Kenya's Real Estate Sector Retail Report

"Cautious Optimism in the Face of Turbulence"

09th October, 2017

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I. Introduction to Cytonn Investments

What We Stand For

Our Mission

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

Our Vision

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

Our Values

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

Excellence
Delivering the best at all times

Client Focus
Putting clients' interest first at all times

Entrepreneurship
Using innovation and creativity to deliver differentiated financial solutions

Accountability
We take both corporate and personal responsibility for our actions

Integrity
Doing the right things

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

— Jack Welch

About Us

Cytonn Investments Management Plc 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 bn	Over Kshs. 82 billion worth of projects under mandate	**5**	Five offices across 2 continents	**250**	Over 250 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

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Why We Exist

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

WE SERVE FOUR MAIN CLIENTS SEGMENTS:

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

WE INVEST OUR CLIENT FUNDS IN:

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

Our Business

Where We Operate

Our Business Lines

Investments
Alternative investment manager focused on private equity and real estate

Real Estate
We develop institutional grade real estate projects for investors

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

Technology
We deliver world-class financial technology solutions

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

Our Solutions

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

HIGH YIELD SOLUTIONS

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

REAL ESTATE INVESTMENT SOLUTIONS

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

PRIVATE REGULAR INVESTMENT SOLUTIONS

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

PRIVATE EQUITY

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

Our Products

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

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

Our People

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

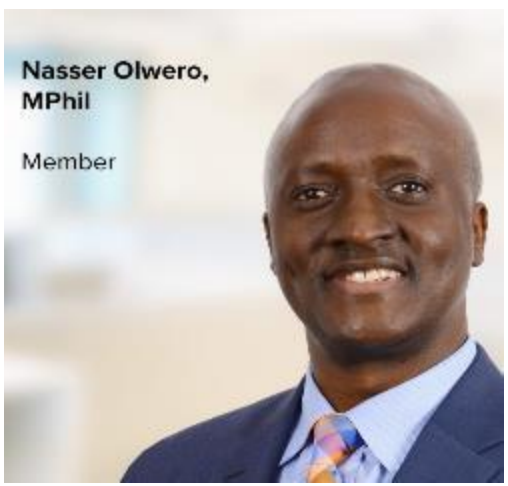
— Patrick Lencioni

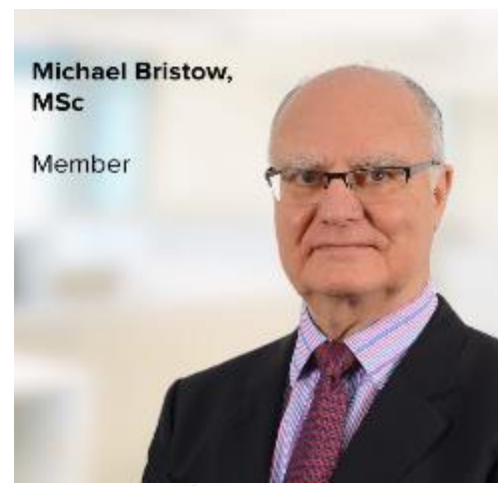
We are focused on one agenda:

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 …

II. Overview of Real Estate in Kenya

Real Estate in Kenya

Real estate sector in Kenya expected to continue growing on the back of growing middle class, and the entry of institutional developers/financiers and government incentives

Macro-economic Contribution

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

High Returns

- Real estate has consistently out performed other asset classes in the last 5 years, generating returns of 25.0% p.a., compared to an average of 12.4% p.a. in the traditional asset classes
- Residential units generate an average rental yield of 5.6%, while commercial and retail sectors generate an average yield of 9.2% and 9.6%, respectively in Nairobi

Recent Developments

- The real estate sector which was previously dominated by individual developers has seen entry of more institutional developers such as SACCOs, private equity firms and foreign institutions
- Evolution of structured products, REITS in the capital markets, as a way to raise funding and exit real estate developments, is likely to attract more institutional investors
- The government has also introduced various initiatives such as the scrapping of NEMA application fees, land title search fees and a reduction on corporate tax from 30% to 15% for housing developers who take on projects with a 100 or more units

Market Outlook

- We expect continued growth on the back of improved macroeconomic conditions, sustainable high returns, and a growing middle class
- The industry however continues to face challenges such as the unfavourable interest rate environment with the CBK's interest cap law that have seen private sector credit growth from a high of 25.8% in June 2014 to 1.5% recorded in August 2017

Introduction to Real Estate in Kenya – RE Contribution to GDP

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





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

Source: KNBS Economic Survey 2017

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III. Kenya’s Retail Report

Executive Summary

Increased supply affecting returns in the retail sector with yields in Nairobi declining by 0.4% points from 10.0% in 2016 to 9.6% in 2017

- We carried out a research on the retail industry in Nairobi & metropolitan, Eldoret, Mombasa, Kisumu and Mt Kenya regions.
- The Report aims to inform investors and retailers on the current state of the retail market in Kenya in terms of supply, demand, drivers, challenges and performance in 2017 and compare with 2016 performance to gauge trends and hence outlook
- From the research and analysis, as at 2017, Nairobi has a retail space of approx. 5.6 mn SQFT, a 41.6% increase from 3.9 mn SQFT in 2015/16, as a result of the opening of malls such as Next Gen Mall, Two Rivers, Ciata City Mall, Rosslyn Riviera among others which added cumulative retail space of 1.7 mn SQFT
- The retail sector has average yields of 8.3%, and occupancy rates of 80.2%, a decline from last year's 8.7% and 82.9%, respectively, mainly due to increased supply and a tough economic environment
- Nairobi is the best performing region with average rental yields of 9.6% a 0.4% points decline from 10.0% yield in 2015/2016
- Destination malls are the best performing typology with an average rental yield of 10.3%, compared to a market average rental yield for the retail sector of 8.3%
- The sector has revolutionized with developers focusing on international grade malls due to the influx of foreign retailers such as Game and Carrefour into the country; with brick and mortar retailers facing competition from growing online shops as consumer's tastes and preferences lean towards convenience and better international quality
- The outlook for the real estate sector is positive, as it still offers higher returns compared to other asset classes with average returns of 25.0%
- The retail sector offers relatively high returns compared to other sectors like residential which offer 5-7.0% yields. Nairobi is sufficiently supplied with retail space factoring in the incoming supply in the next 2-3 years. The opportunity is thus in other regions such as Mombasa which has low supply both current and in the pipeline

Retail Sector Performance Summary

In 2017 rental yields declined by 0.4% points to 8.3% from 8.7% in 2016, as a result of a 9.0% decline in asking rents and a 2.7% points decline in occupancy rates

Item	FY 2016	2017' YTD	Δ Y/Y
Asking Rents (Kshs/SQFT)	154.9	141.0	**(9.0%)**
Occupancy (%)	82.9%	80.2%	**(2.7%)**
Average Rental Yields	8.7%	8.3%	**(0.4%)**

- The retail sector's performance softened during the year, with rental yields declining by 0.4% points to 8.3% from 8.7%, as a result of declines in asking rents and occupancy levels, which reduced by 9.0% and 2.7%, respectively

- The growth in vacancy rates is attributed to the growth on mall space supply, which has increased by 41.6% year on year against a stagnated demand for the same and the tough operating environment characterized by constrained credit supply, which reduced expansion efforts by retailers

Source: Cytonn Research

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"Kenya's Retail Report – Cautious Optimism in the Face of Turbulence"

Retail sector performance softened with yields declining by 0.4% points from 8.7% to 8.3% as a result of increased supply and a tough operating environment

Value Area	Summary	Effect on Retail Market
Increasing Supply	• Nairobi, Mombasa, and Kisumu counties have the largest mall space supply with market shares of 59.4%, 10.0% and 7.4%, respectively. Nairobi's supply is expected to grow with a 3-year CAGR of 7.3% CAGR to 6.90mn Sqft in 2020 from 5.6mn Sqft in 2017	• Increased supply in Nairobi County has led to developers focusing on the Nairobi Metropolitan and other counties, such as Kiambu, Machakos and Nakuru, • The spurge in mall spaces have resulted in 'ghost malls' as retailers move onto the next best mall • Investors are also increasingly developing international grade mall space so as to attract foreign retailers
Returns	• As of 2017, the retail sector offers attractive returns of 8.3%.. • Nairobi and Kisumu outperform other regions with average rental yields of 9.6% and 9.1%, respectively, while Eldoret area has the lowest average rental yield of 6.6%	• This continues to attract developers into the retail market, which has resulted in a growth of retail space at a 10-yr CAGR of 13.7% • Despite the higher rental yields in Nairobi, the city has sufficient retail space supply factoring in incoming supply in the next 2-3 years and thus investment opportunity is in other regions such as Mombasa which has relatively low supply
Market Sentiments	• Despite the financial troubles faced by Nakumatt and increased competition from foreign retailers, retailers have a positive outlook for the sector and its potential for growth especially with the adoption of technology	• This has led to increased use of technology in the retail sector with stores like Naivas investing Kshs 180mn on an e commerce platform to diversify their product offering and customer experience

We expect less development of brick and mortar malls and more growth in terms of expansion from foreign retailers

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A) Introduction

Introduction

The research aims to provide an insight into Kenya's retail real estate market

- Retailing is a distribution channel function, where one organisation buys products from supplying firms or manufactures them and then sells these directly to consumers
- Kenya's retail market is attracting increased interest from local and international investors as witnessed through expansion of local stores, entry of international retailers and increased construction of malls
- Market studies rank Kenya as the country in Sub-Saharan Africa with the largest shopping centre space after South Africa, and with the largest development pipeline
- While kiosks, market stalls, supermarkets and cosmetic shops are still the most prevalent stores, the formal retail market has grown with several malls being constructed to offer consumers the convenience of a one-stop shop
- We therefore carried out this study with an aim of providing insight into Kenya's retail market market and provide an opinion on the following:
    - Supply of retail space in Nairobi Metropolis, Kisumu, Mombasa, Nakuru, and Mt Kenya regions
    - Trends and recent developments in the retail sector
    - Prevailing market rents, yields, occupancy and uptake of retail space
    - Consumer spending habits
    - Retail market outlook
    - Investment opportunity in retail real estate

Factors Driving Growth of the Retail Market in Kenya

Kenya's growing middle class has been the driving force behind growth of retail sector

Positive Demographics

- Kenya's high population growth of 2.6% p.a against world's 1.2% has created demand for retail good and services. The rising middle-class has increased purchasing power as well as varying tastes and preferences for different goods and services
- Kenya's urbanization rate at 4.4%, which is relatively high compared to the world's 2.1%, has resulted in a need for retail stores and entertainment spots for the youth

Foreign Investment

- Due to the current growth of the Kenyan economy, that has averaged at over 5.1% for the past 5 years, the country has received varied interests from international industry players
- Multinationals such as Johnsons & Johnsons, Volkswagen & Swavroski, among others, have set up shop in the country with international retail developers such as Actis, Azaelia Holdings and Avic CATIC, being behind the country's largest malls such as Garden City, The Hub and Two Rivers Malls, respectively

Infrastructural Development

- The country has seen a rapid improvement of its infrastructure making it accessible for investors to venture in otherwise inaccessible areas
- As a result, malls have cropped up along major Kenyan routes, for instance, malls such as Garden City along Thika Road, NextGen along Mombasa Road and Sarit Centre in close proximity to Waiyaki way

E-commerce

- Digitalization of cash systems & popularity of mobile wallets, bar coding to help in security measures and a high internet penetration rate of 58.0% against the world's at 42.0% have aided in growth of e-retailing
- As a result, successful online shops such as Jumia, Kilimall, Rupu, just to mention a few are cropping up with shops like Jumia recording an increase of 366.0% in mobile sales between 2015/2016
- As per the KNBS Economic survey, internet and mobile money subscriptions stood at 58.8% & 70.5% in 2016, an increase from 54.2% and 60.6% in 2015, respectively

Factors Affecting Supply of Retail Space

High financing costs negatively affect retail space development, but improved infrastructure is opening up satellite towns for development

Availability of Land

- Availability of development land has been low within towns and urban centres resulting in relatively high prices
- Developers are however shifting focus to Satellite Towns such as Kiambu, Rongai, and Kitengela, where large tracts of land are available and relatively affordable, thus resulting in increased supply

Access to Funds

- Malls being large developments require a huge capital outlay. Lack of proper funding for developments has resulted in excessive debt funding
- Lack of adequate funding has also resulted in stalling of projects, and extended project time frames, thus increasing financing and for existing outlets, operation costs. This has resulted to some outlets accruing huge debts that are paralyzing to normal business operation

Competition

- Spurting of malls in the same region has resulted in stiff competition between malls. This is likely to result in decreased mall construction in areas such as Thika Road and Limuru Road
- Mall developers face the risk of obsolescence of retail space, thus losing tenants to newer malls. They therefore have to continually revamp their malls so as to meet the tenants' and consumers' expectations

Infrastructure

- Improved infrastructural developments such as improved roads, the SGR, electrification, and ICT have opened up new development areas such as Athi River and Ruaka
- Completion of the Thika Super Highway has resulted in an influx of malls along the busy highway, while the Northern Bypass has influenced growth of Ruaka Town and construction of the Two Rivers mall

Fragmented Markets

- Kenya's retail market is mostly concentrated in urban areas due to higher purchasing power and good infrastructure . In addition, poor infrastructure in rural areas makes accessibility difficult
- Rural areas therefore continue to have low retail space supply due to inaccessibility and low purchasing power

Factors Affecting Demand For Retail Space

Location, security and competition significantly affect the demand for retail space in Kenya

Location

- Ease of access results in increased consumer traffic, making the location attractive to retailers
- Proximity to urban areas, densely populated areas or high-end settlement will result in a large consumer base for retailers' products

Security

- Retailers in the country estimate losses incurred through theft and shoplifting being worth Kshs 3 bn every year. In addition, retailers risk massive losses during times of political, social unrest and terrorism, with supermarkets being the worst hit
- Retailers are therefore less likely to seek space in areas affected by tension and insecurity

Competition

- A surge in malls in the capital has led to the evolution of 'ghost malls' as the supply supersedes demand, attributed to inflation and an unfavourable lending environment
- On the other hand, expansion of formal retail chains such fashion retail stores has been difficult due to competition from informal retailers of second hand clothes, also called "mutumba"

Online Retail

- The shift from shopping physically from retail stores to making orders online, may result in reduced demand for retail space in the long run as retailers will opt to save on costs for leasing retail space
- According to Jumia, online sales in Kenya increased to 58.0% in 2015. from 11.0% in 2011
- However, Kenyans still prefer physical shopping due to insecure delivery systems, cyber crimes and lack of proper physical addresses especially in rural areas necessitating the need for retail stores

B) Trends in the Retail Sector in Kenya

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Trends in Kenya's Retail Sector

Brand consciousness, green malls, entry of international retailers and online shopping are some of the key trends in the retail market in Kenya in 2017

Brand Consciousness

- The Kenyan retail space has seen a significant change as a result of evolving consumer lifestyles
- Kenyans are more connected to global trends, which has resulted in popularity of foreign products evidenced by the rise of international shops in fashion, beauty and food sectors such as Maybelline, Mocha, clothing stores such as LC Waikiki, Woolworths are setting up shop in Kenya in order to tap the market

Green Malls

- More retail centres are going green as a way of being environmentally friendly and also offer a safer shopping environment which is expected to increase occupancy rates. Examples of green malls in Kenya are The Garden City and Rosslyn Riviera with Garden City getting the Leadership in Energy and Environmental Design (Leed) Gold pre-certification award by United States Green Building council

Entry of International Retailers

- According to oxford Business Group, Kenya's formal retail penetration is 35.0% making it the second highest in Africa, after South Africa's 60.0%, which has served as an incentive for foreign retailers
- Foreign retailers such as Carrefour, Botswana's Choppies and Game have been able to penetrate the market with considerable success further supported by a widening middle class

Online Shopping

- According to Economic Survey 2017, internet mobile penetrations as at 2016 stood at 58.8% and 70.5%, an increase from 54.2% and 60.6% in 2015, respectively
- This has led to the growth of e-retailing with online shops such as Jumia, and social media growing rapidly. This has further been enabled by mobile wallets gaining popularity
- The popularity of online shops might result in reduced popularity of brick & mortar malls

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Recent Developments

Nakumatt and Uchumi account for 73.0% of all Kenyan retailers' supplier debts, as of 2017

Retailers' expansion strategies

- in a bid to tap into the booming e-retailing industry, Naivas Supermarket which opened its 35^{th} store as anchor tenant in Ciata City mall, announced its new venture into a Kshs. 180.0 mn ecommerce platform that will see goods get delivered countrywide using their system, Naivas Pay, while also contesting against Carrefour for space previously occupied by Nakumatt in Thika Road Mall
- This is due to an increase in demand for convenience by the Kenyan shopper. According to Communications Authority of Kenya (CAK) courier items sent locally grew 59.3% y/y as of June 217

Fall of Retail Giants

Nakumatt previously the leading retail store in Eastern Africa has recently undergone severe cash crunch leading to closures of at lease three retail outlets in Uganda and shutting down four of its flagship branches in Kenya by October 2017, due to accrued supplier debts that accumulated to Kshs 30 bn by 2017. Uchumi suffered the same fate in 2016 owing to supplier debts that had accrued to Kshs 2.8 bn. The challenges facing the retailers have been as a result of:

- Reduced credit advancement to private sector following the CBK Interest rate legislation
- High inflation rates which hit an annual high in May 2017, at 11.7%
- Poor governance in the family-led business, lack of wise expansion strategies and internal losses
- Entrance of international retailers who get the advantage of tax holidays
- Poor supply chain management which. As per The Ministry of Industry and Trade, Uchumi and Nakumatt accounted for 73.0% of the total debt owed by Kenyan retailers to suppliers

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Recent Developments

The retail sector is poised for more investments by foreign investors

What's Next…

- Nakumatt announced a proposed merger that would see the retailer sign a multibillion deal with Tuskys. If successful, the retailer will be able to access Tuskys suppliers and will help end their financial distress and restore the retailer to full operations and inventory levels.
- The Central Bank of Kenya may revise the interest rates legislation due to its negative effect on the country's economy, especially in the private sector

The retail sector is thus in Kenya is likely to experience a paradigm shift with international retailers such as Carrefour making inroads to the Kenyan market taking advantage of the gap caused by the crisis and malls replacing supermarkets as anchors by other retailers such as fast-food stores which have high footfall

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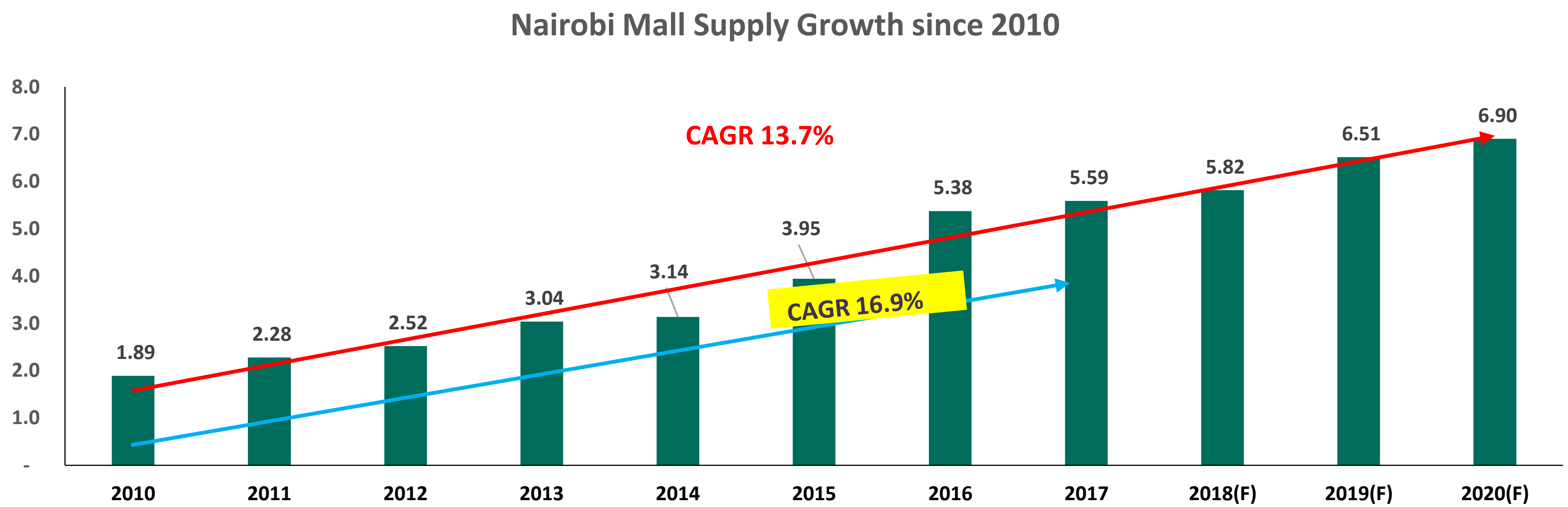
C) Retail Space Supply in Kenya

Retail Space Supply Nairobi – Growth Rates

Retail space in Nairobi will grow to 6.9 mn SQFT by 2020, at a 13.7% CAGR



- Nairobi currently has a mall space supply of approximately 5.6 mn SQFT, a having grown from 1.9 mn SQFT in 2010 a 7-yr CAGR of 16.9%, making it the largest shopping centre in Sub-Saharan Africa after South Africa, which has approx. 23.0 mn SQFT of mall space
- The increase in mall space has been largely driven by intensive investment by mall developers seeking to tap into the widening middle class whose purchasing power has been on a rise and have an appetite for sophisticated lifestyles, as well as infrastructural development
- We project that by 2020, the retail space supply will have grown to over 6.9 mn SQFT, which is a 10-yr CAGR of 13.7%, with the addition retail space such as the Kileleshwa Mall, Cytonn Towers, The Karen Water Front, the new Sarit Centre expansion, among others

Source: Cytonn Research

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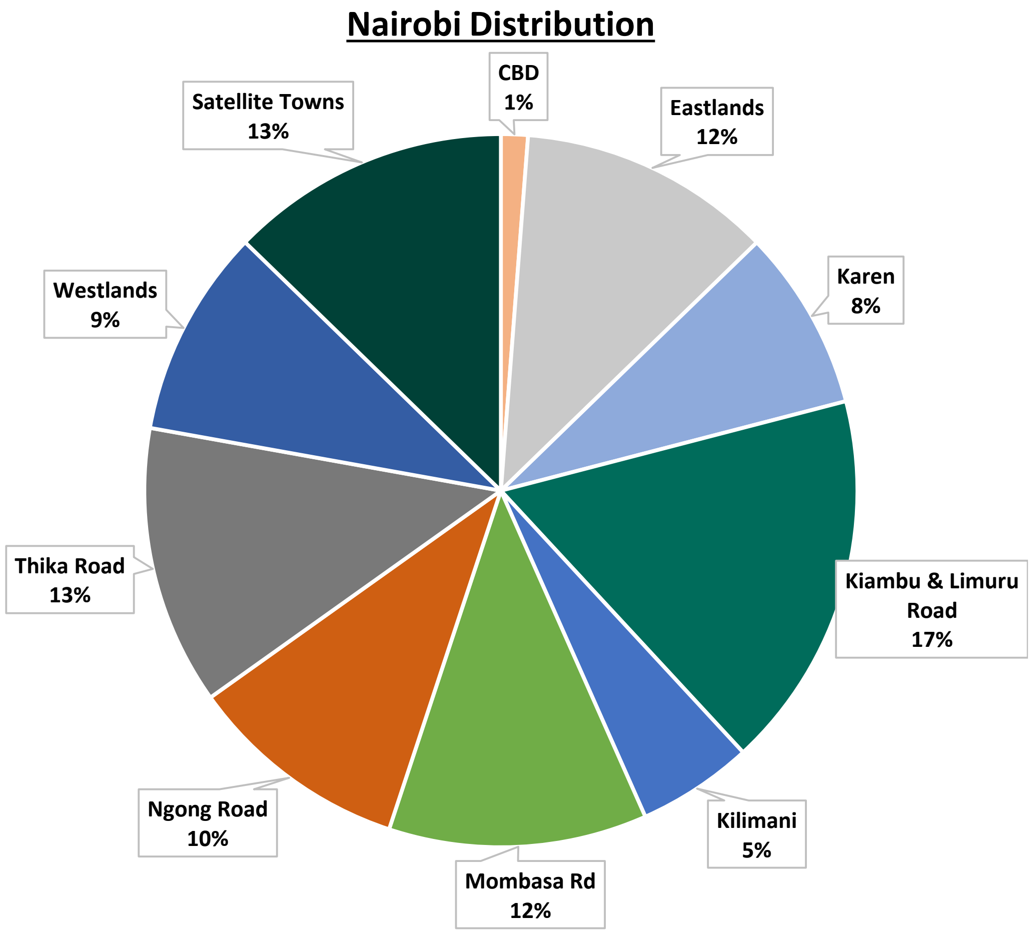
Retail Space Supply Nairobi – Current Distribution by Nodes

Kiambu & Limuru Road Area has the largest mall space with a 17.0% market share



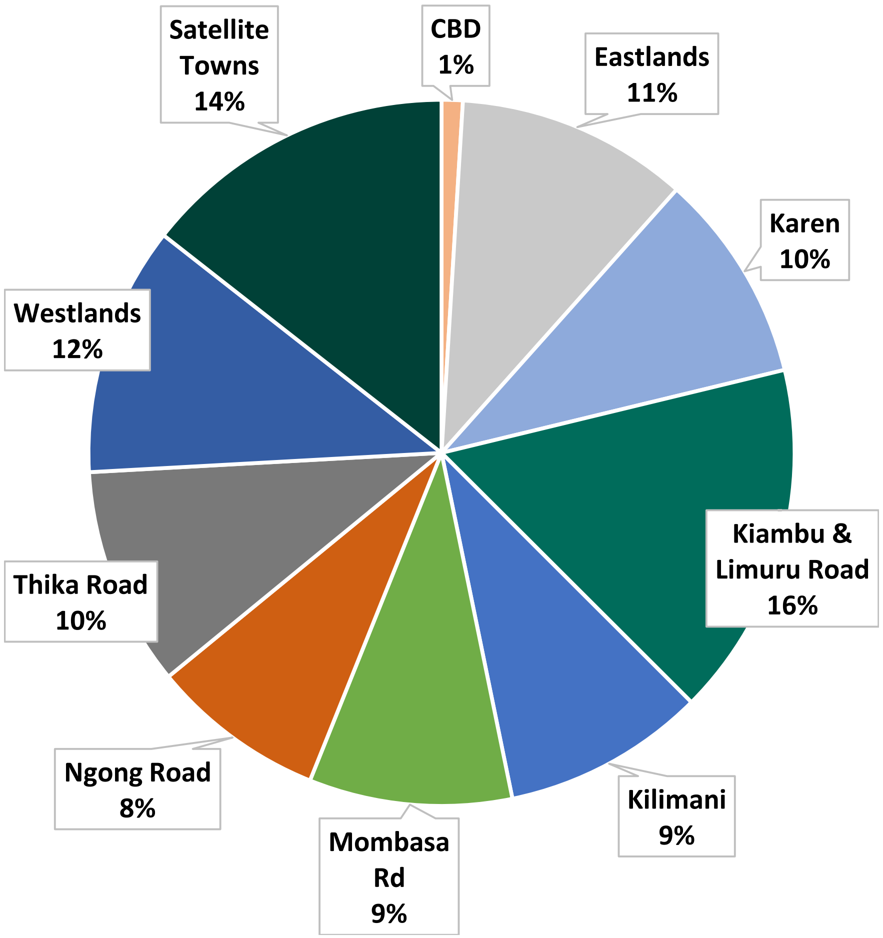
- Kiambu & Limuru Road Area and Thika Road nodes have the largest mall space with 17.0% and 13.0% market share, respectively
- This is due to the opening of the Two Rivers mall on Limuru Road earlier this year
- The areas with largest supply have good road connectivity and also serve middle and high end income suburbs, making them attractive investment opportunities for mall investors
- CBD and Kilimani, Kileleshwa & Lavington areas had the least market share, attributable to lack of development land in the CBD and previously-strict zoning regulations in Kilimani, Kileleshwa & Lavington areas

Source: Cytonn Research

Retail Space Supply Nairobi Distribution by Nodes in the Next 3-Years

Kiambu & Limuru Road will still have the largest market share, at 16.0%

Mall Supply in the Next 3 Years



- Kiambu & Limuru Road will still have the largest mall space, with a total market share of 16.0%
- Kilimani's contribution to Nairobi's total supply will increase to approx. 9.0% due to upcoming malls such as Kileleshwa mall, Cytonn Towers and Fairview Plaza malls
- Satellite Towns, which as per our sample includes areas like Kiambu and Machakos, will have the second largest market share at 14.0% of the Nairobi Metro's mall supply due to upcoming malls like the Kiambu Mall in Kiambu Town and Crystal Rivers in Athi River
- Other upcoming malls include Karen Waterfront, Mountain View mall on Waiyaki way, and Comesa mall in Eastlands

Source: Cytonn Research

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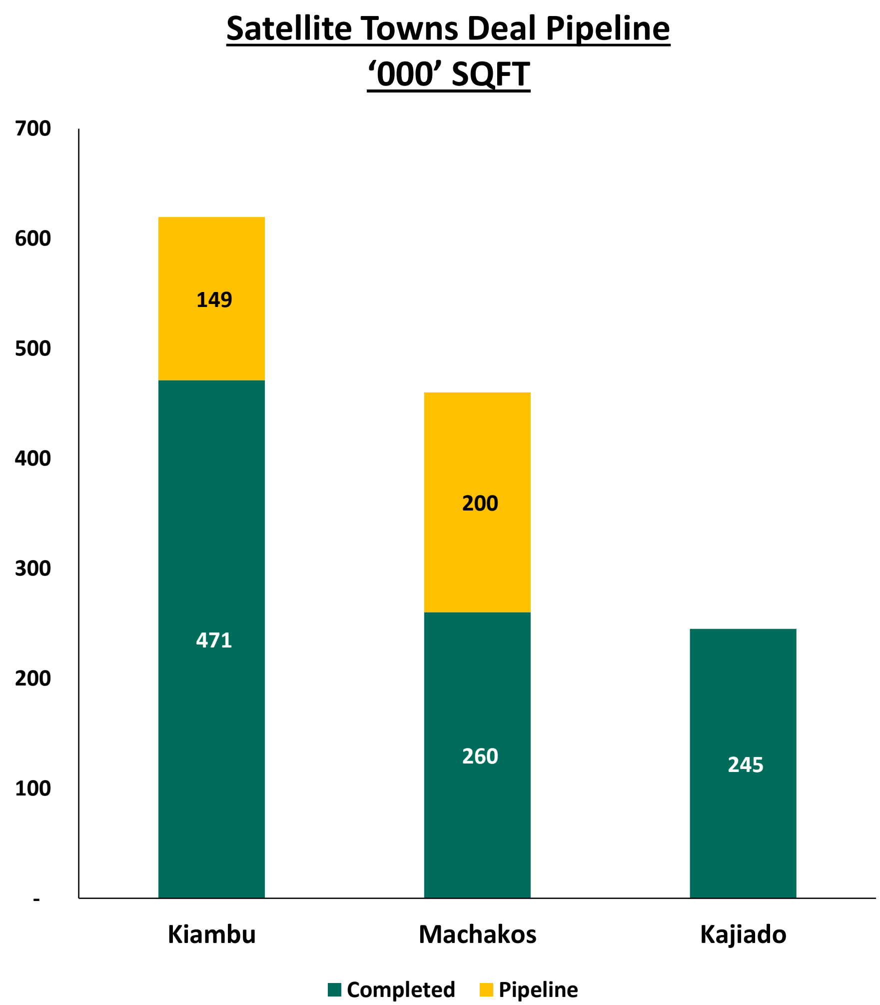
Retail Space Supply in Nairobi Metropolitan Area

Machakos County has the largest deal pipeline with 200,000 SQFT of retail space under construction

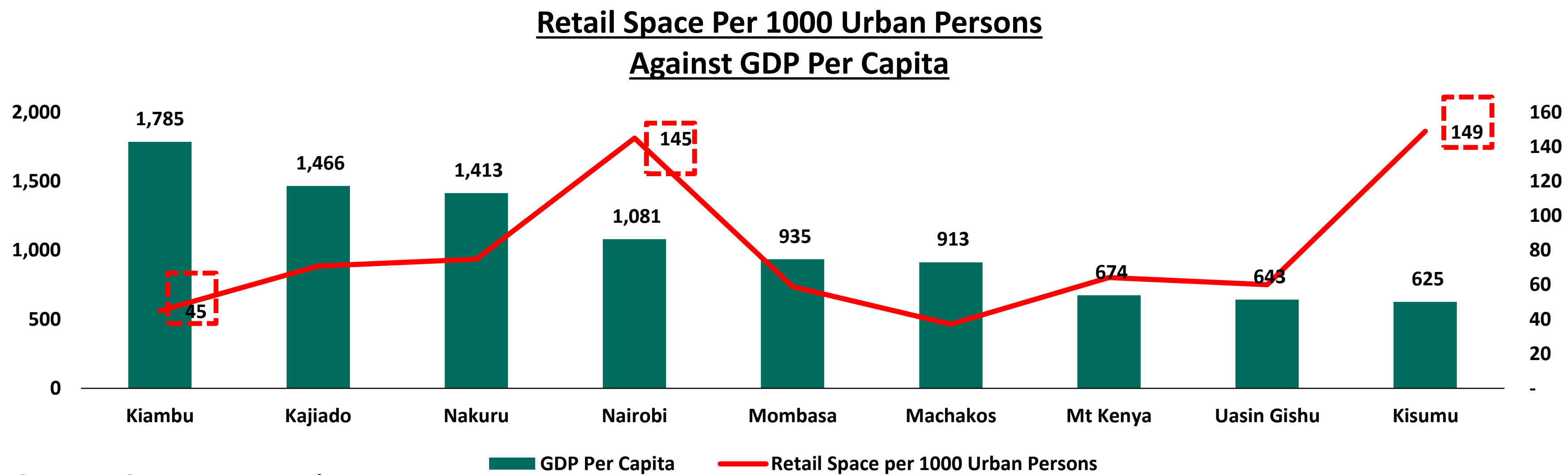


- Kiambu County has the largest mall space supply with 471,000 SQFT of mall space and a deal pipeline of 149,000 SQFT due to the upcoming Kiambu Mall
- The County enjoys a large urban population and has been ranked the wealthiest county in Kenya with a GDP per capital of USD 1,785 which is 22.7% higher compared to the country's which is USD 1,455, as well as a booming real estate market
- Machakos County has a large development pipeline with the construction of The Crystal Rivers Mall underway bringing the total mall space in the county to 460,000 SQFT
- Development in Machakos County is supported by improving infrastructure, affordable land and over 51.8% of its population being urban
- From our sample, Kajiado County, however, has no deal pipeline for the near future and is served by Maasai Mall, Milele Mall and Red Heron in Rongai, Ngong and Kitengela, respectively

Source: Cytonn Research

Retail Space Supply in Kenya – GDP Per Capita Vs Supply

Kiambu has the least retail space per 1,000 people at 45 SQM per person



Source: Cytonn Research

- Kenya has a GDP Per Capita of USD 1,455. However, as per the 2015 World Bank report on national and subnational economic growth in Kenya, Kiambu was listed as the richest county in Kenya with a GDP per capital of USD 1,785. However, the county has the least retail space per 1,000 persons at 45 Sqm per 1,000 urban persons, showing that it still has potential for retail growth

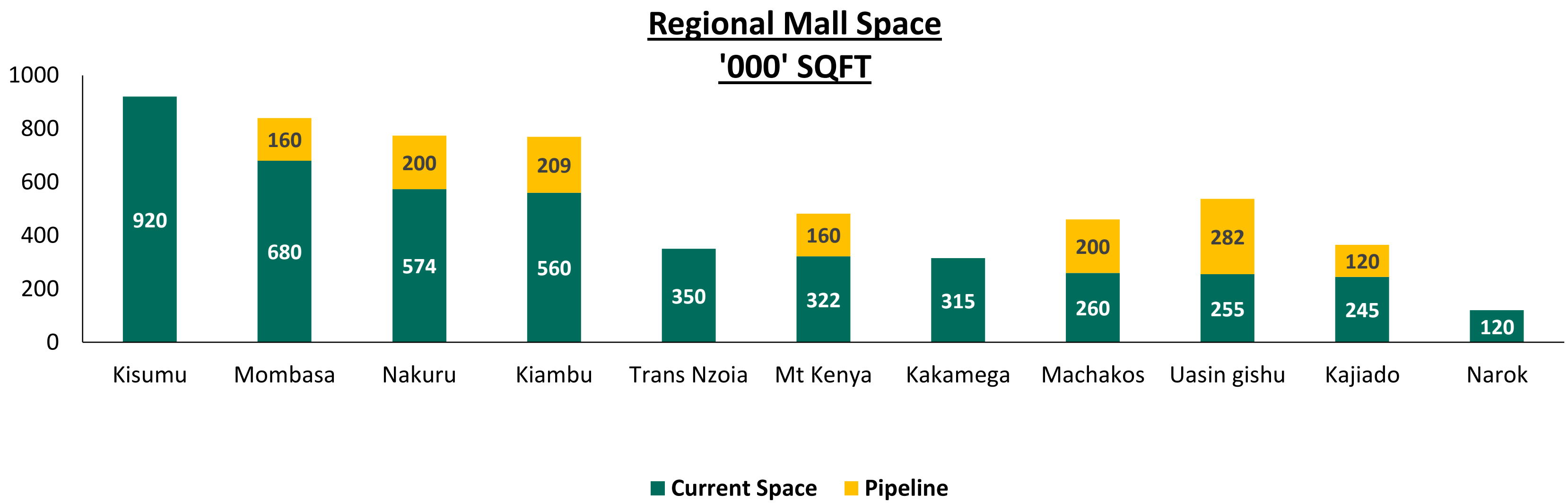
- Nairobi and Kisumu had the highest retail space per a 1,000 urban persons at 145 and 149 sqm per 1,000 persons, respectively, which is low compared to other counties that ranked higher such as Kajiado and Mt Kenya

Source: Word Bank "Bright Lights Big Cities" Policy Paper 2015

Cytonn REAL ESTATE

Retail Space Supply in Kenya – Regional Distribution and Pipeline

Kisumu has the largest mall space in Kenya after Nairobi with 920,000 SQFT of retail space

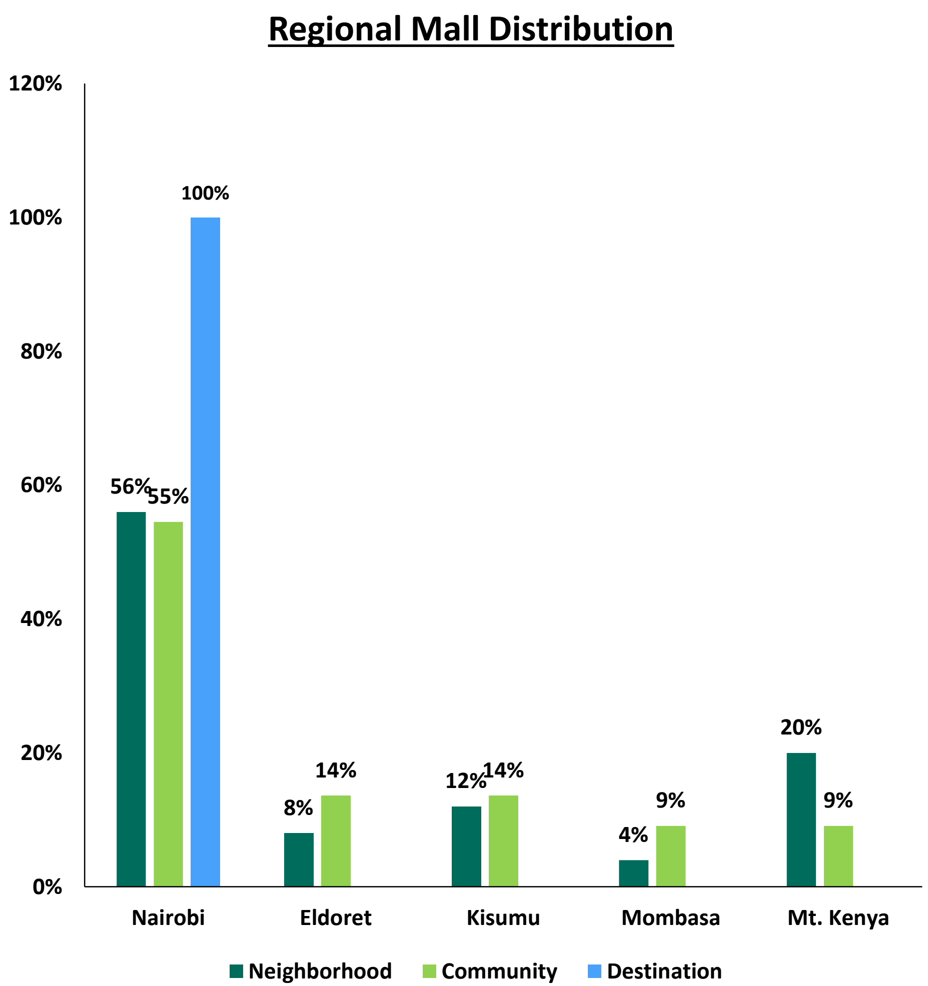


- Kisumu, Mombasa and Nakuru have the largest mall supplies in Kenya after Nairobi with 0.9 mn, 0.7 mn and 0.6 mn SQFT, respectively
- The three are the biggest towns in Kenya after Nairobi hence a high urbanized population at 52.1%, 100.0% and 45.4%, respectively. Additionally, they are tourist towns and thus attracts large numbers of local and international visitors
- Uasin Gishu, Kiambu, Machakos and Nakuru regions have the largest deal pipelines, attributable to the fact that they are fast growing regions, especially in the real estate sector

Source: Cytonn Research

Retail Space Supply in Kenya – Regional Distribution by Class

Neighborhood malls are the most common in Kenya accounting for 51.0% of the total mall space in Kenya



- Neighbourhood malls have the highest market share with 51.0% while community and destination malls take up 45.0% and 4.0% of the market share, respectively

- Nairobi is the only county with all types of malls, accounting for 56.0%, 55.0% and 100.0% of the total market share of neighbourhood, community and destination malls, respectively

- Neighbourhood and community malls are the dominant types with a presence in all counties which is attributable to the fact that they attract the middle and lower middle income groups due to their affordability in products offered as well as construction costs in comparison to regional malls

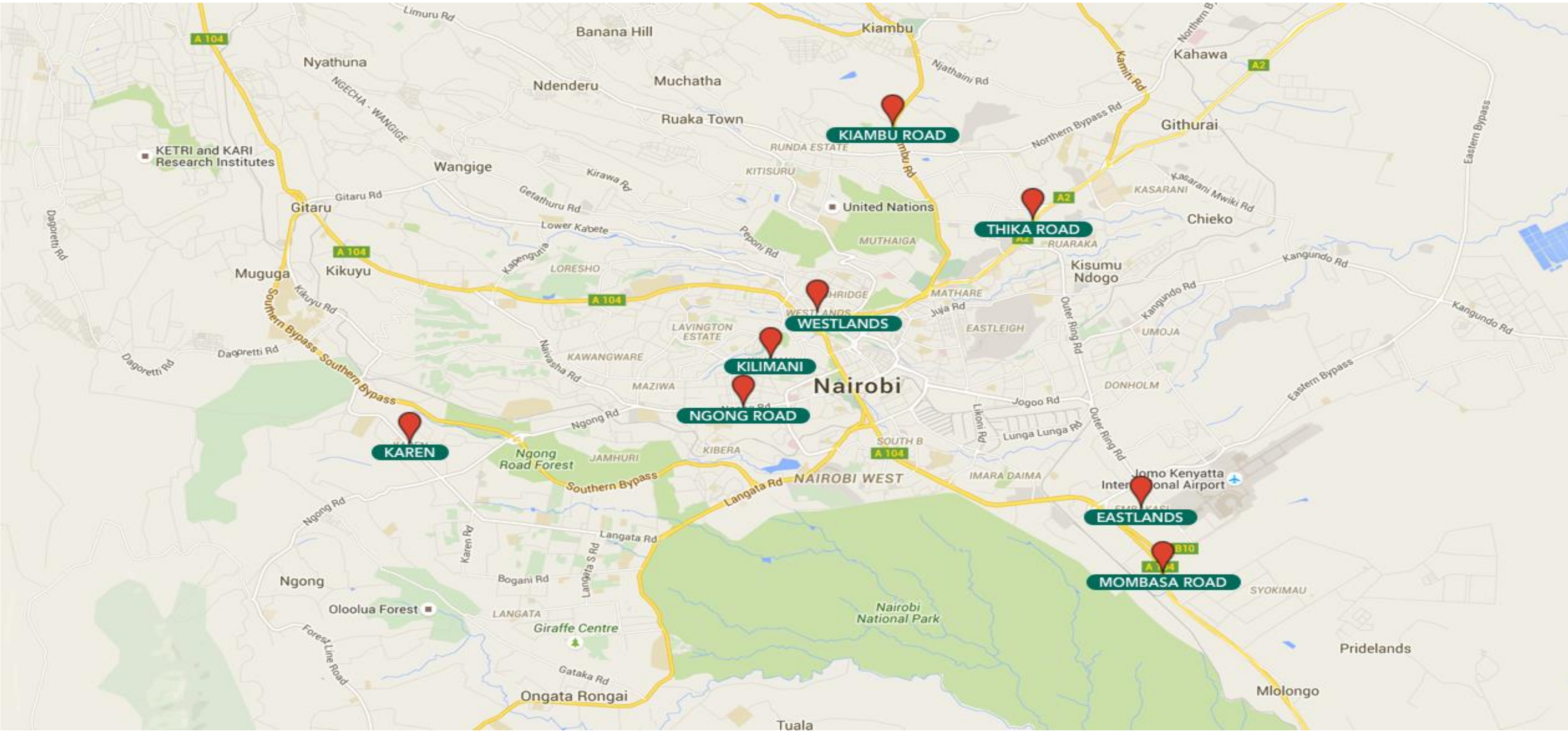
Source: Cytonn Research

IV) Retail Market Performance

A) Performance By Nodes

Retail Sector Nodes in Nairobi

Karen, Westlands, Kiambu Road and Thika Road are the main retail nodes in Nairobi



In our sample;

- *Kiambu Road includes Limuru Road*
- *Kilimani,Kileleshwa & Lavington includes Kilimani,Kileleshwa & Lavington and their environs,*
- *Ngong & Lang'ata Road covers area between Community, Lang'ata Road up to Dagoretti Corner*
- *Westlands includes Parklands and Mountain View*

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Nairobi Metropolitan Area Retail Market Performance

Westlands and Karen were the best performing retail suburbs in Nairobi with average rental yields of 13.5% and 11.2%, respectively

Location	Rent 2017	Occupancy 2017	Rental Yield 2017	Occupancy 2016	Rental Yield 2016	Change in Occupancy Y/Y	Change in Yield Y/Y
Westlands	235	91.0%	13.5%	92.0%	12.3%	(1.0%)	1.2%
Karen	206	96.3%	11.2%	96.3%	12.5%	0.0%	(1.2%)
Kiambu & Limuru Road	216	78.2%	10.6%	90.0%	10.1%	(11.8%)	0.4%
Kilimani, Kileleshwa and Lavington	181	87.0%	10.3%	86.0%	10.6%	1.0%	(0.3%)
Thika Road	199	75.3%	8.7%	89.3%	10.0%	(14.0%)	(1.3%)
Ngong Road	171	81.8%	8.7%	93.3%	9.7%	(11.6%)	(0.9%)
Mombasa Road	180	68.8%	8.3%	83.3%	8.2%	(14.6%)	0.1%
Satellite Towns	130	82.5%	7.7%	88.3%	9.3%	(5.8%)	(1.6%)
Nairobi Eastlands	149	61.8%	6.1%	85.0%	7.5%	(23.3%)	(1.4%)
Average	**185**	**80.3%**	**9.6%**	**89.3%**	**10.0%**	**(9.0%)**	**(0.4%)**

- Retail in Nairobi has relatively high yields of 9.6% on average compared to other real estate themes such as the residential sector with yields ranging from 5% – 7% and commercial office with average rental yields of 9.2%

- In 2017, Nairobi's performance softened across all submarkets with yields declining by 0.4% points, as a result of increased supply which led to a 9.0% points y/y from an average of 89.3% to an average of 80.3% with Nairobi Eastlands having the largest decline in occupancy levels at 23.3% points followed by Mombasa Road and Thika Road with 14.6% points and 14.0% points declines in occupancy levels, respectively

- These These nodes got significant amount of retail spaces between 2016 and 2017 with malls such as K – Mall and Southfield in Nairobi Eastlands adding 220,000 SQFT, Next Gen Mall adding 490,000 SQFT of retail space in Mombasa Road and Unicity adding 115,000 SQFT on Thika Road

Source: Cytonn Research

Performance by Nodes

Westlands was the best performing submarket, with a yield rate of 13.5% and an occupancy of 91.0%

Westlands

- Westlands was the best performing submarket with high yields of 13.7% and occupancy rates of 91.0% attributable to its high rents as a result of proximity to CBD and its being an upper middle income neighborhood

Karen

- Karen was the second best performing submarket, with a yield rate of 11.2% and an occupancy of 96.3%. This is attributable to its affluent population, prime rents and lower competition compared to low end areas, the malls compete against second tier supermarkets

Kiambu & Limuru Road

- Average yields increased to 10.6% from 2016's 10.1% attributable to to its changing status into one the fastest rising residential areas and apt location along Nairobi's periphery. The node also serves high end markets such as Muthaiga, Runda and Ridgeways, attracting premium rents

Kilimani, Kileleshwa & Lavington

- The area performed fairly well with average occupancy rates of 87.0%, an increase from 86.0% in 2016 and average yield of 10.3% which was a decline form 2016's 10.6%, which could be attributed to the area's dominance by aged malls

Ngong & Lang'ata Road

- Ngong & Lang'ata Road has both community and neighborhood malls as the area serves population segments from both lower and upper middle income classes. The average rent for the area was Kshs. 171 per SQFT with average occupancy rate of 81.8% and a yield of 8.7%

Performance by Nodes

Nairobi Eastlands was the worst performing submarket with average yields of 6.1%

Mombasa Road

- Malls in Mombasa road have an average occupancy of 68.8% but low yields of 8.3% compared to other regions like Karen and Kilimani, Kileleshwa & Lavington due to it zoning as an industrial zone as well as traffic jams which tend to discourage footfall

Thika Road

- Thika Road has all types of malls, i.e, neighborhood, community and regional with community malls taking the bulk of the share. The average yields plummeted to 8.7% from 10.0% in 2016, attributable to an increase in malls within the node resulting in low occupancy levels in some malls such as Juja City and Unicity malls

Nairobi Eastlands

- Nairobi Eastlands remained the poorest performer with average yields of 6.1% and occupancy rates of 61.8%. This could be attributed to low occupancy rates as the formal retail sector faces stiff competition from informal retail outlets that are more popular with the lower middle and low income classes

Satellite Towns

- Satellite towns maintained a high occupancy rates of 82.5% as they tend to serve one mall per town. However, the average rental yield was low at 7.7% compared to other areas along major routes like Thika or Ngong & Lang'ata Road. This is attributed to the low rent charged on the spaces due to their location and quality

B) Performance By Regions

Key Urban Centers Retail Market Performance

Nairobi is still the best performing retail market with yields at 9.6%

Location	Rent 2017	Occupancy 2017	Rental yield 2017	Occupancy 2016	Yield 2016	Change in Occupancy Y/Y	Change in Yield Y/Y
Nairobi	185	80.3%	9.6%	89.3%	10.0%	(9.0%)	(0.4%)
Kisumu	150	75.0%	9.1%	75.0%	9.4%	(0.0%)	(0.3%)
Mt Kenya	136	80.0%	9.1%	90.0%	10.1%	(10.0%)	(1.0%)
Mombasa	130	82.8%	7.3%	76.7%	7.2%	6.1%	0.1%
Eldoret	96	83.3%	6.6%	83.3%	6.6%	0.0%	0.0%
Average	**141**	**80.2%**	**8.3%**	82.9%	**8.7%**	**(2.7%)**	**(0.4%)**

- Retail in Kenya offers attractive returns of about 8.3% as compared to other sectors like residential which offers returns of up 5% - 7%
- Despite a drop down in performance, Nairobi was the best performing region, with average yields of 9.6%. This is attributable to increasing vacancy rates which averaged at 80.2%, a 2.7% points decline from 2016's 82.9% as a result higher rents charged by malls in the City due to higher quality of retail spaces
- Kisumu had average yields of 9.1%, a decrease of 0.3% points from last year's 9.4% yield. This could be attributed to increased supply in the market following the completion of Lake Basin Mall in 2016
- Eldoret had the lowest yield of 6.6%, which is due to the low rental rates charged within that market of on average Kshs 96 per SQFT , 44.2% lower than the market average of Kshs 172 per SQFT

Source: Cytonn Research

C) Performance By Class

Malls Classification

Shopping Malls are classified mainly according to size and number of anchor tenants

- A shopping Mall is a group of retail and other commercial establishments that is planned, developed, owned and managed as a single property, typically with on-site parking provided
- A shopping center will have a minimum retail gross lettable Area (GLA) of 20,000 SQFT
- Shopping Malls are usually classified according to occupancy, brands, tenants, achievements and awards, facilities, building materials, sizes and trade area size
- In our classification we have majored on classification by sizes and number of anchor tenants, and classified into three categories
- We classified malls according to the following criteria

Type	Size (SQFT)	No. of Anchors
Regional Center/ Destination	400,001 - 800,000	2+
Community Center	125,001 - 400,000	0-2
Neighborhood Center	20,000 - 125,000	0-1

Source: Cytonn Research

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Malls Classification, Continued…

Destination malls are those with GLA of 400,000 SQFT – 800,000 SQFT such as Garden City

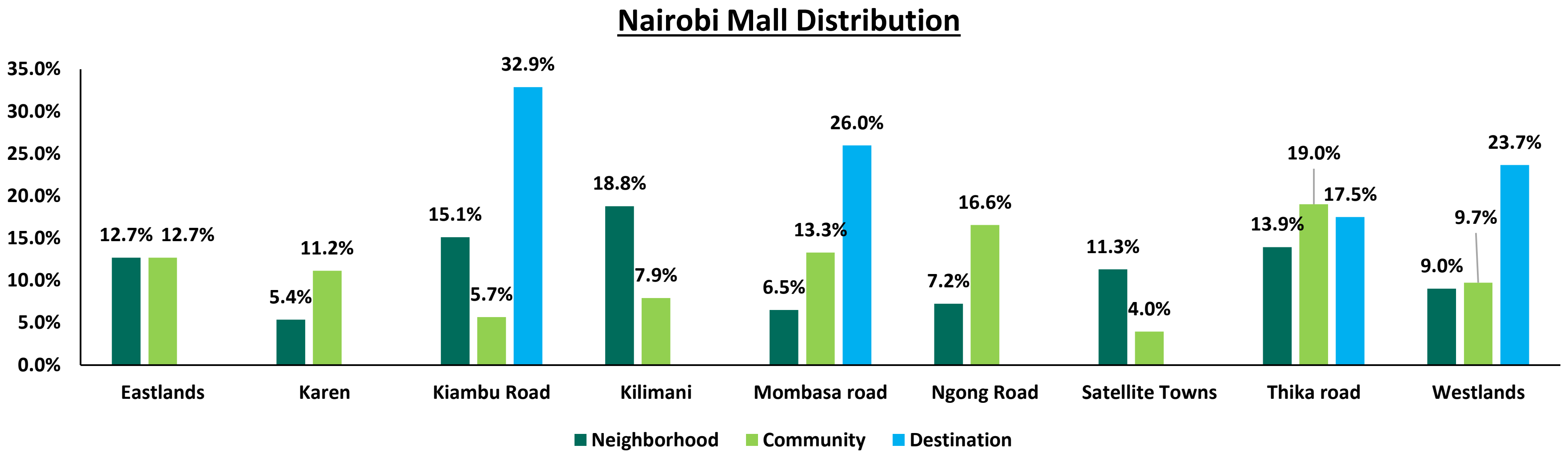
Mall Classification					
Neighborhood		Community			Destination
Hazina Trade Centre	Mountain View Mall	Greenspan	Capital Centre	Spur Mall	Two Rivers Mall
K-Mall	Red Heron	Shujaa Mall	Gateway Mall	Juja City Mall	Nextgen mall
Ridgeways Mall	Milele Mall	The Point	Highway Mall	Crystal Rivers	Garden City
Ciata	Maasai Mall	Comesa Mall	Tmall	Nakumatt Meru	Sarit Centre
Rosslyn Riviera	Nanyuki Mall	Village Market	Junction Mall	Mtwapa	
Lavington Mall	Cedar Mall	Valley Arcade	Greenhouse Mall	United Mall	
Crossroads Mall	Naivas Mall	Yaya Centre	TRM	Mega City	
Prestige Plaza	Mega Plaza	Galleria	The Mall	Lake Basin Mall	
				Zion Mall	
Mountain Mall	West End	The Hub	Westgate	City Mall	
Unicity	Tuff Foam				
	Khetia Hse				
Sky Mall	Ananas				
Eldo Centre					

- Destination malls in Kenya include Two Rivers, Sarit Centre and Garden City among others that attract international retailers and have large built up areas
- In Kenya only Nairobi has destination malls. This is attributable to the fact that Nairobi is the capital city, attracting both local and international consumers, hence high population as well as high consumer purchasing power

Source: Cytonn Research

Malls Classification, Continued…

Kiambu and Limuru Road have the highest proportion of destination mall space in the market at 32.9%



- From our sample size, neighborhood malls are the most common in Nairobi in 2017, accounting for 46.0%, followed by community malls at 43.0% ,while regional/destination malls account for 10.0% of retail space in Nairobi area compared to 2016 where community malls accounted for 51.0% of the market share
- However, basing on mall space, Kiambu Road has the highest market share of destination malls with 32.9%, Thika Road has the highest market share of community malls at 19.0% while Ngong & Lang'ata Road has the highest market share of neighborhood mall space at 16.6%

Source: Cytonn Research

Performance by Class – Nairobi Metropolitan Area

Destination malls have high average yields of 10.3% due to their popularity among international retailers, who pay prime rents for prime space

Class	Rent 2017	Occupancy 2017	Rental yield 2017	Occupancy 2017	Yield 2016	Change in Occupancy y/y	Change in yield y/y
Destination	234.4	77.3%	10.3%	94.0%	11.70%	(16.8%)	(1.4%)
Neighborhood	159.5	82.9%	9.0%	88.0%	9.20%	(5.1%)	(0.2%)
Community	170.8	76.9%	7.5%	85.0%	9.80%	(8.1%)	(2.3%)
Average	**171.2**	**79.8%**	**8.9%**	**88.9%**	**10.2%**	**(9.1%)**	**(1.3%)**

- Destination malls have an average yield of 10.3% attributable to the high rental charges of on average 234.4 Kshs per SQFT 36.0% higher than the market average of 172 Kshs per SQFT
- The high rents are as the retailers are charged a premium for class on rent due to amenities provided and higher footfall in the malls as a result of presence of international retailers mainly as the anchor tenants
- Community malls register a lower rental yields of 8.7% mainly because of competition from retailers such as supermarkets and other small scale retailers. They also have fewer amenities as compared to destination malls

Source: Cytonn Research

Performance by Node & Class – Nairobi Metropolitan Area

Regional malls have high average yields of 10.3% as they attract international retailers, hence increasing the mall footfall

	Neighborhood Malls		Community Malls		Destination Malls	
	Yield	**Occupancy**	**Yield**	**Occupancy**	**Yield**	**Occupancy**
Westlands	13.2%	92.5%	14.2%	85.0%	12.8%	100
Karen	13.1%	89.0%	10.3%	100.0%		
Kiambu & Limuru Road	10.5%	79.3%	7.9%	80.0%	13.4%	73.0%
Kilimani,Kileleshwa & Lavington	10.5%	82.7%	9.9%	100.0%		
Ngong & Lang'ata Road	12.8%	100%	7.4%	75.7%		
Thika Road	9.4%	95.0%	7.9%	60.0%	9.4%	86.0%
Mombasa Road	6.4%	65.0%	10.6%	80.0%	5.8%	50.0%
Satellite Towns	6.8%	82.5%	9.5%	100.0%		
Nairobi Eastlands	5.7%	54.5%	6.5%	69.0%		

- Kiambu and Limuru Road areas offers the highest yields for regional mall due to the presence high quality, newly completed international standards Malls with foreign retailers such as Carrefour
- On the other hand, Westlands offers the best returns for neighborhood and community malls at 13.2% and 14.2%, respectively with average occupancy rates of 92.5% and 85.0%, respectively as the area serves upper middle end population in neighborhoods along Waiyaki way such as Lavington, Parklands and Westlands and has relatively low competition from small scale retailers
- The area is also a major commercial zone with a commercial office market share of 23.7% further creating footfall for malls in the zones hence the high occupancy rates and returns

Source: Cytonn Research

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Performance by Node & Class – Key Urban Centers

Nairobi and Kisumu offers the best yields for neighborhood malls at 9.7% and 87.5% occupancy rates

	Neighborhood		Community		Destination	
Region	**Occupancy**	**Yield**	**Occupancy**	**Yield**	**Occupancy**	**Yield**
Nairobi	80.9%	9.7%	79.7%	9.3%	77.3%	10.3%
Kisumu	87.5%	9.7%	66.7%	8.7%		
Mt Kenya	80.0%	9.1%				
Mombasa	98.4%	9.7%	75.0%	6.1%		
Eldoret	90.0%	7.0%	70.0%	5.8%		

Source: Cytonn Research

- Regional malls are only located within Nairobi, offering the highest yields of 10.3%
- Neighborhood malls in Nairobi and Kisumu regions have the highest the highest yields of 9.7%, and average occupancy rates of 80.9% and 87.5%, respectively, as consumers gravitate towards convenience when shopping, hence more demand for neighborhood malls which are mostly in residential neighborhoods

D) Retail Market Opportunity

Retail Space Opportunity - Kenya

Yields, GDP Per Capita and contribution to current and upcoming supply were used for the rank

- The following criteria has been used for ranking retail space performance according to location and to find the most viable retail space opportunity:

Retail Space Opportunity Criterion for Kenyan Cities/Towns				
Yields	**4-6.5%**	**6.5%-9%**	**>9%**	
Points	1	2	3	
GDP per Capita in Kshs	**200-500**	**501-800**	**>801-1100**	**>1100**
Points	1	2	3	4
Current Supply /Total Supply	**< 10%**	**10%-30%**	**> 30%**	
Points	3	2	1	
Upcoming Mall Supply /Total Supply	**< 6.0%**	**6.1-10.0%**	**>10.0%**	
Points	3	2	1	

Source: Cytonn Research

Retail Space Opportunity - Kenya

Mombasa is the best investment opportunity for mall developments in the country

Region	Yield	Current Supply/Total Supply	GDP/Capita	Upcoming supply/Total Supply		
Weight	0.2	0.3	0.2	0.3	Weighted Score	Rank
Mombasa	2	3	3	3	2.8	1
Kiambu	2	3	4	2	2.7	2
Machakos	2	3	3	2	2.5	3
Mt Kenya	3	3	2	2	2.5	3
Kajiado	2	3	4	1	2.4	5
Uasin Gishu	2	3	2	2	2.3	6
Kisumu	3	3	2	1	2.2	7
Nairobi	3	1	3	1	1.8	8

- Mombasa and Kiambu regions offer the best investment opportunity to mall investors, due to their low supplies in mall space, both existing and upcoming
- Nairobi was the worst market to invest in country wide owing to its current large supply which accounts for 59.4% of the country's total supply while also accounting for 49.7% of the upcoming supply in Kenya, indicating that the capital has sufficient supply of retail space

Source: Cytonn Research

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V. Market Sentiments

A) Retailers Sentiments on the Market

Current State of the Retail Market

Players believe that there is increase in demand for convenience and thus retail must adjust towards embracing online platforms

- We conducted a survey among top management of major retail chains to get their sentiments on the market and the results are as follows:

Situation	Sentiment
Forecast on new trends/activities in retail market	• Increased use of technology hence supporting online retail • Increasing demand for convenience and thus retail must adjust towards embracing online platforms • Increase in purchasing power due to growth of middle class • Rise of estate retailers hence decrease in malls footfall • Increased retailers and partners in business both local and international brands • Increased use of social media to boost sales/online business • Great potential for innovation • The retail industry is on the rise though there is intense competition which can be attributed to international entrants

- Key industry players believe that the retail market is on a high growth path, however facing competition, attributable to international brands
- They believe that there is an increase in demand for convenience and thus retail must adjust towards embracing online platforms
- There is potential for growth of retail sector due to increase in purchasing power, basing it on growth of middle class

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Strategies Being Applied for Growth

Aggressive marketing is the key strategy being applied by retailers in the medium and short term

Situation	Sentiment
Strategies being employed for growth/ survival in the short term and long term	Aggressive marketing, specialization and promotions for loyal customers like use of loyalty cards
	Timely payment of distributors
	Good management, customer satisfaction and product diversification
	Good customer service
	Offering variety products to the clients
	Embracing social media marketing
	Fair pricing/ home and office delivery
	Closing high net worth deals in low seasons and single sales in the short term
	Exploring strategic partnerships and also considering possibility of franchising
	Pricing goods at reasonable prices & maintaining good relations
	Rebranding

- Retailers are mainly focusing on client retention through pricing, customer service, and product differentiation in the short term
- They are also focusing on organic growth, through partnerships and franchising in the medium term and online marketing is also a key target area for developers in the medium term

Preferred Product Lines

Food and lifestyle products are the most preferred items in retail stores

Situation	Sentiment
Preferred Product Lines	FCMG
	Electronics
	Food products
	Lifestyle products
	Construction materials

- The most preferred products in the Kenyan retail space are food and lifestyle products
- Increased demand for food products has seen retailers increase the range of food products from labelled pastries to currently fully operational cafes with sitting space in most of the retail stores
- The demand for lifestyle products such as clothes, accessories, watches, perfumes and foot wear is being driven by the increase in the disposable income among the middle class as well as changing lifestyle and peer pressures
- The above factors are not expected to change and hence we expect further an increase in demand for this products and hence an increase in the overall retail market in Kenya

Key Challenges

The key challenges facing retail sector are high inflation rates, interest rates and taxation

Situation	Sentiment
Main challenges Affecting Retailers	• Increased prices from the suppliers • Shortage of stock • High inflation rates, interest rates and taxation • Product misconceptions • Low sales • Competition from major retailers • Political environment • Lengthy importation procedures • Entry challenges into the new market and funding • Fluctuating demand by customers

- According to the retailers, the key challenges facing retail sector are high inflation rates, interest rates and taxation amidst the current political environment
- Other challenges are mainly increased prices by the suppliers and lengthy importation processes

Possible Solutions to the Retail Sector Challenges

The key possible solution to retail sector challenge is to embrace direct importation to cut on intermediary costs, and seek for low interest sources of funding

Situation	Sentiment
Possible solutions to the challenges	• Government stability to stop inflation • Aggressive branding/ unique recipes/ promotions through loyalty cards to customers • Government incentives to boost retail sector • Fair pricing by suppliers • Improve on client/customer service • Product differentiation • Low interest funding alternatives • Aggressive and targeted marketing • Supplier contacts to ensure delivery in time • Retailers to rely on local product rather than importing • Direct importation from manufacturers to reduce on intermediary costs hence translating to lower prices to consumers

- According to the retailers, the challenges facing retail sector can be countered through government providing incentives to boost the sector
- Other viable solutions are, embrace direct importation to cut on intermediary costs, and seek for low interest sources of funding

Last Takes

Retailers believe industry is headed for further growth though there is an increase in competition

Situation	Sentiment
Last Takes	Bright future for the retail sector amidst the stiff competition
	Barriers to entry should be reduced and access to cheaper funding encouraged
	Government should intervene to reduce on factors like double taxation and high importation fees
	Marketing is the key to success of the retail chains

- Generally the key industry players expect the sector to grow due to increase in purchasing power, driven by growth in middle class
- They are however of the view that government should greatly intervene to reduce on factors like double taxation and high importation fees

Retail Industry Players Sentiments

Based on market sentiment, the retail industry is headed for continued growth though the market is more competitive

Measure	Sentiment	Outlook
Current State	Increased demand due to growth in middle class income earners, translating to increase in purchasing power	Postive
Future Expectations	Expectations of growth at a high rate. More players to enter the market	Positive
Strategies	Strategies targeting organic growth through, strategic partnerships, franchising, product differentiation and aggressive marketing	Positive
Products	FMCG and Lifestyle products	Positive
Challenges	Mitigatable	Positive
Last Takes	• Retailers are bullish on market performance however are expecting to face increased competition	Neutral

- The sentiments of the retailers in Kenya point to a growing market in terms of revenue, customer base and products
- All the retailers interviewed expressed positive sentiment on the sectors potential growth
- We thus expected them to increase investment into the sector as per their long and short term plans

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VI. Retail Market Opportunity and Outlook

Retail Market Opportunity and Outlook

The opportunity in the residential sector lies in specific markets that have low supply such as Mombasa

Measure	Sentiment
Supply	• Increasing supply with Nairobi currently having a mall space supply of approximately 5.6 mn SQFT, a having grown from 1.89mn SQFT in 2010 at 7-yr CAGR of 16.9%. Expected to grow with a 3 year CAGR of 7.3% to 6.90mn square feet of retail space by 2020
Retail Market Performance	• Retail still offers attractive returns especially in Nairobi with average rental yields of 9.6% and occupancy of 80.3% higher then the commercial office yield of 9.2% and residential market yield of 5.6%
Retailers Sentiments	• Positive expectations about the retail sector growth due to a widening middle class and a growing economy
Opportunity and Outlook	• **We expect to witness reduced development activity of pure malls, Nairobi and Kisumu outperform other regions with average rental yields of 9.6% and 9.1%, respectively, with opportunity being in Mombasa which has low supply of retail space with a market share of just 10.0%**

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Thank You!

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