



General Real Estate Market Analysis

Q3'2017

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



The real estate sector has witnessed a reduction in transaction volumes in the market partly due to the political uncertainty brought about by the extended electioneering period and oversupply in the market segments, especially in the commercial office segment. Other factors include the continued credit constraint in the market and the financial challenges of the key retailer in the market, Nakumatt, which was the key anchor tenant in many prime malls.

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



The most notable events in Q3'2017, across all themes, include:

Residential

There was a decline in residential sector activity mainly attributed to the wait and see approach adopted by risk averse investors during the electioneering period and reduced credit supply by banks as a result of the enactment of the Banking Amendment Act 2015. During Q3'2017, the following activities were recorded;

1. Kenya National Bureau of Statistics (KNBS) released its annual Leading Economic Indicators Report, which showed a 16.3% decline in value of building approvals between January and May 2017 to Kshs 105.7 bn from Kshs 126.3 bn in the same period in 2016. The residential building approvals declined by 28.2% from Kshs 74.2 bn to Kshs 58.1 bn, while commercial building approvals recording a decline of 9.3% from Kshs 52.0 bn to Kshs 47.6 bn in the same period.
2. Hass Consult released their Q2'2017 House Price Index showing a 3.1% q/q drop in sale prices, and a 2.0% q/q drop in rental prices. Detached houses recorded the biggest q/q price drop at 4.0%, while apartments recorded a 1.4% q/q price drop during Q2'2017.
3. Kenya Bankers' Association also released their Housing Price Index for Q2'2017 highlighting a slower growth in property prices at 1.0% compared to a 1.1% increase in Q1'2017. Apartments registered the highest rise at 1.0% compared to prices of bungalows and Maisonettes at 0.3% and 0.4%, respectively, indicating higher demand for more affordable units given the lower cost of construction per unit on the developers' side and therefore relatively lower prices for sale.
4. Cytonn released the Nairobi Metropolitan Area Residential Report 2017 indicating that average prices increased by 3.8% in 2017 compared to a 7.4% increase in 2016 while rental yields remained fairly stable averaging at 5.6% in 2017 compared to the 2016 average of 5.2%. This indicates sustained demand for rental housing whereas demand for sale houses declined.

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



The performance of the residential sector in 2017 according to Cytonn Investments is as summarized below:

(all values in Kshs unless stated otherwise)

Year on Year Change in Price Appreciation and Rental Yield

Unit Typologies	Average Price Appreciation 2017	Average Rental Yield 2017	Total Returns 2017	Average Price Appreciation 2016	Average Rental Yield 2016	Total Returns 2016	Y/Y Change in Total Return
Detached	4.2%	5.2%	9.4%	6.5%	5.2%	11.7%	(2.3) %
Appartement	3.5%	6.0%	9.5%	8.3%	5.2%	13.5%	(4.0) %
Average	3.8%	5.6%	9.4%	7.4%	5.2%	12.6%	(3.2) %

Prices in 2017 appreciated albeit at a lower rate of 3.8%, which is 3.7% lower than the same in 2016 due to a slow-down in demand attributed to investor anxiety over the 2017 elections. Rental yields remained stable at 5.5% compared to 5.2% yield in 2016 indicating sustained demand for rental housing.

Source: Cytonn Research

On the mortgages front, the Central Bank of Kenya released their Annual Bank Supervision Report 2016, which indicated that there was a 1.5% drop in the uptake of home loans from 24,453 mortgages in 2015 to 24,085 in 2016. In addition, the value of non-performing mortgages increased from Kshs 11.7 bn in 2015 to Kshs 22.0 bn in 2016. The decline in uptake of mortgages was attributed to tighter credit rating standards adopted by banks following the interest rate cap, thus locking out potential borrowers. Mortgage growth has been slow in

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com
Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com
Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



Kenya and this has been attributed to low incomes and high property prices with the average mortgage loan size increasing to Kshs 9.1 mn in 2016 from Kshs 8.3 mn in 2015. Cytonn Investments, in September 2017, released a mortgage and rental affordability report indicating that given the median household income of Kshs 325,000, mortgages are unaffordable with an average index of 65 across Nairobi sub-markets, where an index of 100 and above shows affordability. On the other hand, rents are affordable in most sub-markets in Nairobi with an average index of 124.

The decline in performance in the residential sector is deemed to be only temporary, and is expected to recover in the near-term and increase in the medium-term, supported by high demand due to (i) the huge housing deficit, estimated at 2.0 mn units, (ii) rapid urbanization at 4.4% p.a. compared to a global average of 2.0%, (iii) government incentives such as the 50% tax cut for developers who supply 100 affordable units annually, and (iv) the CBK governor announcing the plans to push for the repeal of the Interest Rate Cap so as to reverse the negative effect it has had on private sector credit growth. Investors have still indicated a positive outlook through plans to develop housing including;

1. Cytonn Real Estate launched a mixed-use development dubbed Cytonn Towers, in Kilimani, that will include residential apartments in addition to the hotel, serviced apartments and office space,
2. Superior Homes announced plans to commence development of a gated community on 337-acres in Athi River that it is set to acquire from East Africa Portland Cement. The firm is currently selling Phase 5 of their 'Green Park' Master-planned development started in 2005,
3. Acorn Holdings Limited, a partnership between local real estate developer Acorn Group and Helios, a London based private equity fund, announced plans to begin construction of 3,800 hostel units in Nairobi at a total cost of Kshs 7.4 bn. The development is targeting the student population which has grown by a CAGR of 18.0% in the last 5 years to 564,500 in 2016 from 251,200 in 2012, according to Economic Survey 2017.

Going forward, we expect slow performance given the postponement of the 2017 elections and the political unrest in various parts of the country. However, should



we hold peaceful elections, we expect the market to recover and transactional volumes to increase in Q1'2018.

Commercial Office

In the third quarter of 2017, the commercial office sector softened further with occupancy levels, rental yields and prices declining by 1.9% points, 0.1% points and 1.4%, respectively, q/q. This is attributable to the slowdown in economic activities as a result of the general election as well as increased supply in some submarkets constraining performance as shown below:

Summary of Commercial Office Returns in Nairobi Over Time							
Year	FY 2016	Q1 2017	H1 2017	Q3 2017	Δ Q1 (2017)	Δ H1 (2017)	Δ Q3 (2017)
Occupancy (%)	88%	86%	86%	84%	(1.8%)	(0.4%)	(1.9%)
Asking Rents (Kshs/Sqft)	103	102	100	101	(0.6%)	(2.3%)	1.0%
Average Prices (Kshs/Sqft)	13,003	13,211	13,103	13,055	1.6%	(0.8%)	(0.4%)
Average Rental Yields (%)	9.40%	9.0%	9.2%	9.1%	(4.8%)	2.8%	(0.1%)
Commercial office market softened slightly in the third quarter of the year with occupancy rates, yields and asking prices declining by 1.9% points, 0.1% points and 0.4% , respectively attributable to the slowdown in economic activities as a result of the elections							

Source: Cytonn Research

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



In submarket analysis, in Q3'2017 as in the first half, Gigiri and Karen were the best performing nodes with average rental yields of 12.9% and 10.4%, respectively, mainly attributable to low supply in these markets, prime locations as well as high quality office space which attract clientele maintaining the occupancy level at above the 85% mark and enabling developers to charge prime rents. Nodes with increased office space such as Upper hill had lower returns with average rental yields of 8.5% and occupancy levels of 78.9% as shown below;

Summary of Commercial Office Performance by Nodes Q3 2017				
Location	Price Per Sqft "Kshs"	Rent Per Sqft "Kshs"	Occupancy %	Rental Yields %
Gigiri	14,000	135	70.0%	12.9%
Karen	14,583	120	87.4%	10.4%
Parklands	12,417	99	77.3%	9.7%
Kilimani	13,353	103	85.6%	9.4%
Westlands	13,125	108	91.7%	9.3%
UpperHill	13,737	106	78.9%	8.5%
Msa Road	11,643	78	78.3%	8.3%
Nairobi CBD	12,750	86	91.4%	8.3%
Thika Road	11,500	78	81.1%	8.1%
Grand Total	13,055	101	84.1%	9.1%

Karen and Gigiri are the best performing nodes due to superior locations enabling it to charge prime rents, they also have relatively lower supply of office space and of high quality thus boosting its occupancy levels which average at 87.4%. Thika Rd, Mombasa Road and the CBD had the lowest yields mainly due to poor locations and low quality office space hence attracting lower rental charges. Upperhill witnessed a decline in rental yields from 9.0% in FY 2016 to 8.5% in the third quarter of 2017 mainly attributed to increased supply thus reduced occupancy levels and returns



Despite the softening of the market, developers are still bullish on the office market evidenced by the following activities in the quarter aimed at increasing office space supply in Nairobi:

1. World Bank's plans to fund construction of a USD 30 mn office complex at an undisclosed location that will house various parastatals such as Kenya National Highways Authority (KenHA), Kenya Urban Roads Authority (KURA), Kenya Rural Roads Authority (KERRA), the Engineers Board of Kenya, the National Construction Authority and the National Transport and Safety Authority. The complex, developed by Chinese firm, AVIC, will include 350,000 square feet of office space, a 500-seater auditorium and a service building,
2. Kasarani Investments Holdings Ltd, a subsidiary of Garden City developer Actis, announcing plans to start construction of a business park comprising of 600,000 square feet of office space, a hospital, hotel and a residential village adjacent to the Garden City Mall along Thika Road, in November 2017.
3. Given that the market has an oversupply of 3.2mn square feet of office space from the Cytonn analysis and the political environment is still heated, we expect the slowdown in the performance of the office market to persist to the end of the year with developers reducing development activity except in specific pockets of value such as in Grade A offices, in sub markets like Karen and Gigiri, which still have a low supply and have attractive returns with yields of on average 12.9% and 10.4%, respectively, serviced and furnished offices, which are gaining trend with occupancies averaging 66.1%, and yields averaging 13.4% and in Mixed Use Development that are likely to have higher uptakes as a result of the live work play environment.

Retail sector

In Q3'2017, the retail sector softened as well with average occupancy levels declining by 1.7% points q/q from 83.1% in H1 2017 to 81.4% in Q'3 2017, the rents declined by 0.5% points q/q as well resulting in a 0.4%-point decline in rental yields from 10.2% in H'1 2017 to 9.8% in Q'3 2017.

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



Summary of Retail Market Performance in Nairobi Over Time					
Item	FY 2016	H1 2017	Q3 2017	Δ H1 2017	Δ Q3 2017
Asking Rents (Kshs/Sqft)	170	190	189	11.8%	(0.5%)
Occupancy (%)	89.3%	83.1%	81.4%	(6.2%)	(1.7%)
Average Rental Yields	10.0%	10.2%	9.8%	0.2%	(0.4%)

Retail sector softened in 2017 with average rental yields declining by 0.4% points as a result of a decline in occupancy levels and rents by 1.7% points and 0.5% points attributable to increased supply in some submarkets and a tough economic environment lowering retailers returns hence a reduction in expansion measures by retailers

Source: Cytonn Research

In submarket analysis, prime suburbs such as Westlands, Karen and Kiambu and Limuru Road continued with the good performance recording average occupancy levels of more than 90% and attractive yields of more than 11.0%. Increased supply in some nodes such as Thika Road and Eastlands constrained their performance with the malls recording relatively low average occupancy levels of 75.3% and 61.8% leading to low rental yields of 8.4% and 6.3%, respectively.

(all values in Kshs unless stated otherwise)

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



Summary of Retail Sector Performance in Nairobi

Location	Rent	Rent + other Income	Occupancy %	Yield %
Westlands	235	258	91.0%	13.7%
Karen	231	254	98.0%	13.0%
Kiambu and Limuru Road	216	238	81.6%	11.2%
Kilimani and Lavington	181	199	87.0%	10.3%
Ngong Rd	179	197	88.8%	9.8%
Mombasa Road	188	207	68.8%	8.8%
Thika Road	191	210	75.3%	8.4%
Satellite Towns	130	143	82.5%	7.7%
Eastlands	153	169	61.8%	6.3%
Average	189	208	81.4%	9.8%

Prime suburbs such as Westlands and Karen recorded attractive returns with average rental yields of 13.7% and 13.0%, respectively due to high quality offering of retail space and tenants and high demand from retailers due to the stronger financial muscle of the neighbourhoods
Malls in Eastlands and Thika Rd recorded lower returns with average rental yields of 8.4% and 6.3% as a result of increased supply and low demand from retailers due to the weaker financial muscle of the neighbourhoods. The Malls recorded average occupancy levels of less than 80%

Source: Cytonn Research

For more information contact:

Source: Cytonn Research
Akshay Shah on +254 738 410 702 | properties@chandaria.com
Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com
Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



The sector has been showing a mixed performance with some outlets showing resilience despite the tough economic times, while others like Nakumatt continue to shut branches.

The major highlights during the quarter were:

Naivas opened its recent store as the anchor tenant for Ciata Mall, along Kiambu Road, occupying 35,000 sqft of space

Nakumatt shut down its NextGen and TRM stores due to a cash crunch resulting from supplier debts while Naivas and Carrefour showed interest for the TRM space previously occupied by Nakumatt, which goes ahead to show that the retail sector is still strong given that some outlets are still on an expansion strategy while foreign retailers continue to set up shop in the sector. The formal retail industry penetration is approximately 30% showing immense opportunity for growth.

We expect a positive growth of the sector with the poorly performing outlets like Uchumi and Nakumatt who were previously considered as the country's retail giants being replaced by newer entrants and foreign stores. The sector will continue to grow supported by i) a rapidly growing population at 2.6% p.a and increase middle class with appetite for lifestyle shopping experience, ii) increased disposable income as a result of growing GDP at on average 5.1% p.a over the last five years and hence higher level of disposable income, iii) enhanced infrastructure, and (ii) foreign investment into the sector through foreign players.

Hospitality

In Q3'2017, the hospitality sector bucked the poor performance witnessed in the other real estate themes recording an upward trend as a result of increased demand for hotel facilities from both leisure and business travelers. This is affirmed by the Kenya National Bureau of Statistics (KNBS) data, which indicated that between

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



January and May 2017, the number of international visitor arrivals increased by 10.9% at Jomo Kenyatta International Airport to 320,588 from 288,905 in the same period in 2016 and by 8.5% at Mombasa's Moi International Airport to 38,397 from 35,388. It was also noted that among the 874,385 international visitors in Kenya in 2016, about 69,000 were Chinese nationals and the number was expected to raise in 2017.

This growth is attributable to;

Aggressive marketing, which has helped restore confidence among key international markets such as Europe, USA and the new emerging markets in Africa and Asia as well as the domestic market,

Increase of direct flights between Kenya and China which has increased the number of Chinese tourists flying into Kenya, and,

Wildebeest migration which occurs between July and October attracts tourists into the country.

The sector remains unfazed by the electioneering period, where players in the industry continue to cash in on leisure and business travel creating a high demand for accommodation. However, despite the upward trend in the hospitality sector in the country, the chairman of Western Kenya Hospitality Leaders Association, noted that hoteliers in the Western part of Kenya made losses during the August elections period due to political uncertainty. We however expect a return to normalcy after the conclusion of the re-election.

On developments, Kenyan hotel group, Sarova Hotels, Resorts and Game Lodges, in July, unveiled a Kshs 1.3 billion new hotel in Nakuru County. The Sarova Group of hotels took over the management of Woodlands Hotel and Spa in March after signing a management agreement with the hotel's management. The 147-room Sarova Woodlands Hotel, targets the hospitality performance in the area that recorded a high ADR of USD 218 and a TRevPAR of 81 despite a

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



relatively low average annual occupancy of 29.0% in 2016, which is set to be boosted by both local and international leisure and business travelers in Nakuru. Construction activities in the industry have also been on the rise with traditional hotels trying to reclaim their position amidst the stiff competition. Nairobi Serena Hotel has embarked on expansion and refurbishment of existing facilities, while Ole Sereni Hotel in Nairobi is constructing a new facility adjacent to its Mombasa Road branch. In addition, Crowne Plaza in Upper Hill has opened a mixed-use annex adjacent to the Hotel with Hilton expanding to Upper Hill in Pinnacle Towers building by 2020. The increased construction and expansion activities are driven by the need for hotel brands to remain unique and relevant in the market amidst competition from global brands such as Sheraton, Ramada, Marriott, and Movenpick which have entered the market in the last few years.

Land Sector

The land sector recorded a decline in levels of activity, as the investors and developers adopt a wait and see approach due to the uncertainty posed by the political pressure. The most notable activities are:

The Johannesburg Stock Exchange listed ADvTECH Ltd, an education, training and placement company based in South Africa, announced the purchase of a land parcel in Tatu City. The parcel will be used to set up a THRASS education system Crawford schools brand, in line with the company's expansion strategy to various countries in Africa.

The Lands Ministry announced the launch of the live digital lands registry services, at the Nairobi Registry. The services targeted for online registration include registration of lease, transfer of land, transfer of lease, charge or discharge and subdivision. The process is expected to improve accountability and efficiency in the ministry, and thus making the process less constraining for citizens and real estate developers especially due to the fact that ineffective land

For more information contact:

Akshay Shah on +254 738 410 702 | properties@chandaria.com

Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com

Raymond Kanno on +254 723 447 996 | properties2@chandaria.com



administration processes weigh heavily financially on both parties.

Prices remained relatively stable with capital appreciation in 2017 at average of 19.4%.

Listed Real Estate

In the listed real estate sub sector, in the quarter, Stanlib Fahari I-REIT released their H1'2017 earnings, registering a 220.8% growth in earnings per unit to Kshs 0.43 per unit from Kshs 0.13 per unit in H1'2016 attributed to a significant reduction in fund-management costs and increased rental income. The positive returns may in the long run spur investments in the sector though there remain concerns as approximately 60% of the revenues are going to professional fees, a clear indicator that the whole arrangement is primarily in the interest of the commercial interests around the REIT rather than the investor hence translating to low returns to the investor of 5.9% dividend yield from our analysis, compared to government securities such as T-bills yields which are currently at 8.1%, 10.3%, and 11.0% for the 91, 182, and 364-day papers, respectively, and market average yields for retail space in Nairobi at 9.8% while that of office space is 9.1% on average. In our view, there is need to align its interests with those of the investors, to improve the Fahari I-REIT performance.

The Fahari I-REIT's share price declined by 14.3% q/q and 9.6% year to date to close at Kshs 10.80 per unit this week, which is a 48.0% decline from Kshs 20.75 at the time of the listing in November 2015. The prices for the instrument have remained low averaging at Kshs. 11.5 in 2017 largely due to (i) opacity of the exact returns from the underlying assets, (ii) poor dividend yield of 5.9%, and (iii) the negative sentiment following the poor performance of Fusion D-REIT, which was undersubscribed in 2016.

Source: Bloomberg



To boost the listed real estate sector, the Capital Markets Authority (CMA), in July, backed the exemption of Real Estate Investment Trusts (REITs) from Value Added Tax (VAT), which accrues to both rent and professional services, in addition to exemption from stamp duty and capital gains tax. The regulator hopes that this incentive will spur interest in the product that opens up the property market for retail investors. Currently the Stanlib Fahari i-REIT is the only REIT in the market.

On the other hand, Britam Asset Managers has been licensed by the Capital Markets Authority (CMA) to operate as a (Real Estate Investment Trusts) REITs Manager. This move by Britam is to diversify their investment portfolio traded at Nairobi Securities Exchange (NSE) and offer investors an opportunity to invest in real estate as a viable investment option.

We remain cautiously optimistic on the performance of real estate driven by the (i) high annual returns of above 20%, with 2016 returns at 25.8%, (ii) positive demographics such as high population growth at 2.6% p.a. against a Sub Saharan average of 2.3%, (iv) rapid urbanization at 4.3% p.a., versus a global average of 2.0%, (v) an expanding middle class, and iv) improvement in infrastructure opening up new areas for development. The sector is however likely to record subdued activities given the re- election scheduled for 26th October 2017 and the political unrest in various parts of the country. However, should we hold peaceful elections, we expect the market to recover and transactional volumes to increase in 2018.

This condensed report is courtesy of Cytonn Investments Limited



For more information contact:

*Akshay Shah on +254 738 410 702 | properties@chandaria.com
Andrew Gwadiwa on +254 720 019 145 | properties3@chandaria.com
Raymond Kanno on +254 723 447 996 | properties2@chandaria.com*