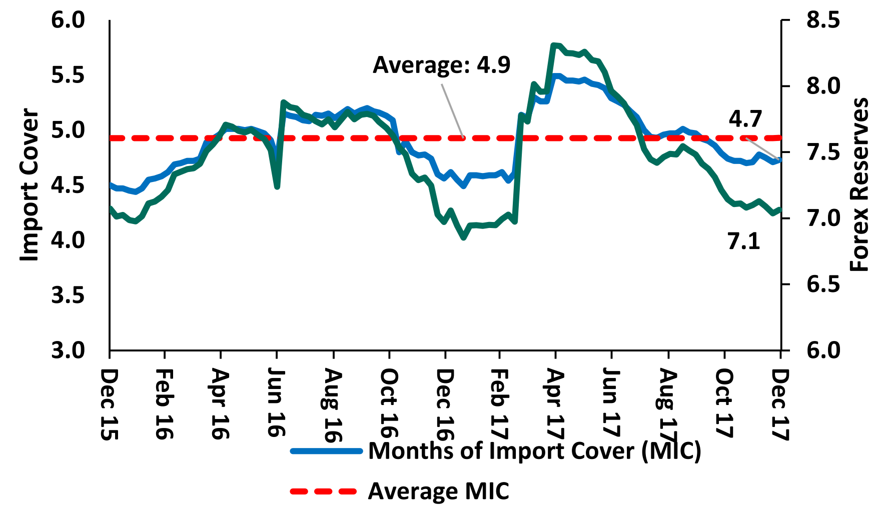
Exchange Rate

We expect the Shilling to range between Kshs 102.0 and Kshs 107.0 to the USD in 2018

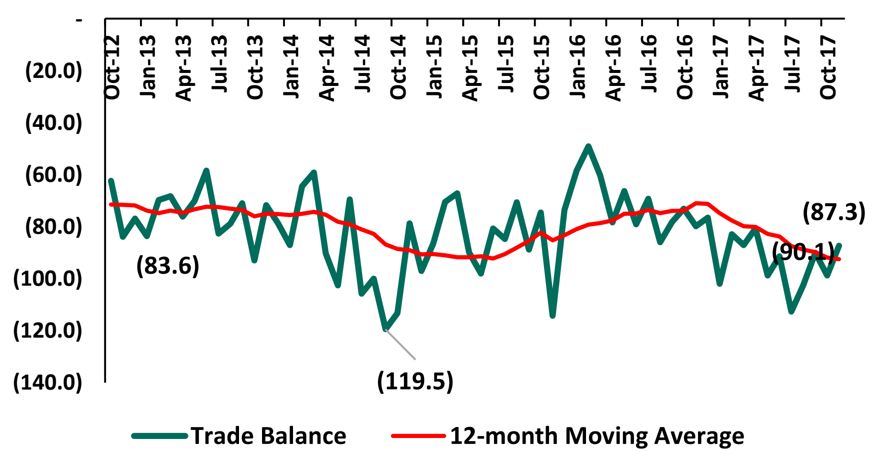
Kshs. Vs USD



Kenya Months of Import Cover and Forex Reserves



Trade Balance



- In 2018, the shilling is likely to come under pressure from an expected increase in the value of oil imports should global oil prices continue to rise; but remain supported by (i) declined food imports and improved agricultural exports as production improves due to improved weather conditions, (ii) the CBK's foreign exchange reserves of USD 7.0 bn (equivalent to 4.7 months of import cover), and (iii) the continued weakening of the US Dollar

2018 Macroeconomic Outlook - Summary

Four indicators are positive, two are neutral and one is negative. Overall effect is positive

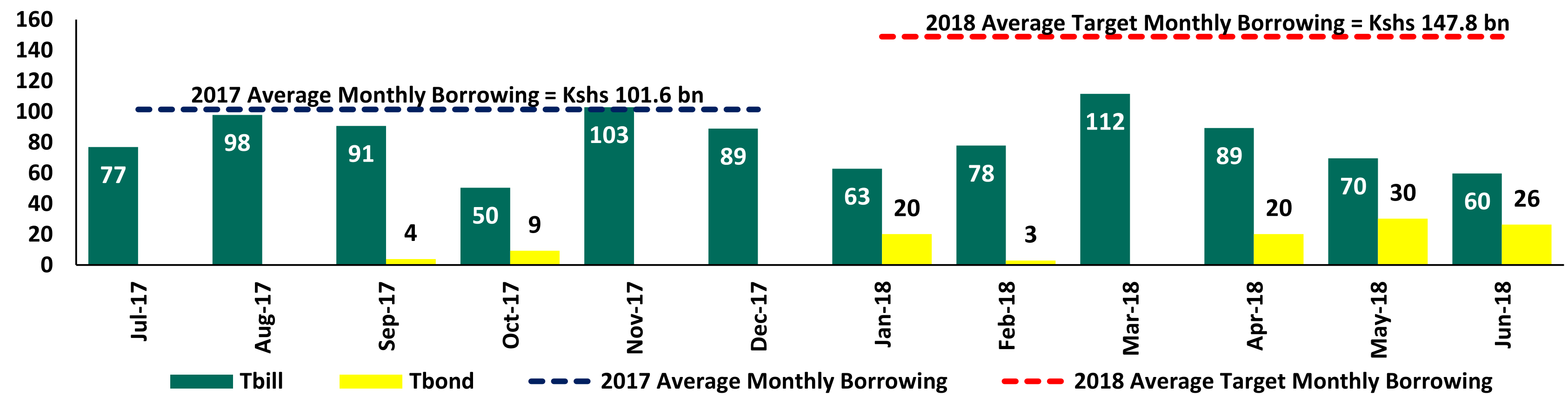
Macro-Economic & Business Environment Outlook		
Macro-Economic Indicators	**2018 Outlook**	**Effect**
Government borrowing	Government to come under pressure to borrow as it is well behind both domestic and foreign borrowing targets for FY 2017/18, and KRA is unlikely to meet its collection target due to expected suppressed corporate earnings in 2017, whose 2nd half will constitute the 1st half of the fiscal year 2017/18. This might result in further borrowing from the domestic market to plug in the deficit	**Negative**
Exchange Rate	We project that currency will range between Kshs 102.0 and Kshs 107.0 against the USD in 2018 The CBK will continue to support the Shilling in the short term through its sufficient reserves of USD 7.0 bn (equivalent to 4.7 months of import cover)	**Neutral**
Interest Rates	We expect upward pressure on interest rates, especially in the first half of the year, as the government falls behind its borrowing targets for the fiscal year. However, with the Banking (Amendment) Act, 2015, the MPC might be unable to do much with the CBR which has remained at 10.0% throughout 2017	**Neutral**
Inflation	Inflation is expected to average 7.5%, which is just at the upper bound of the government target range of 2.5% - 7.5%	**Positive**
GDP	5.4% growth projected in 2018, higher than the expected growth rate of 4.7% in 2017, and in line with the 5-year historical average of 5.4%	**Positive**
Investor Sentiment	Given (i) the now settling operating environment following the elections in Q3'2017, (ii) the expectation that long term investors will enter the market seeking to take advantage of the valuations which are still historically low, and (iii) expectations of a relatively stable shilling, we expect investor sentiment to improve in 2018	**Positive**
Security	We expect security to be maintained in 2018, especially given that the elections are now concluded and the government is settling into office. The USA has also lifted its travel warning for Kenya, placing it in the 2nd highest tier of its new 4-level advisory programme, indicating positive sentiments on security from the international community	**Positive**

IV. Fixed Income Market Outlook

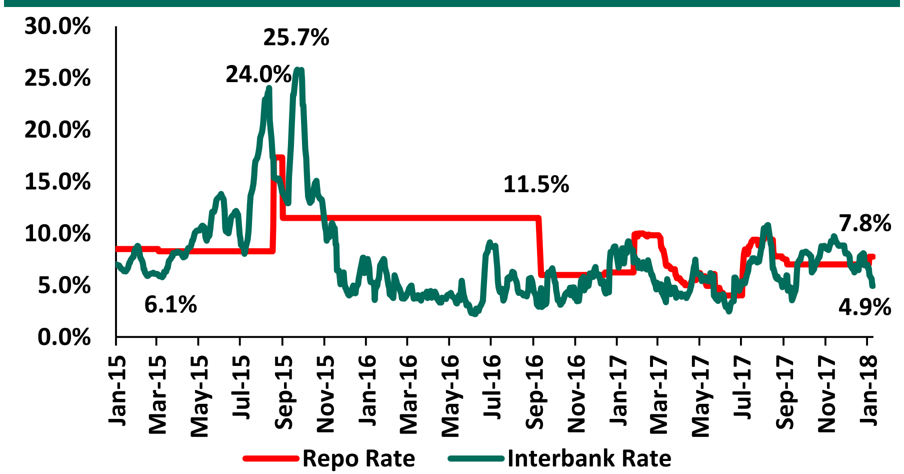
Market Liquidity and Government Borrowing

The government will need to borrow Kshs 147.8 bn on average each month for the rest of the fiscal year in order to meet its domestic borrowing target

Fiscal Year 2017/18 Government Domestic Borrowing Programme - Redemptions



Interbank & Repo Rates



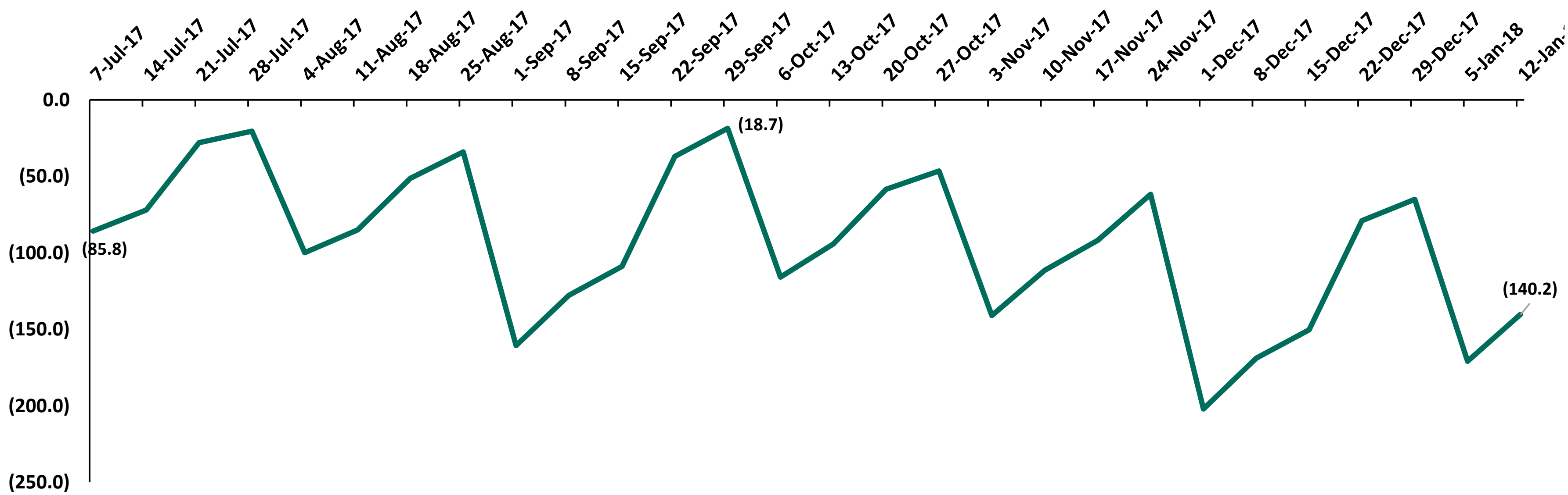
- The government will need to borrow Kshs 147.8 bn on average each month in the second half of the fiscal year in order to meet its domestic borrowing target of Kshs 410.2 bn and also cover the arising T-bill and T-bond maturities, as illustrated in the graph
- Currently, the government requires Kshs 115.8 bn each month

Source – Central Bank of Kenya

Revenue Collection 2017-2018 Fiscal Year

The revenue collection deficit has been widening in the current fiscal year, with the government unlikely to meet its revenue collection target

Revenue Collection Deficit 2017-2018 Fiscal Year (Kshs bn)



- The revenue collection deficit has been on an increasing trend since the start of the fiscal year. However, as a percentage of the collection target, the deficit has moved from a monthly average of 43.6% to 13.3% currently, indicating improved efforts. However, the government is unlikely to meet its revenue collection target, with depressed earnings growth expected

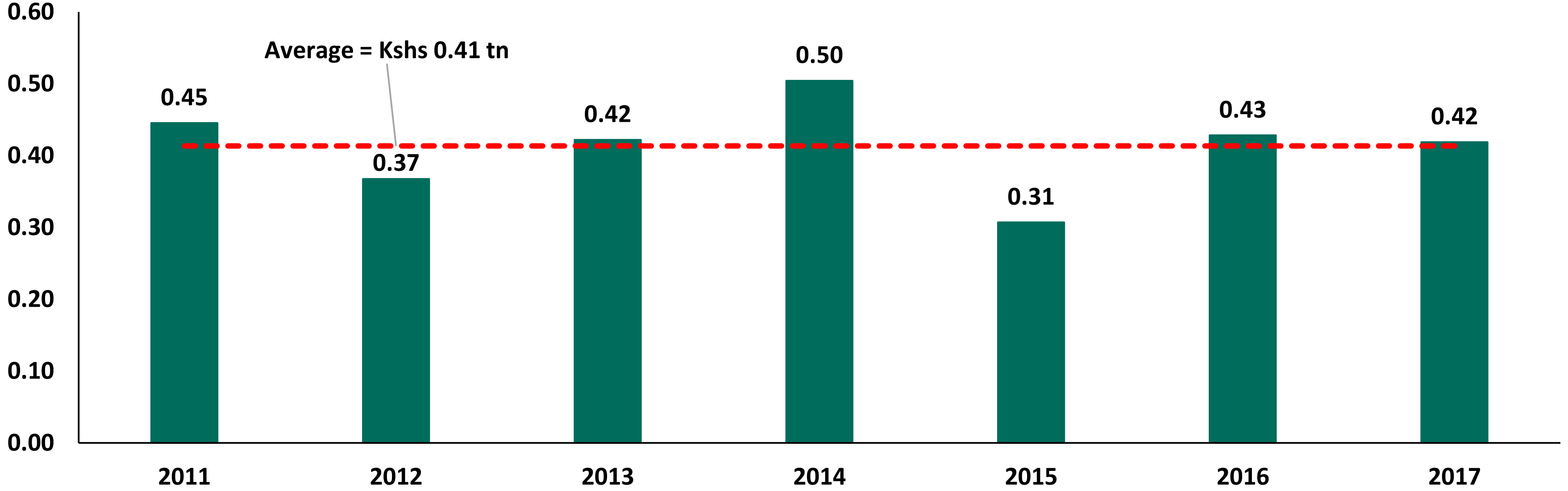
Source- Central Bank of Kenya (CBK)

Cytonn INVESTMENTS

Secondary Bond Market Activity

We expect secondary bond market activity and turnover to decline marginally in 2018 as interest rates remain stable, with the government rejecting expensive bids in primary auctions thus causing downward pressure on secondary market bond yields

Bond Turnover (Kshs tns)



- In 2017, secondary bond market turnover declined marginally by 2.2% to Kshs 419.0 bn in 2017 from Kshs 428.3 bn in 2016, with yields declining for the medium to longer dated papers
- In 2018, we expect secondary bond market activity and turnover to decline marginally as the interest rate environment remains stable with the government only accepting bids deemed reasonable while rejecting those considered expensive in primary auctions, thus resulting in downward pressure on bond yields in the secondary market

Source- Central Bank of Kenya (CBK)

Cytonn INVESTMENTS

Fixed Income Market Outlook

Of the 7 indicators we track, 3 are positive (inflation, investor sentiment and security), 2 are neutral (monetary policy and currency), and 2 are negative (government borrowing and revenue collection). It is due to this that we think it is prudent for investors to be biased towards short-term papers

Macro-Economic Indicators	2017 Experience	2018 Outlook	Current View
Government Borrowing	• Government was been behind its target on its domestic borrowing schedule since the fiscal year 2017/18 begun, closing the year 2017 having borrowed Kshs 87.9 bn against a pro-rated target of Kshs 205.1 bn	• Government to come under pressure to borrow as it is well behind both domestic and foreign borrowing targets for FY 2017/18, and KRA is unlikely to meet its collection target which might result in further borrowing from the domestic market to plug in the deficit	**Negative**
Revenue Collection	• The KRA missed their collection target for the 2016/2017 FY having collected Kshs 1.4 tn against a target of Kshs 1.5 tn. The 2017/2018 FY target was set at Kshs 1.7 tn. As per the Q3'2017/18 budget review, the KRA met 89.1% of its first quarter target	• KRA is unlikely to meet its collection target due to expected suppressed corporate earnings in 2017, whose 2nd half will constitute the 1st half of the fiscal year 2017/18	**Negative**
Monetary Policy	• CBR has been maintained at 10.0% throughout 2017 • The 91 Day T-Bill hit 8.1% from 8.6% recorded at the beginning of January 2017	• Upward pressure on interest rates, especially in the first half of the year, as the government falls behind its borrowing targets for the fiscal year. However, with the Banking (Amendment) Act, 2015, the MPC might be unable to do much with the CBR which has remained at 10.0% throughout 2017	**Neutral**
Inflation	• Inflation declined to 4.5% in December from 7.0% in January, on account of improved weather conditions. The inflation rate hit a high of 11.7 % in May, driven by an increase in basic food prices • Inflation averaged 8.0% in 2017, compared to 6.3% in 2016	• Inflation to average 7.5%, which is just at the upper bound of the government target range of 2.5% - 7.5%	**Positive**

Fixed Income Market Outlook, continued…

Of the 7 indicators we track, 3 are positive (inflation, investor sentiment and security), 2 are neutral (monetary policy and currency), and 2 are negative (government borrowing and revenue collection). It is due to this that we think it is prudent for investors to be biased towards short-term papers

Macro-Economic Indicators	2017 Experience	2018 Outlook	Current View
Exchange Rate	• The shilling depreciated by 0.7% against the dollar in 2017, having remained relatively stable for the better part of the year, with volatility only witnessed during the election period following the August 8th election and the repeat presidential poll on 26th October. Volatility was mainly driven by speculation in the forex market and demand from oil importers	• We project that currency will range between Kshs 102.0 and Kshs 107.0 against the USD in 2018 • The CBK will continue to support the Shilling in the short term through its sufficient reserves of USD 7.1 bn (equivalent to 4.7 months of import cover)	**Neutral**
Investor Sentiments	• Investor sentiment was high, with foreign investors entering the market in search of attractive valuations, amid a relatively peaceful election period. However, Foreign investors were net sellers in 2017 with net outflow of USD 117.1 mn compared to net inflows of USD 88.8 mn recorded in 2016	• Given (i) the now settling operating environment following the elections in Q3'2017, (ii) the expectation that long term investors will enter the market seeking to take advantage of the valuations which are still historically low, and (iii) expectations of a relatively stable shilling, we expect investor sentiment to improve in 2018	**Positive**
Security	• In January, the U.S. Department of State issued a travel warning regarding threats by Al-Shabaab on the Somalia border, coastal and north-eastern counties. In March, the U.K government issued a warning due to security concerns in parts of Laikipia County. As the election date approached, security was beefed up across the country	• We expect security to be maintained in 2018, especially given that the elections are now concluded and the government is settling into office. The USA has also lifted its travel warning for Kenya, placing it in the 2nd highest tier of its new 4-level advisory programme, indicating positive sentiments on security from the international community	**Positive**

Fixed Income Market Outlook

We think investors should be biased towards short-term fixed income instruments as we expect upward pressure on interest rates in 2018, despite the government's efforts to keep them stable

- Of the 7 indicators we track:
  - ✓ 3 are positive (inflation, investor sentiment and security)
  - ✓ 2 are neutral (monetary policy and currency), and
  - ✓ 2 are negative (government borrowing and revenue collection)
- It is due to this that we think it is prudent for investors to be biased towards short-term papers

Rates in the fixed income market have remained stable as the government rejects expensive bids despite being behind their borrowing target. However, a budget deficit that is likely to result from depressed revenue collection creates uncertainty in the interest rate environment as any additional borrowing in the domestic market to plug the deficit could lead to upward pressure on interest rates. Our view is that investors should be biased towards short term fixed income instruments to reduce duration risk

Cytonn INVESTMENTS

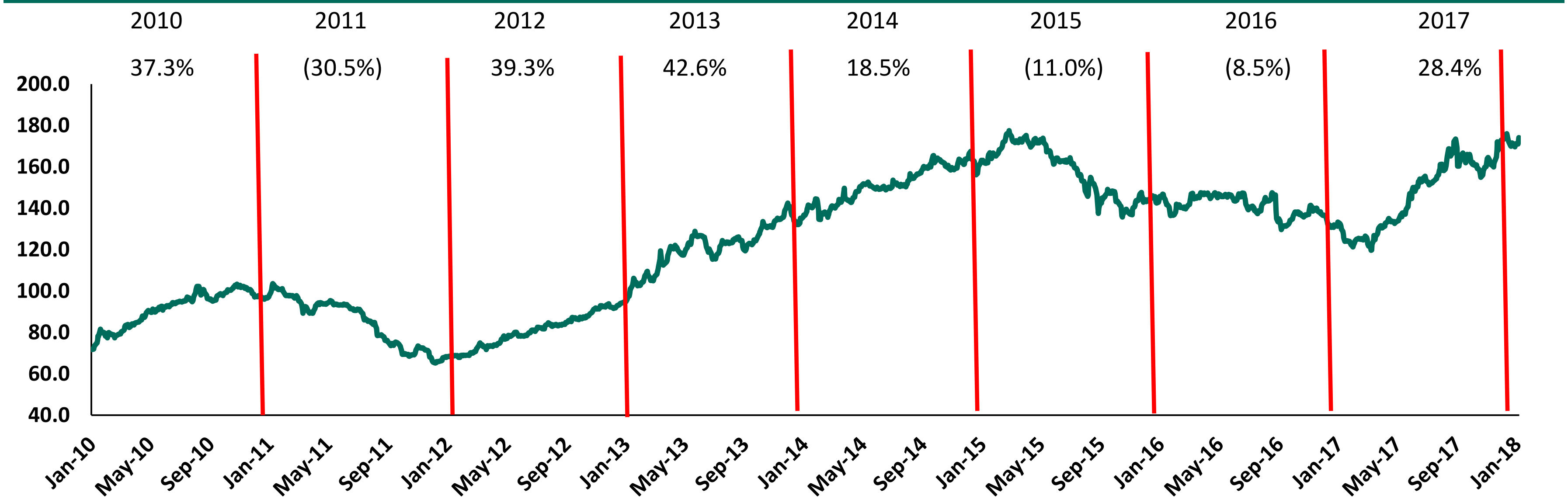
V. Equity Markets Outlook

Kenya Equities Performance

NASI has gained 49.3% on LTM basis and 28.4% in 2017, compared to an 8.5% decline recorded in 2016

- During the year 2017, the Kenya equities market registered strong performance with NASI, NSE 25 and NSE 20 gaining 28.4%, 21.3% and 16.5%, respectively, compared to losses of 8.5%, 15.8% and 21.1% for NASI, NSE 25 and NSE 20, respectively, recorded in 2016

NASI Yearly Returns

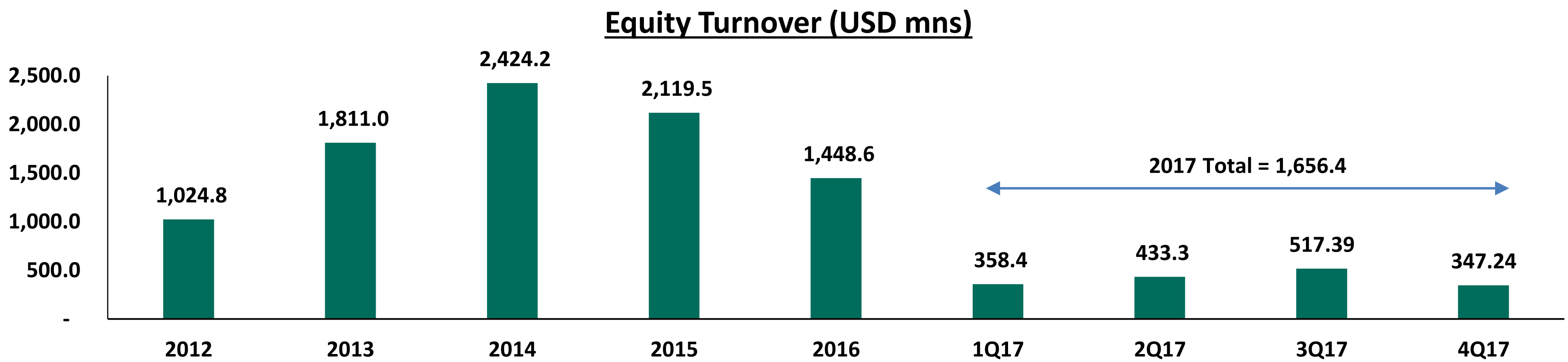


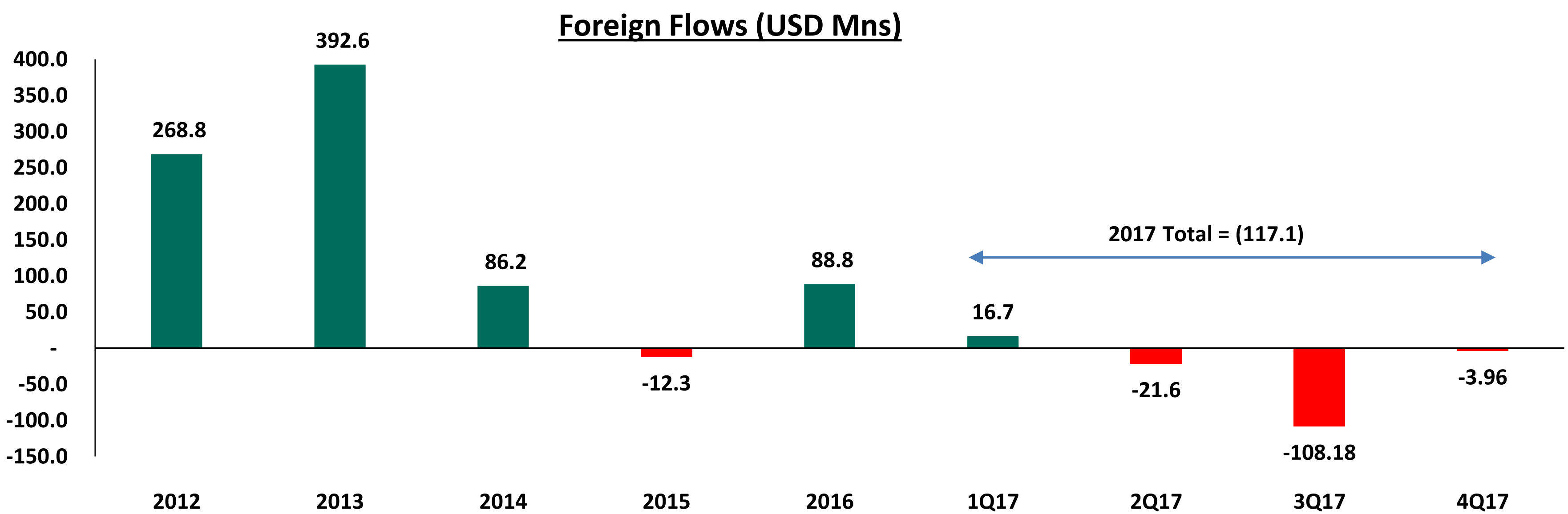
- The positive performance in 2017 was driven by gains in select large caps such as DTB, KCB Group, Safaricom, Equity Group and Co-op which gained 62.7%, 48.7%, 39.7%, 32.5% and 21.2%, respectively
- NASI is currently up 4.8% YTD and 49.3% for LTM

Source- Bloomberg

Market Turnover & Foreign Flows

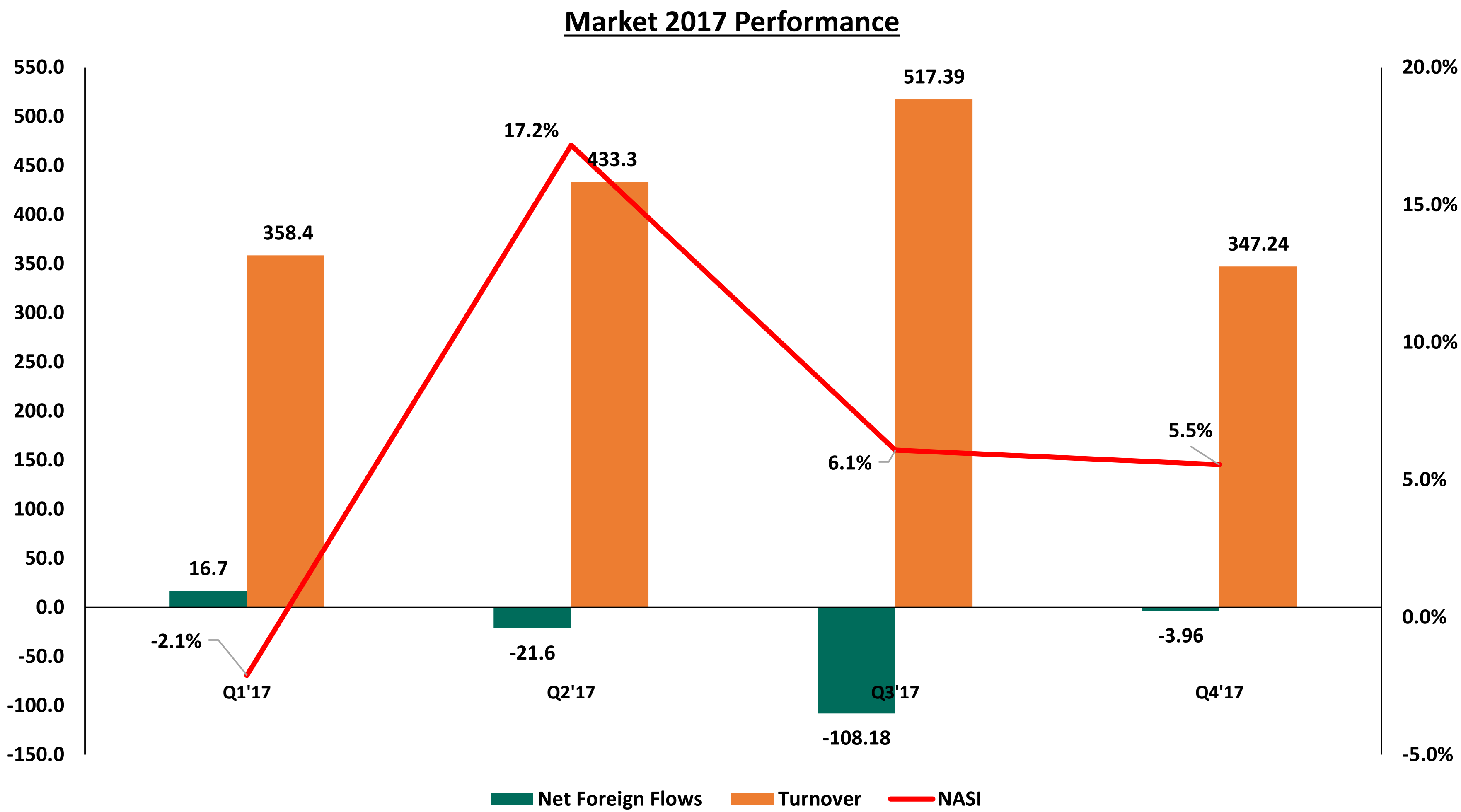
Turnover in 2017 increased by 14.3% to USD 1,656.4 from USD 1,448.6 in 2016, while the market registered net foreign outflows of USD 117.1 mn compared to net inflows of USD 88.8 mn in 2016





Market Performance, Turnover & Foreign Flows for 2017

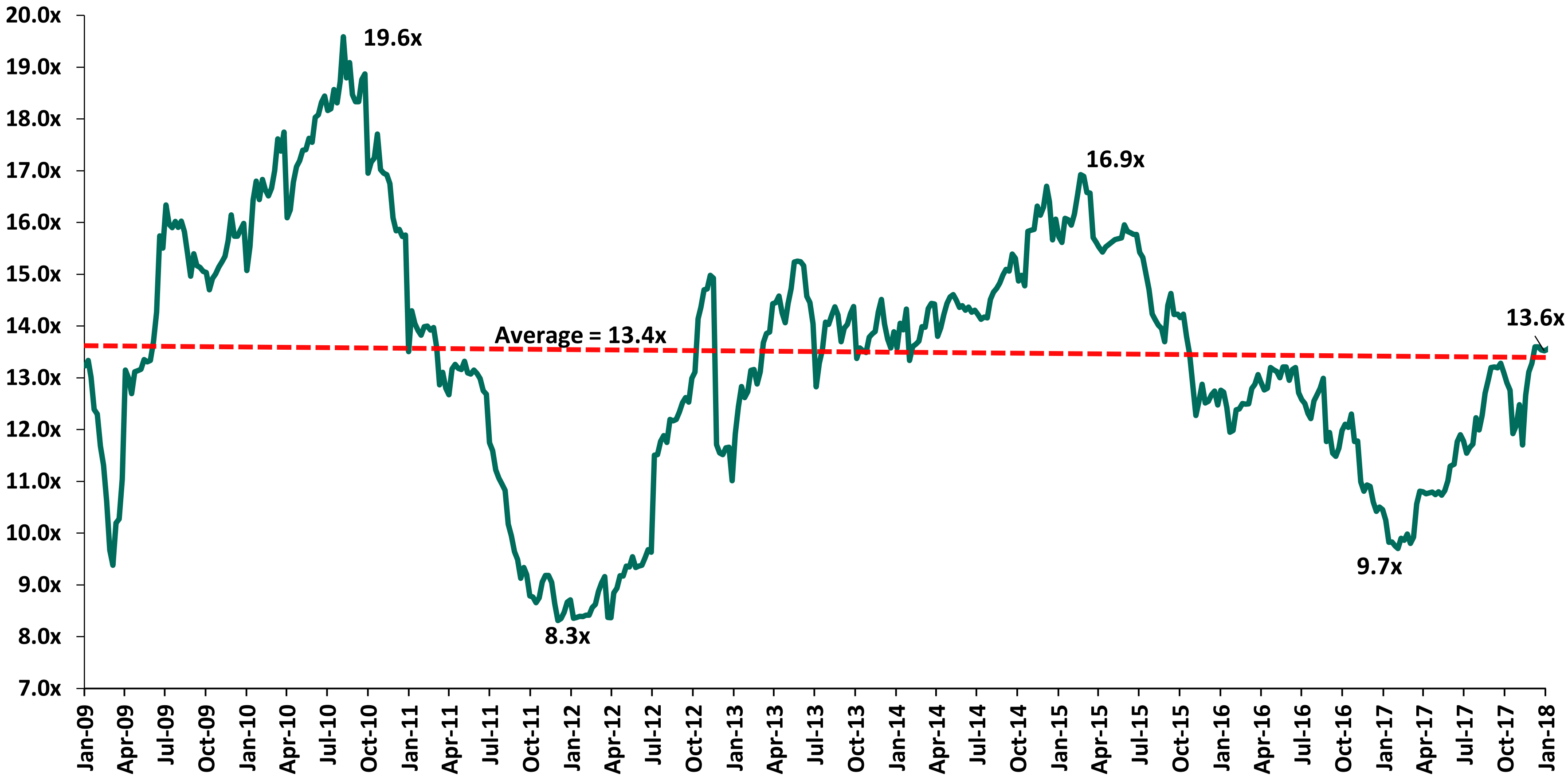
NASI recorded a gain of 28.4% in 2017, despite the market recording net foreign outflows of USD 117.1 mn, which could be an indication that the market is not driven by foreigners



NASI P/E

NASI is currently trading 1.1% above the historical average of 13.4x. This point is 19.6% below the most recent peak of 16.9x in February 2015

NSE All Share Index P/E

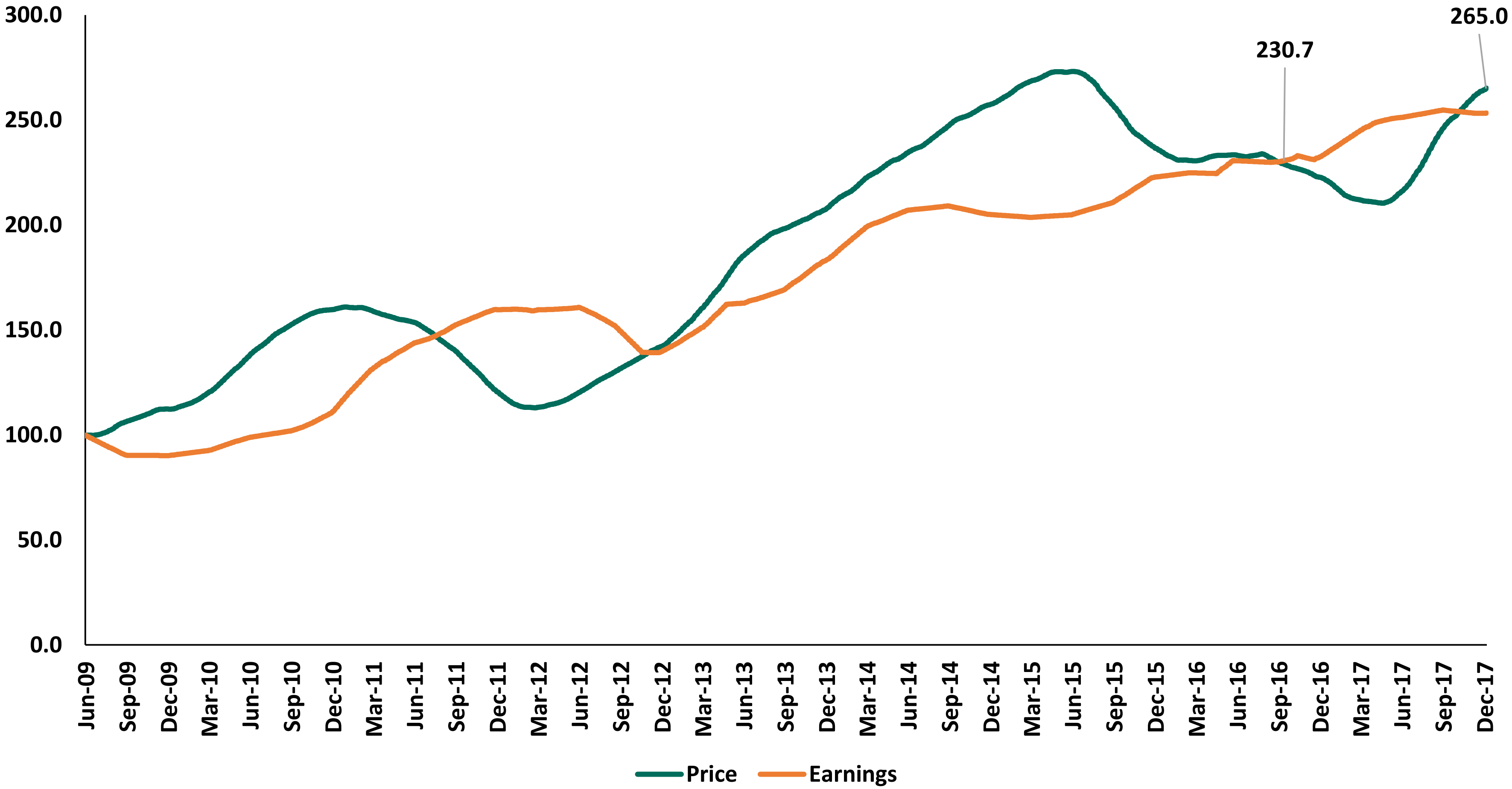


Source: Bloomberg

Prices vs Earnings Growth

Increase in prices has not only been driven by earnings growth. Despite the 8.9% increase in earnings, average prices have increased by 18.7% in 2017, supported by improving investor sentiment

Price vs Earnings



Factors That Will Affect the Equities Market in 2018

We expect better corporate earnings in 2018 compared to 2017, mainly supported by a more stable macro-economic environment

Factor	Effect on Equities market
Corporate Earnings	• We expect corporate earnings to average 12.0% for 2018, supported by a more stable and favourable business operating environment • Banks are likely to record better earnings than in 2017 given the impact of interest rate caps has been felt in 2017
Capital Markets Investor Sentiment	• We expect the equities market to register increased foreign inflows in 2017, mainly supported by expectations of a relatively more stable macro-economic environment, existence of attractive stocks in under-valued sections of the market, and generally, Kenya remains more attractive compared to other frontier markets, which will attract investors seeking the high growth in frontier markets
Interest Rates	• We expect the MPC to maintain the CBR relatively at the current rate of 10.0%, as the CBK monitors inflation rate and exchange rate • Inflation rate is expected to remain within the government target of 2.5% - 7.5% due to improved weather conditions, while the currency is expected to remain stable supported by CBK

Factors That Will Affect the Equities Market in 2018

Increased regulation is expected to build more stable sectors thus boosting investor confidence in the Kenyan equities market

Factor	Effect on Equities market

Diversification of Capital Markets and New Listings	• We do not expect any major listing on the Nairobi Securities Exchange (NSE) in 2018. Key initiatives that CMA and NSE will be implementing include:
	  • possible setting up of a commodities exchange,
	  • CDSC's plan to launch a new trading platform that will allow a settlement cycle of 1 day (T+1),
	  • The recently approved launch of a short-selling and security lending facility due in June 2018,
	  • To add listed equities from other African countries, starting with Nigeria
	• All these are expected to increase liquidity in the market and improve depth of the capital market

Regulation	• Key regulatory change in 2018 is the global IFRS 9, in which banks are expected to adopt a more forward-looking approach in provisioning for bad loans • We also expect enhanced corporate governance practices following adoption of the guidelines stipulated in the Code of Governance and the Companies (General) (Amendment) Regulations, 2017 • The regulations are expected to boost investor confidence in the equities market

Equities Outlook: Review of Key Market Drivers

We hold a "Neutral" outlook for investors with a short-term investment horizon, since the market has rallied and brought the P/E above its historical average, but are "Positive" over the long-term

Equities Market Indicators	Outlook 2018	Current View
Macro-economic Environment	• GDP growth is expected to recover in 2018, from the depressed average of 4.7% recorded in the first three quarters of 2017, and come in at between 5.3%-5.5%. This will be driven by recovery of agriculture, continued growth in real estate and tourism and public infrastructural investments. Key risk lies in the subdued private sector credit growth, that averaged 2.4% in 2017, below the 5-year average of 14.0%, and this may impact adversely on economic growth • Interest rates are expected to remain at the current levels as the CBK monitors inflation and exchange rates	**Neutral with a bias to Positive**
Corporate Earnings Growth and Valuations	• We expect corporate earnings growth of 12.0% in 2018, higher than the expected 8.0% growth for 2017, boosted by a more stable and favourable business operating environment. Assumption of corporate earnings growth rate of approximately 12.0% gives a forward P/E of 12.3x, which is 10.7% cheaper than historical average of 13.4x and 27.3% below the most recent peak of 16.9x recorded in Feb 2015	**Neutral**
Investor Sentiment and Security	• We expect 2018 to register increased foreign inflows from the negative position in 2017, mainly supported by a stable business operating environment and long term investors who enter the market looking to take advantage of the current low valuations in sections of the market. • We expect security to be maintained in the country supported by government initiatives towards maintaining internal security even as we expect minimal political activity in the year	**Positive**

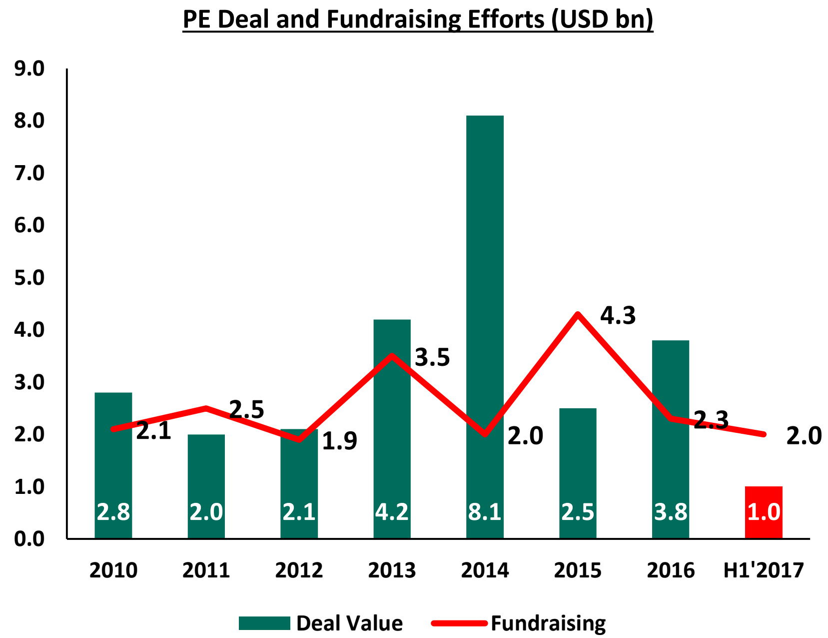
We maintain a "NEUTRAL" recommendation on equities for investors with short-term investment horizon since the market has rallied and brought the market P/E slightly above its' historical average. However, pockets of value exist, with a number of undervalued sectors like Financial Services, and with expectations of higher corporate earnings this year, the market will be cheaper for long-term investors hence we are "POSITIVE" for investors with long-term horizon

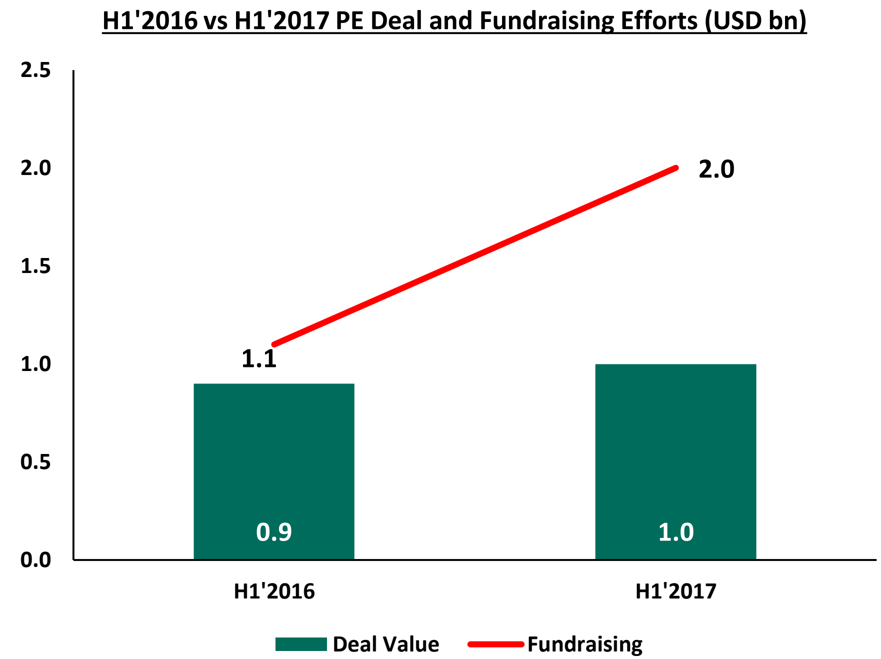
VI. Private Equity Outlook

Private Equity Outlook

Private Equity investments in Africa continues to be propelled by improved ease of doing business and high return potential across major sectors

- The year 2017 saw a increase in private equity deals in the Sub-Saharan Africa Region, recording 1.0 bn as at H1 2017 compared to 0.9 bn as at H1 2016.
- East Africa and West Africa had the largest share of private equity deals at 56% of the total number of PE deals reported in 2017 H1;





Private Equity Outlook

Private Equity investments in Africa continues to be propelled by improved ease of doing business and high return potential across major sectors

- We expect the trend to continue into 2018, especially in East Africa, which remains the backbone of the sub Saharan economy, attributed to:
    i. A general improvement in ease of doing business
    ii. high return potential across major sectors, especially those underserved by the Government
    iii. a well-diversified economy, resilient to external shocks
    iv. consolidation in sectors such as financial services, creating an avenue for increased private equity activity,
    v. The continued deepening of the capital markets which provide an avenue for PE investors to exit, and
    vi. Improved political stability
- We expect investors to remain focused on the following key sectors:
    i. Financial Services,
    ii. Education, and
    iii. Telecommunication, Media and Technology (TMT)

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Financial Services Sector

The financial services sector continues to be one of the most attractive sectors given favorable valuations, consolidation and innovation within the sector

- Kenya's Financial Services Sector is already going through consolidation as evidenced by heightened M&A activity over the last 4 years. The consolidation of the industry is attributed to heightened regulations in the sector which require companies to shore up capital. Those who fail will either be acquired or merge. Key to note is that the transactions have been trading at a discount, highlighting the attractive valuations for PE investors to penetrate the market
- Below is a summary of key transactions done over the last few years and their transaction multiples

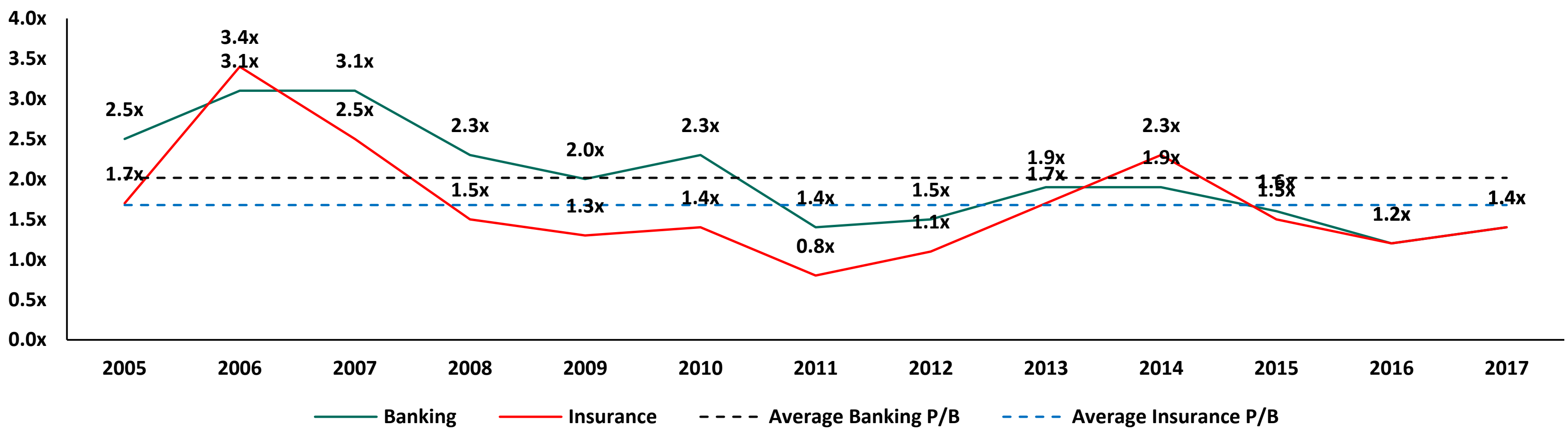
Banking Sector Transaction Multiples over the last 2 Years						
Acquirer	**Bank Acquired**	**Book Value (bn Kshs)**	**Transaction Stake**	**Transaction Value (Kshs bns)**	**P/Bv Multiple**	**Date**
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	**2.3x**	Mar-15
I&M Holdings	Giro Commercial Bank	3.0	100.0%	5.0	**1.7x**	Jun-16
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	**1.4x**	Jun-16
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	**1.6x**	Nov-16
Diamond Trust Bank Kenya	Habib Bank Limited Kenya	2.4	100.0%	1.8	**0.8x**	Mar-17
Average			**85.2%**	**2.7**	**1.6x**	

Insurance Sector Transaction Multiples over the last 2 Years							
No.	**Acquirer**	**Acquired**	**Book Value (bn Kshs)**	**Stake**	**Transaction Value(bn Kshs)**	**P/B**	**Date**
1.	Old Mutual Plc	UAP Holdings	9.6	60.7%	11.1	**1.9x**	Jan-15
2.	MMI Holdings	Cannon Assurance	1.7	75.0%	2.4	**1.9x**	Jan-15
3.	Sanlam	Gateway Insurance	1.0	51.0%	0.6	**1.1x**	Mar-15
4.	Barclays Africa	First Assurance	2.0	63.3%	2.9	**2.2x**	Jun-15
5.	IFC	Britam	22.5	10.4%	3.6	**1.5x**	Mar-17
6.	Africinvest III	Britam	28.5	14.3%	5.7	**1.4x**	Sep-17
	Mean			**45.8%**	**4.4**	**1.7x**	

Financial Services Sector

The financial services sector continues to be one of the most attractive sectors given favorable valuations, consolidation and innovation within the sector

10 year Price to book value: Banking and Insurance



- Given the moratorium on licensing new banks, it is a great opportunity for PE firms to acquire banks and insurance companies at favourable multiples.
- The focus on financial services sector is driven by:
  - i. the increasing demand for credit,
  - ii. the growing financial services inclusion in the region through alternative banking channels
  - iii. increased innovation and new product development within the financial services sector
  - iv. the growing middle class supporting an inherent increase in consumption expenditure, and an increase in the percentage of the population that will require financial services

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Education Sector

The Education Sector continues to be one of the most attractive sectors driven by (i) under provision of services by the government attracting private players, and (ii) a growing middle class willing to pay extra for quality

- We expect an increase in investment in the education sector with a focus on (i) ECDE, (ii) Private Primary, (iii) Private Secondary level education, and (iv) technical and vocational training institutes
- The key drivers of investment in the sector will be:
  - demand for quality education and a more comprehensive curriculum;
  - A rise in number of candidate who don’t meet the minimum University grade
  - the entry of international brands over the past years such as the Nova Academies, GEMS Cambridge, and bridge schools;
  - a shift of demand from government funded education towards private education providers driven by the frequent disruptions in public schools; and
  - Renewed support from the government on technical institutions, through education loans
- Informed by demand for education and the ability to afford the education provided, PE investors in the education sector can focus on the following counties to provide either, Early Childhood Development (ECD), Primary or Secondary level education, and technical colleges as highlighted in the table in the next slide

Investment Opportunity - Level of Education and Location

Only 5 counties provide investment opportunities in all 4 levels of education

Education Sector Investment Opportunities

	County	ECD Level	Primary Level	Secondary Level	Technical Institute
1.	West Pokot County	√			√
2.	Turkana County	√			√
3.	Samburu County	√			√
4.	Isiolo County	√			√
5.	Kilifi County	√			√
6.	Nairobi City County	√			√
7.	Kwale County	√			√
8.	Nyandarua County		√		√
9.	Trans-Nzoia County		√		√
10.	Lamu County	√	√		√
11.	Nyamira County	√	√		√
12.	Busia County	√	√		√
13.	Vihiga County		√	√	√
14.	Embu County		√	√	√
15.	Tharaka County		√	√	√
16.	Kiambu County		√	√	√
17.	Machakos County		√	√	√
18	Muranga County		√	√	√
19.	Nakuru County		√	√	√
20.	Elgeyo Marakwet County	√	√	√	√
21.	Kirinyaga County	√	√	√	√
22.	Taita Taveta County	√	√	√	√
23.	Laikipia County	√	√	√	√
24.	Nyeri County	√	√	√	√

*- √- *Shows an investment opportunity in the level of education*

Source –Cytonn Research

Cytonn INVESTMENTS

Telecommunication, Media and Technology (TMT)

The TMT Sector continues to play a major role as a complimentary sector for various sectors in the economy

- Kenya continues to register growth in ICT, driven by a young and innovative Kenyan generation, and the demand to provide an all inclusive economy. Technology is increasingly being used to complement sectors such as financial services, agriculture, health and the energy sector.
- The sector will remain attractive to investors as it is supported by:
  i. support for innovation by the government
  ii. increased exposure of Kenya's tech products to the global market and foreign investors
  iii. relative ease of entry into the sector
- Sectors likely to benefit from investment in technology innovations are:
  i. health sector, with an aim to increase efficiency and improve service delivery. The sector has also displayed innovation with companies such as PeekVision, offering medical services via a mobile platform
  ii. The government, in a bid to increase transparency and reduce corruption in government dealings
  iii. the agricultural sector with a focus on providing information to farmers and easier sourcing of market for farm produce
  iv. financial services sector, as financial service providers strive to be innovative in their products thus improving customer reach and satisfaction, and also reducing operational costs
  v. The energy sector, where companies are innovating ways which they can facilitate energy provision to marginalised areas and also offer flexible payment terms. Companies such as M-Kopa and M-PAYG are offering such pay as you go services

Private Equity Outlook

We remain bullish on private equity given the high potential return in the sector and a general improvement of ease of doing business

- Our outlook for private equity remains positive
- We expect an increase in the number of deals and deal volume in education, and technology sector
- For the financial services sector, we expect increased consolidation in the industry and more PE investors to take advantage of the cheaper market valuations

We remain bullish on PE as an asset class given:(i) the abundance of global capital looking for opportunities in Africa, (ii) the attractive valuations in private markets compared to public markets, and (iii) better economic growth in Sub Saharan Africa as compared to global markets.

VII. Real Estate Market Outlook

Market Outlook 2018- Real Estate in Kenya Overview

Political calmness and government incentives will be some of the key real estate drivers in 2018

- In 2017, the performance of the real estate sector in Kenya softened as a result of;
    i. Political uncertainty due to the extended electioneering period resulting in investors adopting a wait and see attitude and thus a decline in building approvals by 18.4% in Nairobi between January and July 2017 to Sh149.5 billion compared to Sh183.2 billion during the same period in 2016.
    ii. Reduced credit supply due to the capping of interest rates that saw private sector credit growth decline to 2.4% as at October 2017 from a 5 year CAGR of 14.4%, with the number of active mortgage accounts dropping by 1.5% to 24,085 at the end of December 2017
    iii. Softening of the retail and commercial office sector performance mainly as a result of i) an oversupply of 3.2mn SQFT for office space in Nairobi and ii) Internal challenges facing retailers on financing and supply chain management, especially Nakumatt and Uchumi leading to the closure of some of their stores
- The above occurrences resulted in total returns in real estate averaging at **14.5%** in 2017 from **25.8%** in 2016
- However there were pockets of value in some submarkets which earned high returns of between 25%- 31%. These markets include Kilimani and Karen
- In 2018, we expect the sector to recover mainly due to;
    i. Political calmness after the conclusion of 2017 elections
    ii. Economic recovery with the GDP projected to come in between 5.3% and 5.5% compared to the expected 4.7% in 2017
    iii. Government incentives such as tax relief of 15.0% for developers putting up more than 100 affordable housing units p.a, the scrapping of the land title search fees, NEMA and digitization of lands ministry

Cytonn REAL ESTATE

Key Factors Driving Real Estate Sector

Positive demographics, infrastructural development and housing deficit in Kenya are some of the factors that will drive real estate performance in 2018

Demographic Trends

- High urbanization rates of 4.4% against global averages of 2.1%
- Expanding middle class with increased purchasing power due to higher disposable income, which increased to Kshs 6.6 tn in 2016 from Kshs 5.7 tn in 2015
- High population growth with a 5-year CAGR at 2.6%

Housing Deficit

- Kenya has a housing deficit of approximately 2.0mn units with an annual shortfall of 200,000 units
- We expect to witness increased development as a result of government incentives such as;
  - ❖ 15.0% corporate tax relief to developers who put up at least 100 low-cost residential houses annually and
  - ❖ Digitalization of lands ministry
  - ❖ Scrapping of NEMA and NCA levy
  - ❖ Inclusion in its 4 key strategic pillars of focus for the period 2017-2022, "Big Four" alongside food security, manufacturing and affordable healthcare

Sustained Infrastructural Development

- Government initiative to build 10,000kms of road network in the next 5years which will increase traction in different areas, so far tenders have been awarded for Ngong Road Phase II & III and Ruaka to Ruiru Bypass
- In addition, areas such as Ruiru and Kitengela are mapped for connection to the main sewer which will allow for higher density developments and boost real estate prices

Key Factors Driving Real Estate Sector

Domestic tourism, recognition of Kenya as a regional hub and a better operating environment will also drive real estate performance in 2018

Domestic and MICE Tourism

- Domestic tourism has grown with Kenyans accounting for 54.2% of total bed nights in 2016 compared to 53.7% in 2015 and 46.9% recorded in 2014
- In addition, the number of conferences held in the country increased by 16.5% in 2016 compared to a 3.0% increase in 2015, driven by the positioning of Nairobi as a regional hub, improved security and political calmness
- We expect the trend to continue, given the completion of the Standard Gauge Railway (SGR) that has eased access to and from the Coast and government incentives such as scrapping of VAT from National Park fees

A Better Operating Environment

- Characterized by: (i) Tax relief of 15% for developers developing more than 100 affordable housing units p.a, (ii) Scrapping of the land title search fees, NEMA application fees and NCA levy iii) digitization of lands ministry, (iv) the relaxation of zoning regulations that will facilitate optimal land use in areas such as Spring Valley, Kileleshwa and Riverside Drive v)political calmness

Kenya as a Regional Hub

- We expect increases Foreign Direct Investments(FDI) in 2018, with the entry of multinationals such as Isuzu and JP Morgan Chase, despite a 57.9% drop in FDI's in 2016, with the projects decreasing to 40 in 2016, compared to 90 in 2015
- Consultancy firm EY (formerly Ernst & Young) ranked Kenya as 2017's second-most attractive foreign investment destination in Africa

Key Challenges Facing the Real Estate Sector

Access to funds, increased supply and competition are some of the challenges that will constrain the real estate sector's performance in 2018

Inadequate and High cost of Funds

- Banks have reduced credit advancement to small and medium sized companies as a result of the interest rates cap that stands at 14.0%
- Mortgages also reduced as a result of the interest capping with the number of active mortgage accounts dropping by 1.5% at the end of 2016, to 24,085 from 24,458 in 2015
- Despite the capping of interest rates, the actual cost of credit is still high averaging at 19.0% thus increasing the development costs

Increased Supply and Competition

- The commercial office segment is likely to experience lower returns as a result of the oversupply in the sector which is expected to be 3.9 mn SQFT in 2018
- With the entry of international retailers, we expected high competition in the retail sector which is likely to constrain the performance of small operators

Lack of Affordable Development Class Land

- There is inadequate development land supply at effective prices thus increasing the costs of development and consequently end user prices
- On average, land prices have grown with a 6- year CAGR of 17.4%

Trends in the Real Estate Sector

Smart buildings, shared space and alternative fundraising are some of the trends expected to characterize the real estate market in 2018

Alternative Fundraising

- The capping of interest rates at 14.0% has led to low credit supply hence developers are likely to find other innovative ways of raising funds. Some of which include project notes and Real Estate Investment Trusts(REITs)

Serviced Apartments

- Serviced apartments is a concept that is expected to shape the hospitality industry in Kenya. The supply of serviced apartments grew at a 5-year CAGR of 23.6% between 2011 and 2016 and is expected to continue with the same trajectory in the future with current occupancies at 72.1% in Nairobi

Serviced Office

- The serviced office concept has grown in popularity among users due to the convenience and flexibility. Among developers and providers, it is attractive due to the high returns it offers with average rental yields of 13.4% at 66.1% occupancy

Fractional home ownership

- More traction in the hospitality sector with the growing popularity of fractional home ownership

Smart Cities

- The adoption of smart buildings as Kenya continues to embrace new technology-rich ecosystem, through pro-active legislation and support of technologies designed to enhance the lives of all people, for example through the proposed Konza city

Residential Market Performance Projections

We expect an 7.7% increase in price and an 5.5% increase in rent resulting to an 0.5% increase in rental yield

Metric	2016	2017	Average Change	2018 (F)	
Value of Residential Completions (bn)	70.1	79.8	13.9%	90.9	The value of residential buildings is bound to continue on an upward trajectory to grow to at least Kshs 90.9 bn driven by increased housing stock from both the government and private developers despite 18.4% reduction in approvals in 2017
Uptake	84.3%	86.7%	2.4%	89.1%	From the Cytonn Research, we expect housing deficit to come in at 2.0 mn for the Nairobi region. From this, we expect uptake to increase, albeit slowly, by 2.4% points, particularly as the government enables uptake through provision of affordable mortgages
Rental yield	4.9%	5.2%	0.5%	5.7%	With a sustained demand for rental properties, we expect rental yields to come in at 5.7% supported by a 5.5% rental rates increase and a 7.7% price growth
Price Per SQM	107,137.0	113,431.0	7.7%	122,165.2	Price appreciation is expected to come in at 7.7%, as the market picks up from last year's softened growth due to unfavorable macroeconomic conditions and political headwinds. this will be supported by increased effective and speculative demand as well as upward economic growth
Rent Per SQM	540.1	548.5	5.5%	578.7	Rental rates are bound to grow upwards by 5.5% supported by infrastructural developments and as affordability remains out of reach for many prospective buyers

- According to Cytonn Research, the best areas to invest in apartments are Ridgeways and Kilimani due to high uptake and market returns of 18.4% and 15.4%, respectively as well as ongoing infrastructural development while Juja and Runda Mumwe offer the best investment opportunity for detached units owing to high uptake and returns to investors of 17.3% and 12.0%, respectively.

Source: KNBS, Cytonn Research

Commercial Office Market Performance Projections

Increased supply will constrain performance in the sector with occupancy rates and yields expected to decline by 1.4% points and 0.2% points to 83.3% and 9.0%, respectively

Summary of Commercial Office Returns in Nairobi Over Time								
Year	FY'11	FY'13	FY'15	FY'16	FY'17	Annualized Change 2013-2017	2018F	Reason for Forecast
Occupancy (%)	**91.0%**	**90.0%**	**89.0%**	**88.0%**	**84.6%**	**(1.4%)**	**83.3%**	Given the expected increase in oversupply of 21.9% from 3.2mn SQFT in 2017 to 3.9mn SQFT in 2018, we expect occupancy rates to continue on the downward trend to average at approximately 83.3% in 2018
Asking Rents (Kshs/Sqft)	**78**	**95**	**97**	**103**	**101**	**1.5%**	**98**	Despite the marginal increments over the last four years, we do not foresee an increase in rents in 2018 and we expect the rents to soften slightly, reducing by 3.0% to average at Kshs 98 per SQFT per month
Average Prices (Kshs/Sqft)	**10,557**	**12,433**	**12,776**	**13,003**	**13,058**	**1.2%**	**12,875**	Despite the marginal increase over the last four years, as a result of the increased supply we expect the prices to drop by 1.4% similar to the occupancies and average at Kshs 12,875
Average Rental Yields (%)	**9.8%**	**10.0%**	**9.3%**	**9.4%**	**9.2%**	**(0.2%)**	**9.0%**	We expect office yields to soften slightly, reducing by 0.2% points to average at 9.0% in the Nairobi market mainly as a result of increase in supply and thus lower occupancy rates

- We expect the performance of the commercial office theme to soften further in 2018 with average yields and occupancy rates coming in at 9.0%, and 83.3% respectively from 9.2% and 84.6% respectively in 2017 mainly as a result of the increase in supply with an expected oversupply of 3.9mn SQFT in 2018The sector will thus witness a reduction in development activity

Source: Cytonn Research

Retail Market Performance Projections

The retail sector is expected to soften as a result of increased supply with yields expected to decline by 0.4% from 9.6% to a projected 9.2% in 2018

Nairobi's Retail Sector Performance 2016-2018F					
Item	**FY' 2016**	**FY' 2017**	**2018F**	**Δ Y/Y**	**Reason for Forecast**
Asking Rents (Kshs/SQFT)	206.2	185.2	183.5	**(0.9%)**	We expect asking rents to soften, reducing by 0.9% to Kshs 183.5 from Kshs 185.2 as a result of increased supply
Supply in Nairobi (mn SQFT)	5.4	5.6	5.8	**4.1%**	Supply of retail space is expected to increase by 4.1% to 2018, 5.8 mn SQFT due to opening of malls such as Southfield Mall in Embakasi that will add 269,000 SQFT in retail space.
Occupancy (%)	89.3%	80.3%	79.5%	**(0.8%)**	Due to the expected increase in as a result of the opening of South Field Mall in Embakasi others in the pipeline such as Comesa Mall in Eastlands , Mountain View Mall along Waiyaki way and Karen Water Front in Karen, we expect occupancy rates to decline by 0.8% points to 79.5%
Average Rental Yields	10.0%	9.6%	9.2%	**(0.4%)**	Mainly as a result of increase in supply and thus lower occupancy rates, we expect retail yields in Nairobi to soften slightly by 0.4% points to average at 9.2%

- The performance of the retail sector is expected to soften, with asking rents, occupancy rates and yields declining by 0.9%, 0.8% points and 0.4% points, respectively to average at Kshs. 183.5, 79.5% and 9.2%.

Source: Cytonn Research

Cytonn REAL ESTATE

Nairobi Hospitality Sector Projections

We expect a 11.0% international arrivals, which will result in improved occupancies and revenues

Hospitality Sector Performance Projections 2018						
Factor	**2014**	**2015**	**2016**	**2017***	**2018F**	**Δ 2017/18**
International Visitor arrivals ('000)	1,350	1,181	1,340	1,453	**1,612**	**11.0%**
Total Bed Nights ('000)	6,282	5,879	6,449	6,584	**7,244**	**10.0%**
Total Beds Available ('000)	19,877	20,187	21,259	22,351	**23,499**	**5.1%**
Kenya Bed-Night Occupancy Rate	31.6%	29.1%	30.3%	29.5%	**30.8%**	**1.4%**
Nairobi Room Occupancy Rate	54.0%	53.0%	53.0%	49.0%	**53.0%**	**4.0%**
Nairobi ADR (USD)	145.2	142.9	137.0	125.5	**139.3**	**11.0%**
Nairobi RevPAR (USD)	77.5	75.9	72.0	61.2	**73.8**	**20.6%**

- With the stabilizing political environment, improved security and continued marketing, we expect an 11.0% increase in international arrivals for both business and holiday purposes in 2018, which will result in demand for hospitality services
- Despite the expected increase in room and bed supply, the aforementioned factors and the continued growth of MICE and domestic tourism will result in better performance of the hospitality sector in 2018 with bed occupancy rates expected to rise by 1.4% points
- In Nairobi alone, we expect the ADR to increase by between 11.0% and 19.0% y/y to average at between USD 139.3 and USD 150.0, average room occupancy to increase by 4.0% points to average at 53.0% resulting in an increase in RevPAR by between 20.6% and 29.9% y/y to average at between USD 73.8 and USD 79.5

* *Source: KNBS, Cytonn Research 2018*

Mixed Use Development performance

We expect increased investment in MUD's backed by high returns and the live-work-play-invest opportunity to end buyers

All values in Kshs unless stated otherwise

MUD Analysis								
Name of Property	Initial Price SQFT	Current Price SQFT	Yield	Value Appreciation Per annum	Sales Achieved	Occupancy	Weighted Price	Yield
Adlife Plaza	13,500	15,500	10.1%	5.0%	93%	93%	9,687	14.8%
Sifa Towers	11,000	13,000	12.0%		91%	91%	11,700	10.7%
Timau Plaza	9,500	12,500	10.0%	5.0%		100%	10,750	10.3%
Green House Building	9,000	14,000	9.0%	9.0%	100%	95%	11,200	9.9%
K-Rep Center	10,000	13,000	10.6%	4.0%		95%	9,750	9.3%
Average	10,600	13,600	10.3%	4.6%	95%	95%	10,618	11.0%

- In recent years, a new trend is emerging of integrated mixed-use developments, these are composed of extensive retail space in malls, Grade A office spaces in office towers and residential precincts composed of apartments, villas and hospitality features
- They Include Garden City, Two Rivers, Le Mac and The Hub. The growing popularity in mixed use developments is driven by several advantages, including, Higher rates, Higher occupancy, Efficient use of space and Economies of scale
- The real estate sector is to embrace the concept of **Mixed Use Developments**, with **Montave** in Upper Hill, **Pinnacle Towers** in Upper Hill, **Le Mac** in Westlands and **Cytonn Towers** in Kilimani expected to come in to the market, either completed or with construction having commences, in the 2018.
- This trend is backed by the MUD's high returns, for MUD comprising of Office and retail recording an average rental yield of 11%, at 95% occupancy rates, as shown below:

Source: Cytonn Research

Cytonn REAL ESTATE

Land performance Projections

The land prices in Nairobi Metropolitan Area are expected to record an annual capital appreciation of 10.2% in 2018

All values in Kshs unless stated otherwise

Summary of the Performance Review and Outlook across all regions

Location	*Price in 2011	*Price in 2015	*Price in 2016	*Price in 2017	*Price in 2018f	6-year CAGR	Price change from 2011	Annual Capital app. (2017)	Annual Capital app. (2018)f
Satellite Towns - Unserviced Land	9m	16m	21m	22m	25m	18.5%	2.9x	7.8%	13.8%
Nairobi Suburbs - High rise residential Areas	46m	80m	97m	103m	117m	15.7%	2.4x	7.6%	13.0%
Nairobi Suburbs - Commercial Areas	156m	377m	458m	478m	499m	20.7%	3.1x	4.4%	4.4%
Nairobi Suburbs - Low Rise Residential Areas	56m	91m	106m	109m	121m	13.1%	2.1x	6.0%	10.8%
Satellite Towns - Site and service schemes	6m	13m	14m	15m	16m	18.9%	3.2x	6.3%	9.0%
Average						17.4%	2.7x	6.4%	10.2%

Asking price per acre

- In 2018, we expect the performance to remain positive, informed by the historical performance over 6 years, as from 2011 to 2017
- We expect an annual capital appreciation of 10.2% in 2018, as the market recovers from the 2017 deep from 17.6% annual capital appreciation in 2016 to 6.4% in 2017 due to the reduced economic activities as a result of the prolonged electioneering period.
- Satellite Towns, unserviced land and areas zoned for high rise residential areas such as Kilimani, Dagoretti, Ridgeways, and Kileleshwa, are expected to record high capital appreciation of 13.8% and 13.0%, respectively supported by relaxation of zoning regulations and increased investment in infrastructure including roads and sewerage
- The commercial zones are expected to retain an annual capital appreciation of 4.4% due to the high supply of office space in these areas hence less attractive to investors

Source: Cytonn Research

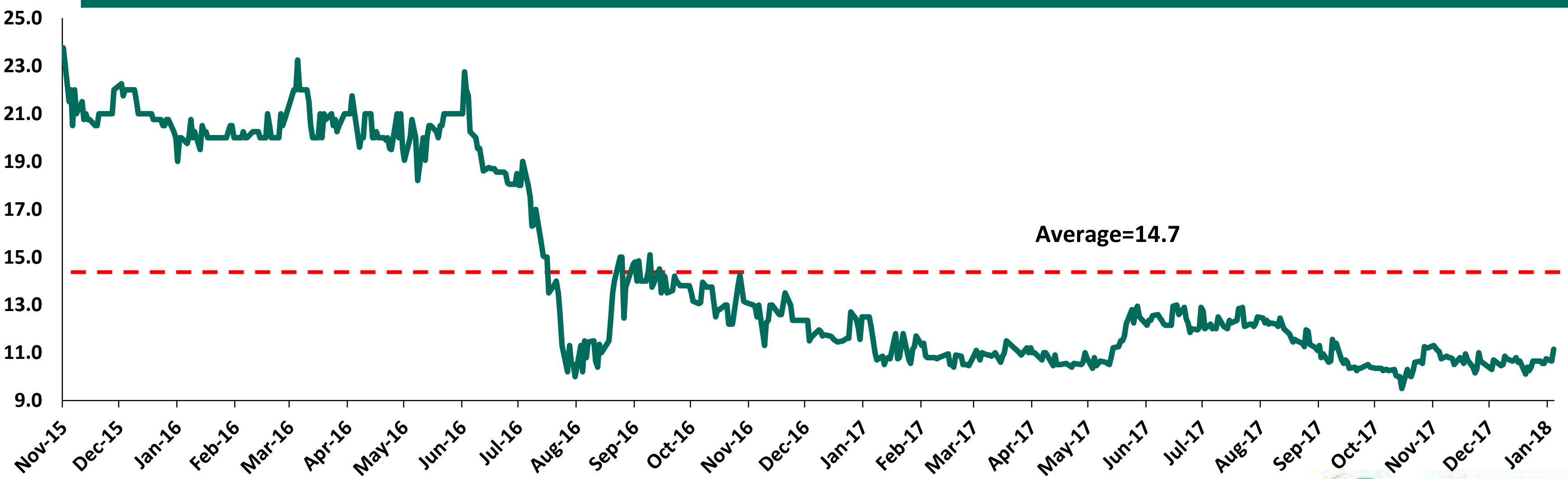
Cytonn REAL ESTATE

Listed Real Estate

Kenya's Listed REIT declined by 48.4% by close of 2017 from its 2015 listing price

- The Fahari REIT share price came in at Kshs 10.7 at the close of 2017, a 48.7% decline from its initial listing value of Kshs 20.8 in November 2015 and 10.8% lower than Kshs 12.0 at the beginning of 2017. The performance has been largely limited by a poor market sentiment with investors inclining heavily towards brick and mortar real estate which offer higher yields at 10.0% for retail and 9.3% for office sector, and government securities' average at 12.2%, respectively against an average yield of 5.9% earned from the REIT
- Having opened the year at Kshs 10.7, we expect the share price to average at Kshs 11.4 in 2018 based on its average performance in 2017,

FAHARI I-REIT PERFORMANCE



Source: Bloomberg

2018 Real Estate Sector Outlook

Three themes are positive, two are neutral and one is negative. Overall performance is expected to be neutral

Thematic Performance and Outlook		
Themes	**2018 Outlook**	**Effect**
Residential	• We expect the uptake, yield, rents and prices to increase by 2.4% points, 0.5%, 5.5% and 7.7%, respectively y/y driven by sustained demand, improved credit environment and government incentives	**Positive**
Commercial Office	• We forecast a decline in yields by 0.2% points to 9.0% in 2018 from 9.2% in 2017 as a result of oversupply. With the average occupancy rates expected to decrease by 1.4% points from 84.6% to 83.3%	**Neutral**
Retail	• Occupancy rates are expected to decline by 08% points to 79.5% from 80.3% and rents are expected to decline by 0.9% leading to a 0.4% points decline in yields from 9.6% to 9.2%	**Neutral**
Hospitality	• Stabilising political situation, growth of MICE and domestic tourism, sustained international business and travel tourism and marketing efforts will drive recovery with room occupancy expected to increase by 4.0% points, ADR by 11.0% and RevPAR by 20.6%	**Positive**
Land	• we expect the performance to remain positive, informed by the historical performance over 6 years, as from 2011 to 2017 with an annual capital appreciation of 10.2% in 2018, as the market recovers from the 2017 deep due to the reduced economic activities as a result of the prolonged electioneering period	**Positive**
Listed Real Estate	• The price of the instrument is expected to average at Kshs 11.3, based on its relatively stable 2017 performance. The dividend yield is expected to remain the same at 5.9% given the asset composition in the REIT remains unchanged	**Negative**

With 3 indicators being positive, 2 at neutral and 1 negative, the general outlook for the sector in 2018 is neutral, and therefore investors should be cautious in their investments, ensuring that proper research and due diligence is done to identify the pockets of value such as residential sector, Grade A offices and serviced offices before investing and matching the right products to the right market to boost uptake and ensure they earn high returns in the sector

2018 Key Areas of Opportunities by Sector

Ridgeways, Kilimani, Juja and Runda Mumwe present the best investment opportunity for housing units

- Based on returns, factors such as supply, infrastructure, land prices and availability of social amenities the following are the ideal areas for investment;

Sector	Themes	Locations	Reasons
Residential	**Detached Units**	Juja and Runda Mumwe	Offer the best investment opportunity for detached units owing to high uptake and returns to investors of 17.3% and 12.0%, respectively.
	Apartments	Ridgeways and Kilimani	High uptake and market returns of 18.4% and 15.4%, respectively
Commercial Offices	**Grade A offices**	Gigiri, Karen	Relatively low supply, proximity to commercial hubs and high yields of 10.3% and 9.8%, respectively
	Serviced Offices	Westlands	Prime commercial hubs with high occupancy of 81.2% and yields of 15.3%
Retail Sector	**Neighbourhood Malls**	Counties such as Mombasa	High supply in Nairobi leading to increasing vacancy rates. Retailers are increasingly moving to other counties
Land Sector	**Site & Service Schemes**	Juja, Thika, Ongata Rongai and Athi river	High demand and trunk infrastructural development in satellite towns
Hospitality Sector	**4-star Business Hotels**	Upperhill, Kiambu Rd	Prime commercial nodes with good infrastructure and have relatively low hotel supply
	Serviced Apartments	Upperhill, Kileleshwa/Lavington	Relatively low supply, proximity to commercial hubs and with security

VIII. Appendix

2018 Macroeconomic Outlook –Government Borrowing

Government borrowing is overall negative with pressure mounting on the government to borrow to meet its budget targets

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Factors**	**2018 Outlook**	**Effect**
Government borrowing	**Government debt to GDP**	• The government debt to GDP has been on a rise currently standing at 56.0% above the 50.0% recommended by the IMF for frontier markets and this has attracted criticism from major institutions	**Negative**
	Revenue Collection	• KRA is unlikely to meet its collection target due to expected suppressed corporate earnings in 2017, whose 2nd half will constitute the 1st half of the fiscal year 2017/18. • By end November 2017, the total cumulative revenues collected amounted to Kshs 558.4 bn against a target of Kshs 611.0 bn, which is 91.4% of their 5-month target and 34.2% of the full year target	**Negative**
	Government Expenditure Absorption	• Total expenditures amounted to Kshs 720.2 bn against a target of Kshs 824.2 billion, which is 87.4% of their 5-month target, and 30.2% of their full year target. • Recurrent expenditure amounted to Kshs 510.2 bn against a target of Kshs 494.8 bn, which is 103.1% of their 5-month target, and 35.4% of their full year target	**Neutral**
	Foreign Borrowing	• The government is set to issue a new USD 1.5 bn Eurobond in March this year while the foreign borrowing target is set to be raised upwards which could be at a higher cost due to our alarming debt levels though levelled off by stable macros	**Neutral**
	Domestic Borrowing	• Government to come under pressure to borrow as it is well behind the domestic borrowing target having borrowed Kshs 135.1 bn against a target of Kshs 236.7 bn	**Negative**

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2018 Macroeconomic Outlook -Currency

The currency is largely expected to be relatively stable from the support of the Central Bank, thus we are Neutral

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Factors**	**2018 Outlook**	**Effect**
Currency	**Current Account Position**	• The Treasury expects the current account deficit which was at 7.0% in Q3'2017 to narrow to 6.5% of GDP by December 2017 as the bulk of SGR-related imports are completed, while favourable weather conditions are expected to support food production and agricultural exports. These factors are expected to persist in 2018, with the CBK projecting the 2018 deficit to narrow to 5.4%; despite a higher fuel import bill due to higher global oil prices	**Neutral**
	Forex Reserves	• The CBK will continue to support the Shilling in the short term through its sufficient reserves of USD 7.0 bn (equivalent to 4.7 months of import cover) coupled with the IMF standby facility of USD 1.5 bn (equivalent to 1 month of import)	**Positive**
	Federal Reserve Rate Hikes	• The Federal Reserve is set to hike rates thrice in the year as the economy continues to improve amid weakening of the USD, however, we expect the rate hikes to have minimal impact on the Kenya shilling	**Neutral**
	Non USD Imports	• All imports are valued in USD and thus minimal impact is expected on the Shilling coupled with reduced food imports due to improved weather conditions, and importation for large capital intensive infrastructural projects are mostly done	**Neutral**
	Diaspora Remittances	• The foreign exchange market has remained relatively balanced supported by strong diaspora remittances, which increased by 21.9% y/y and 8.8% YTD in November 2017, to USD 175.2mn. We expect increased inflows from diaspora this year due to positive sentiments thus supporting the currency	**Positive**

2018 Macroeconomic Outlook –Interest Rates

We expect interest rates to remain relatively stable despite the upward pressure from investors as the CBK continues to reject expensive bids and thus we are Neutral

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Factors**	**2018 Outlook**	**Effect**
Interest Rates	**Liquidity**	• In 2018, with the CBK exploring the use of pooled securities under the control of a central counterparty as collateral for interbank money market transactions, we expect that this will serve to redistribute and improve liquidity in the money market • In 2017, the interbank rate averaged 6.3%, higher than 4.7% in 2016, indicating lower liquidity levels in the money market, in line with money supply growth, which declined to a 2017 average of 6.7% in 9 months to September compared to 8.6% recorded in the same period in 2016. • We expect the interbank rate to remain relatively low due to improved liquidity	**Neutral**
	Government Borrowing	• Government to come under pressure to borrow as it is well behind both domestic and foreign borrowing targets for FY 2017/18, and KRA is unlikely to meet its collection target due to expected suppressed corporate earnings in 2017	**Negative**
	Inflation	• Inflation is expected to average 7.5%, which is just at the upper bound of the government target range of 2.5% - 7.5%	**Positive**
	Currency	• We project that currency will range between Kshs 102.0 and Kshs 107.0 against the USD in 2018 • The CBK will continue to support the Shilling in the short term through its sufficient reserves of USD 7.0 bn (equivalent to 4.7 months of import cover)	**Neutral**

Cytonn INVESTMENTS

2018 Macroeconomic Outlook - GDP

GDP growth remains positive mainly driven by key sectors, which we expect to perform well in 2018

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Drivers**	**2018 Outlook**	**Effect**
GDP	**Private Sector Credit Growth**	Private sector credit growth has shown recovery towards the end of 2017, rising from a low of 1.4% in June to close at 2.4%. This year we expect private sector credit growth to remain at low levels mainly due to interest rate caps on banks lending rates	**Negative**
	Infrastructural Development	• Development Expenditure for the financial year ending June 2018 is set to be reduced marginally by 3.7% according to the 2018 Budget Policy Statement (BPS). However, the phase II of the SGR is set to kick off during the year as well as the continuation of the LAPSSET	**Neutral**
	Foreign Direct Investment (FDI)	• FDI activity into Kenya has been on decline since 2011 from USD 1.5 bn to only USD 393.4 mn according to the World Bank. • We expected increased FDI activity this year supported by positive investor sentiment and favourable business environment	**Neutral**
	Key Sectors (Agriculture, Manufacturing, Construction, Tourism, Real Estate)	• Growth in **Agriculture** is set to recover with improving weather conditions and driven by the government's efforts towards food security through re-engineering and mechanization • The **Manufacturing** sector is set to grow rapidly with the government's plan to re-vamp industries and encourage further growth in agri-processing • **Real estate** will continue to exhibit strong growth in 2018 driven by private sector investments and government plans to build 500,000 new homes in the next 5 years • Growth in **Construction** will be driven by government spending on projects such as phase II of the SGR, development of ports, LAPSSET, airport upgrades and energy projects • **Tourism** is one of the sectors of focus, exhibiting double digit growth in 2017. We expect this to continue in 2018 driven by better security and budgetary allocation towards recovery of the sector	**Positive**

2018 Macroeconomic Outlook – Investor Sentiment

Investor sentiment remains positive with measures pointing towards a positive outlook

Macro-Economic & Business Environment Outlook			
Macro-Economic Indicator	**Measures**	**2018 Outlook**	**Effect**
Investor Sentiment	Eurobond Yields	• Kenyan Eurobond yields have remained on a downward trend declining by 5.3% and 4.0% for the 5-year and 10-year Eurobonds, respectively, since the mid – January 2016 peak, an indication that Kenya remains an attractive investment destination • We expect Eurobond yields to continue on a decline and the new Eurobond to fetch relatively low yield in the global market due to high demand from global investors and stability following the 2017 electioneering period	Positive
	Foreign Direct Investment (FDI)	• FDI activity into Kenya has been on decline since 2011 from USD 1.5 bn to only USD 393.4 mn according to the World Bank • We expected increased FDI activity this year supported by positive investor sentiment and favourable business environment	Neutral
	Stock Market Performance	• During the year 2017, the Kenya equities market registered strong performance with NASI, NSE 25 and NSE 20 gaining 28.4%, 21.3% and 16.5%, respectively, compared to losses of 8.5%, 15.8% and 21.1% for NASI, NSE 25 and NSE 20, respectively, recorded in 2016 • We expect long-term investors to remain bullish on the market in 2018 as they take advantage of attractive valuations	Positive
	Currency	• We project that currency will range between Kshs 102.0 and Kshs 107.0 against the USD in 2018. The CBK will continue to support the Shilling in the short term through its sufficient reserves of USD 7.0 bn (equivalent to 4.7 months of import cover) • We expect a relatively stable shilling to enhance investor sentiment in 2018	Positive

Key Factors That Will Drive the Residential Sector in 2018

We expect the residential sector to be shaped by new zoning regulations, sustained demand and the government's affordable housing initiative

Relaxed Zoning Regulations

- The County Assembly has proposed new zoning regulations that will see some low rise suburbs such as Loresho and Kyuna rezoned to allow for high density commercial and residential developments this will,
  - Lead to increased demand for detached units in other areas such as Karen, Runda and Muthaiga which will be among the few high-end suburbs offering the aspect of exclusivity and low densification,
  - Increase real estate activity in the predominantly low rise areas

Sustained Demand

- The current cumulative housing deficit in Kenya stands at 2.0 mn units, and growing annually by 200,000 units, according to National Housing Corporation
- This will be largely driven by demographics such as a population growth of 2.6% compared to the global average of 1.2%, a high urbanization rate of 4.4% versus a global average of 2.1%, thus sustaining the demand for more stock

Affordable Housing Initiative

- The government announced affordable housing as one of the Big Four pillars. Going forward, we expect:
  - More government incentives for low cost housing developers
  - Affordable mortgages to prospective home buyers by working hand in hand with savings and credit co-operative societies,
  - Measures aimed at lowering construction costs for developers such as availing affordable serviced land, and encouraging alternative building technologies in the market, as well as

2018 Residential Sector Outlook

We have a positive outlook for the residential sector, with the uptake, yield, rents and prices expected to increase by 2.4% points, 0.5%, 5.5% and 7.7%, respectively y/y

Thematic Performance Review and Outlook			
Theme	**2017 Performance**	**2018 Outlook**	**Effect**
Residential	• The residential sector's performance softened largely attributable to i. The extended political period which led to investors adopting a wait and see attitude especially for areas known to be more volatile ii. A tough credit environment for both developers and end users with the private sector credit coming in at 2.4% for January to October 2017, compared to the 2012-16 average of 14.4% • Returns in the sector, as a result, declined by 2.6% points to 10.3% from 2016's average of 12.9%	• We expect the sector's performance to improve in 2018 with the value of residential completions increasing by at least 13.9% as the market records increased investment activity following the conclusion of elections • We thus expect the uptake, yield, rents and prices to increase by 2.4%, 0.5%, 5.5% and 7.7%, respectively y/y	**Positive**

We expect the sector's performance to improve in 2018 with the value of residential completions increasing by at least 13.9% as the market records increased investment activity following the conclusion of elections. We thus expect the uptake, yield, rents and prices to increase by 2.4% points, 0.5%, 5.5% and 7.7%, respectively y/y

Key Factors Driving Office Market

Nairobi as a Regional Hub and Growth of professional services and devolution are some of the factors that will drive the Office Market in 2018

Nairobi as a Regional Hub

- Nairobi has positioned itself as a regional and continental hub and has thus attracted multinationals who set up both regional and continental offices these include JP Morgan Chase and Isuzu Motors Ltd who officially launched Isuzu East Africa
- These companies create demand for office space in key commercial areas

Growth of Professional Services and SMEs

- Small and Medium Enterprises (SME) contribute to approximately 45% of Kenya's GDP, 80% of employment in Kenya and constitute 98% of businesses locally according to a CNBC News Report 2014 and are thus a key driver for the commercial office sector

Devolution

- Devolution has created demand for office spaces in counties to cater for County Governments and businesses that are expanding to county headquarters and thus increased real estate development.
- For instance, Cytonn Investments announced plans to expand operations to Nyeri with potential real estate developments worth Kshs 6 bn, and Fusion is developing a Kshs 3.7bn MUD in Meru County.

Outlook Commercial Office Sector

Our outlook for the commercial sector is neutral with the performance for the sector expected to be constrained by the oversupply of 3.9mn SQFT

Commercial Performance Review and Outlook			
Theme	**2017 Performance**	**2018 Outlook**	**Effect**
Commercial	• Performance of the commercial office theme softened in 2017 with occupancy rates declining by 3.4% from 88.0% to 84.6% and rental yields declining by 0.2% points to 9.2% from 9.4% in 2016 • There was an increase in the number of developments with notable developments launched in the year including Cytonn Towers, FCB Mirhab both in Kilimani, and Pinnacle in Upperhill • An oversupply in the sector with the Nairobi region currently experiencing an oversupply of 3.2mn SQFT, that is forecasted to increase by 21.9% in 2018 to 3.9mn SQFT	• We forecast a decline in yields by 0.2% points to 9.0% in 2018 from 9.2% in 2017 as a result of oversupply with the average occupancy rates expected to decrease by 1.4% points from 84.6% to 83.3% • We do not foresee an increase in rental rates with average rates per SQFT expected to decline to Kshs 98 from Kshs 101	**Neutral**

Our outlook for the commercial sector is neutral as the sector's performance continues to be constrained by oversupply, with the Nairobi region expected to experience an oversupply of up to 3.9mn SQFT

The sector however has pockets of value in areas such as grade A offices and serviced offices that attract yields of 10.0% and 13.4% respectively, as well as areas with low supply office spaces especially after the onset of the devolved governments

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Market Outlook 2018- Key Factors Driving Retail Market

In 2018 the retail sector will mainly be driven by increased foreign investments, E – Commerce and positive demographics

Increased Foreign Investment

- Foreign retailers have been making inroads in the country with Carrefour opening 4 new branches in 2017 and Choppies 11 new branches. As the retailers try to cash in to the gap left by local troubled local retail chains for instance Uchumi and Nakumatt. We expect the sector to continue attracting foreign retailers who are attracted by a stable economic growth rate that stands at approximately 5.0%

E - Commerce

- Retailers are increasingly adopting e commerce as a way to expand their market and offer their clients convenience. For instance, in 2017 Naivas and Deacons invested Kshs. 180mn and Kshs 10 mn in e-commerce respectively, with increased technology adoption we expect more retailers to take up e commerce

Positive Demographics

- Characterized by population growth rates that currently stand at 2.6%, 1.4% points higher than global averages of 1.2%, (ii) urbanization rates of 4.4% against global averages of 2.1%, (iii) an expanding middle class with increased purchasing power due to higher disposable incomes which create demand for retail products and thus boost the retail sector

Outlook Retail Sector

Our outlook for the Retail sector is neutral as a result of increased supply and internal challenges facing some major retailers

Thematic Performance Review and Outlook			
Theme	**2017 Performance**	**2018 Outlook**	**Effect**
Retail	• Performance of the retail sector softened, as a result of the tough operating environment constrained by an extended electioneering period, struggling retail chains grappled with the effects of poor of financing and poor supply chain management as well as increased supply • Occupancy rates declined by 9.0% points, from 89.3% to 80.3% between 2016 and 2017 in Nairobi triggered by an increase in of mall space by 41.6% y/y from 3.9mn SQFT to 5.6mn SQFT in 2017. Notable malls opened in the year include the Southfield Mall in Embakasi • Rental yields declined from 10.0% in 2016 to 9.6% as a result of lower occupancy rates, occasioned by increased supply	• Returns are expected to soften as a result of increased supply and the slowdown of traditional retailers such as Uchumi and Nakumatt. Occupancy rates are expected to decline by 0.8% points to 79.5% from 80.3% leading to reduced yields of 9.2% from 9.6% • However, we forecast an increase in international retailer foothold such as French based Carrefour and Botswana's Choppies as they try to cash in to the gap left by local retailers	**Neutral**

Our outlook for the retail sector is neutral occasioned by an over supply that is expected to hit 5.8mn SQFT in 2018 and declined occupancy rates as a result of slowdown of local retail chains

However, we expect an increase in the number international retail stores as foreign retailers try to capitalize on the gap left by local retailers.

Factors that will Influence the hospitality Sector

Increased room supply, continued marketing, domestic tourism and international conferences are some of the main factors that will drive hospitality sector in 2018

Increased Room Supply

- In 2018, we expect increased room supply and bed capacity with Nairobi alone set to register the opening of at least 751 additional rooms in hotels some of which include City Lodge, at Two Rivers Mall, Movenpick Hotel in Westlands and Hilton Garden Inn along Mombasa Road.
- This will result in better hotelier standards as global brands such as Movenpick enter the Kenyan market and as hotels aim to maintain their market presence in an increasingly competitive market

Continued Marketing Efforts

- The Treasury Minister, for the financial year 2017/18 allocated Kshs 1.0 bn for tourism recovery and Kshs 1.0 bn for sustaining new markets in order to continue marketing Kenya as a tourist destination
- Given the significant improvement recorded in 2016 in the sector, the allocation is 55.5% lower than the 2016/17 allocation of Kshs 4.5 bn, but will still have a positive impact in driving demand for tourism and hospitality services

International Conferences

- Given the conclusion of the elections and Nairobi's status as a regional hub, we expect the city to host several international conferences in 2018 including the 2nd African Quaternary (AFQUA) conference and various conferences sponsored by the International Institute of Engineers and Researchers.
- These will result in an increase in demand for accommodation and conference services

Domestic tourism

- The number of Kenyan bed-nights increased by a CAGR of 5.8% between 2012 and 2016 showing the growth in domestic tourism while the number of local conferences grew by a CAGR of 3.0% during the same period, with local conferences accounting for 92.4% of total conferences held in the country.
- We expect the trend to continue given the completion of the Standard Gauge Railway (SGR) that has eased access to and from the Coast and government incentives such as scrapping of VAT from National Park fees

Infrastructure

- We expect continuation of infrastructural projects such as the expansion of the Malindi International Airport, to enable it to accommodate more travellers and completion of the Dongo Kundu By-pass allowing ease of travel to the South Coast

Outlook Hospitality Sector

We retain a positive outlook for hospitality sector in 2018 driven by factors such as stabilizing political situation, sustained international business & travel tourism and Growth of MICE

Hospitality Sector Performance Review and Outlook			
Theme	**2017 Performance**	**2018 Outlook**	**Effect**
Hospitality	• Declined performance with ADR, RevPAR and Occupancy in Nairobi coming at USD 125.5, USD 61.2 and 49.0% compared to USD 137.0, USD 72.0 and 53.0% in 2016, respectively due to political instability during the elections period	• Stabilising political situation, growth of MICE and domestic tourism, sustained international business and travel tourism and marketing efforts will drive recovery with room occupancy expected to increase by 4.0% points, ADR by 11.0% and RevPAR by 20.6%	**Positive**

Our outlook for hospitality for 2018 is positive given the (i)Stabilizing political situation (ii)Sustained international business and travel tourism (iii) Growth of MICE and Domestic Tourism (iv) Government Incentives to boost the sector and (v) Continued marketing to reach new markets such as Asia and America, all factors that will increase demand for hospitality services

Key Factors Driving Land Performance

Growing population, improved infrastructure and legal reforms in Kenya are some of the factors driving land performance

Demographics

- Kenya's population growth rate at 2.6% p.a, rapid urbanization at 4.4% p.a and growing middle class has created demand for development land
- The rising middle-class has increased purchasing power leading to increased demand for housing units and development land

Infrastructure

- Trunk infrastructural development such as roads, Sewer lines, power distribution especially at county has led to opening up of new areas for development e.g. along the Northern Bypass, Eastern and upcoming Western Bypass leading to increased demand

Revision of zoning regulations

- The newly proposed zoning regulations that will see low rise suburbs such as Kileleshwa, Loresho, Kyuna and Spring Valley, rezoned to allow for high density developments
- This will lead to land prices increase due to more value for the investments in the area

Land Supply

- There is limited development land and inadequate of trunk infrastructure in urban areas
- This has resulted to increased demand on agricultural lands especially in satellite towns by both investors and developers since they are available in bulk and at relatively affordable prices

Legal Reforms

- New legislation, digitization of land records and increased transparency in land administration leading to improved efficiency in land dealings

Outlook on Land

Our outlook for the commercial sector is neutral with the sector mainly constrained by an oversupply in the retail and office themes

Thematic Performance Review and Outlook			
Theme	**2017 Performance**	**2018 Outlook**	**Effect**
Land	• Capital appreciation came in at 6.4% in 2017 from 17.6% in 2016 due to the political uncertainty brought about by the extended electioneering period • This was due to some sectors such as Riverside, Old Muthaiga and Ruai witnessing a land price correction with prices dropping by (0.5%), (7.2%) and (5.8%), respectively, over the same period	• In 2018, we expect the performance to remain positive, informed by the historical performance over 6 years, as from 2011 to 2017 with an annual capital appreciation of 10.2% in 2018, as the market recover from the 2017 deep due to the reduced economic activities as a result of the prolonged electioneering period.	**Positive**

We retain a positive outlook, with bias to Satellite Towns, unserviced land and areas zoned for high rise residential areas such as Kilimani, Dagoretti, Ridgeways, and Kileleshwa, with an expected capital appreciation of 13.8% and 13.0%, respectively supported by relaxation of zoning regulations and increased investment in infrastructure including roads and sewerage

Factors Driving Listed Real Estate in Kenya

Need for development capital and institutionalization of real estate are expected to support the sector in 2018

Institutionalization of Real Estate sector

- As more firms look for an easy access route into the real estate sector, we expect more corporations to come into the sector,
- In a bid to diversify portfolios, we expect to see more local and institutional investors such as pension schemes and insurance funds investing in the sector to tap into the regular dividend income for their members as well as government incentives for the sector

Reduced Credit Supply

- With the interest rates caps law, private sector credit growth has slowed coming at an average of 2.4% for the period of January to October 2017, and thus developers require alternative sources of funds. The REIT offers an easy tool for pooling funds to enable development for investors and thus we expect increased uptake for the same

2018 Listed Real estate Outlook

We expect the listed real estate sector to remain depressed in 2018 with persistent challenges such as poor market sentiment and the poor performance of the Fahari I-REIT, thus discouraging investor confidence

Thematic Performance Review and Outlook			
Theme	**2017 Performance**	**2018 Outlook**	**Effect**
Listed Real Estate	• The share price declined by 48.4% to Kshs 10.7 per share from Kshs 20.75 at the time of listing in 2015 and 10.8% lower than Kshs 12 at the beginning of the 2017 • The performance has been largely limited by a poor market sentiment with investors preferring other investments such as stocks attributable to the sector's poor dividend yields	• We expect the price of the instrument to average at Kshs 11.3, based on its relatively stable 2017 performance • As developers seek capital to fund their real estate ventures, we expect this to lead to a better market sentiment hence leading to more uptake • The dividend yield is expected to remain the same at 5.9% given the sector is growing at an extremely slow rate or increase marginally with the expected KShs 245 mn property acquisitions to meet the CMA's regulation	**Negative**

We retain a negative outlook for the sector, however, attempts by key real estate industry players in the region to improve the market sentiment on REITs and other alternative investments and need for capital by developers is expected to drive uptake of the REIT. The dividend yield is expected to remain the same at 5.9% given the asset composition in the REIT remains unchanged

Thank You!

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