Nairobi Commercial Office Report

" *Constrained Performance as a Result of Oversupply* "

12th March 2018

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Cytonn REAL ESTATE

I. Introduction to Cytonn Investments

Cytonn
REAL ESTATE

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

7 Seven offices across 2 continents

400 Over 400 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, 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.

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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
- 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)
- 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
- Patricia N. Wanjama, CPS

II. Overview of Real Estate in Kenya

Introduction to Real Estate in Kenya

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

Macro-economic Contribution

- For the first three quarters of 2017, real estate recorded an average growth rate of 9.3%, a 0.5% points increase from the 8.8% growth rate recorded in 2016 according to the KNBS Q3 2017 GDP Bulletin
- 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 outperformed other asset classes in the last 5 years, generating returns of on average 24.3% p.a., compared to an average of 13.2% p.a. in the traditional asset classes
- Residential units in Kenya in the last five years have generated an average rental yield of 5.0%, while commercial space have generated an average yield of more than 9.0% p.a

Recent Developments

- The real estate sector has seen entry of more institutional and international players in the market. For instance, in Q1 2018, UK based Mace acquired local quantity surveying firm YMR and Turner and Townsend acquired a majority stake in Mentor Management Limited (MML) Kenya, a Nairobi based project management firm
- Government initiatives such as including affordable housing as part of the Big Four Pillars of focus for the next four years are likely to boost real estate development especially the residential theme

Market Outlook

- We expect continued growth in real estate on the back of improved macroeconomic conditions, sustainable high returns, and a changing operational landscape as developers strive to satisfy the huge housing deficit
- Key challenges include: high land and infrastructure development costs and in 2018, if not reversed the Banking Amendment Act 2015, will continue constraining credit supply to the sector thus reducing both development and off take of real estate

Introduction to Real Estate in Kenya – RE Contribution to GDP

Real Estate and construction sectors contribution to GDP has been increasing from 10.5% in 2000 to 12.6% in 2010 to 14.6% in Q3 2017

	2000	2010	Q3 2017
Agriculture	31.3%	23.7%	18.8%
Manufacturing	17.0%	11.5%	10.4%
Wholesale & Retail Trade	16.5%	7.1%	8.5%
Hospitality & Tourism	16.5%	1.7%	1.1%
Real Estate & Construction	10.5%	12.6%	14.6%

Source: KNBS

III. Nairobi's Commercial Office Report

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Executive Summary

The Commercial office theme was oversupplied by approximately 4.7 mn SQFT, average rental yields were 9.2% and occupancy of 83.2%, 4.8% points lower than the 88.0% recorded in 2016. We have a negative outlook for investment in commercial office

- We carried out a research on the commercial office theme in Nairobi. The report aims to inform on the supply and performance of the commercial office subsector in Nairobi in 2017
- In 2017, Nairobi had a total supply of 31.8mn square feet (SQFT) of office space, 3.5mn SQFT of office space were delivered with an average occupancy level of 83.2%. This resulted in a supply of 6.3mn SQFT against a demand of 1.6mn SQFT and thus an oversupply of 4.7mn SQFT. The oversupply is 62.1% higher than in 2016 at 2.1mn SQFT and 46.9% higher than our projection of 3.2mn SQFT. Assuming current occupancy levels persist, we expect a 12.8% increase in oversupply to 5.3mn SQFT in 2018
- On performance, average occupancy rates declined by 7.8% points from 91.0% in 2011 to 83.2% in 2017 with rental yields declining by 0.1% points from 9.3% in 2016 to 9.2% in 2017
- In submarket analysis, Parklands and Karen had the highest returns with average rental yields of 9.7% and 9.5%, respectively with Mombasa Rd and Thika Rd having the lowest returns with average rental yields of 8.5% for each. Grade A offices had the highest average rental yields of 9.8%, with Grade C offices having the lowest average rental yields of 8.4%. Grade B offices are the most common in the market with a market share of 54% and are also the most popular with the highest average occupancy rates of 85.1% on average
- Given the decline in performance and the increase in supply, we have a negative outlook for investments in the commercial office market in Nairobi. We thus recommend for investment in the sector only for the long run and in specific pockets of value; These are
    i. Differentiated concepts such as serviced offices with yields of on average 13.4%, higher than conventional office space yields of 9.2% and
    ii. Green Buildings in prime locations such as Kilimani which charge higher than average rents and are expected to have higher occupancies in future
- We expect market performance to soften further with rental yields coming in at an average 9.0% constrained by the oversupply, slowdown in growth of financial services and SME sectors and the low credit supply inhibiting both development and offtake finance

Nairobi's Commercial Office Report – *"Constrained Performance as a Result of Oversupply"*

Oversupply continues to constrain the commercial office theme with rental yields and occupancy declining, buyers will thus have bargaining power as developers struggle to fill up office spaces

Value Area	Summary	Effect on The Office Market
Oversupply	• In 2017, the market had a supply of 6.3mn SQFT against a demand of 1.6mn SQFT resulting in an oversupply of 4.7mn SQFT. We expect the oversupply will increase by 12.8% to 5.3mn SQFT in 2018	• The office market has softened with occupancy rates and rental yields declining by 4.8% points and 0.1% points, respectively. The low returns will lead to reduced development activity as in 2017, completions reduced by 46.2% against growth by a 3 year CAGR of 32.6% between 2013 and 2016
Returns	• Rental yields and occupancy rates declined 0.1% points and 4.6% points, respectively to 9.2% and 83.2%, from 9.3% and 88.0%, respectively due to the increase in supply • The best performing nodes in the office sector are Parklands and Karen with rental yields of 9.7% and 9.5%, respectively, with Mombasa Road and Thika Road having the lowest yields at 8.5% for each	• The yields are still attractive and hence the continued development of office space with an expected 4.3mn SQFT of office space expected to be delivered in the market in 2018 through buildings such as One Africa place in Westlands and Kings Prism in Kilimani • The oversupply will, however constrain performance further with yields expected to soften further to average at 9.0%
Opportunity & Outlook	• We have a neutral outlook on the commercial office sector with a bias to negative and thus recommend investment to be made in the sector only for the long term and in specific pockets of value where we recommend differentiated concepts such as serviced offices with average rental yields of 13.4% and in MUD's and Green Buildings	• Reduced development activity in the short term that is 1-2 years especially in markets with high supply such as Upperhill and low returns such as the CBD • A buyers market as developers struggle to fill up spaces therefore giving tenants bargaining power

The opportunity lies in differentiated concepts such as serviced offices, MUDs and Green Buildings

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a). Introduction

Key Factors **Driving** Office Market in Kenya

Nairobi as a Regional Hub, Devolution, and Growth of SMEs are some of the factors that will drive the Office Market in 2018

Factor	Characteristics
Nairobi as a Regional Hub	• Nairobi was ranked the most dynamic city in Africa and 10th in the world, by JLL City Momentum Index 2017 due to innovation and technology adoption and it has attracted international investors creating demand for office space • They Include Johnson & Johnson, Wrigley's and Volkswagen who are keen to tap into the growing economy. They thus increase the demand for office space in the city
Growth of Small and Medium Sized Enterprises (SMEs)	• SMEs 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	• Demand for office spaces has persistently increased over time due to Devolution. The emergence of devolved governments has thus led to increased need for office spaces in counties to cater for County Governments and businesses that are expanding to county headquarters therefore leading to increased development of commercial office spaces • For instance, Fusion is developing a Kshs 3.7bn MUD in Meru County and Cytonn Investments expanded to Nyeri and announced plans of potential real estate developments worth Kshs 6 bn
International Players	• There has been an increase in the number of international institutions in Kenya with the foreign direct investments (FDI) growing by USD 393.4 mn as at Dec 2016 • Increased investments will lead to an increase in demand for offices, especially Grade A offices in key commercial hubs such as Upperhill, Westlands and Kilimani

Factors Affecting **Supply** of Office Space

Low Land Supply in Key Commercial Regions, enhanced completion and accessibility to finance will affect the supply of office space

Factor	Characteristics
Competition	• Many developers have focused on construction of offices hence increasing stock to 31.8 mn SQFT in 2017. The increase in supply has thus led to decrease in occupancy rates such that in 2017, the occupancy rates averaged at 83.2%, 7.8% points lower than in 2011 where the average occupancy rate was 91.0%. This thus lowers the developers yielding return • The competition in the market is therefore stiff giving buyers have a bargaining power and leading to lower returns for developers
Accessibility to Finance	• Lack of proper funding for developments has resulted in use of large portions of debt in the funding structure. Debt is however, in limited supply and hence resulted in stalling of projects and extended project time frames. The above affect the supply of office spaces most of which are capital intensive and hence require high capital outlays • The Banking Amendment Act, 2015 and more prudent lending by banks has also resulted in a decline in credit supply in the market and more stringent borrowing terms which will hinder development of office space
Infrastructure	• Improved infrastructural developments of roads, power distribution especially in the Counties, revision of zoning and ICT infrastructure and penetration allowing for home office concept. This impacts supply both negatively and positively
Availability of Land	• Availability of land for development has been low within traditional commercial office zones such as the CBD and Westlands resulting in relatively high land prices • This has resulted in relaxation of zoning regulations and hence increased commercial developments in previously residential areas such as Karen, Gigiri and Kilimani

Factors Affecting **Demand** for Office Space

Location, rental charges and convenience significantly affect the demand for office space in Kenya

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

Commercial Office Market Performance Summary

The commercial office space theme softened in 2017 as a result of oversupply, occupancy rates and rental yields declined by 4.8%% and 0.1% points, respectively to average at 83.2% and 9.2%, respectively

Year	2011	2013	2015	2016	2017	y/y Δ 2016	y/y Δ 2017
Occupancy (%)	91.0%	90.0%	89.0%	88.0%	**83.2%**	(1.0%)	**(4.8%) Points**
Asking Rents (Kshs/Sqft)	78	95	97	97	**99**	0.0%	**1.8%**
Average Prices (Kshs/Sqft)	10,557	12,433	12,776	12,031	**12,595**	-5.8%	**4.7%**
Average Rental Yields (%)	**9.8%**	**10.0%**	9.3%	9.3%	**9.2%**	**0.0%**	**(0.1%) points**

Source: Cytonn Research

- The performance of the commercial office space in Nairobi softened further in 2017 from the declines witnessed in 2016. This is attributable to

  i. an increase in supply, with the market having an oversupply of 4.7mn SQFT in 2017, and an expected oversupply of 5.3 mn SQFT in 2018,
  ii. Reduced demand for office space in the market due to a tough operating environment characterized by political uncertainty and low credit supply as a result of the implementation of the Banking Amendment Act, 2015 thus a slow down in business that typically drive the commercial office market in Kenya such as financial institutions, SME's, NGO's and the Government

- The rental yields in 2017 thus averaged at 9.2%, a 0.1% decline from the 2016 average of 9.3%. Rents and prices, remained stable, mainly attributable to the increase in Grade A office stock in the city charging prime rents, and the price inelasticity of rents, as most leases are long term and have annual or biannual escalations

- Occupancy rates, however, declined significantly to average at 83.2% in 2017, a 4.8% decline from the 88.0% recorded in 2016. The decline in occupancy rates is the highest recorded over the last five years and we thus expect market performance to soften further with commercial office yields coming in at 9.0% in 2018

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b) Trends in the Commercial Office Theme in Nairobi

Trends in the Commercial Office Theme

Serviced offices, green buildings and high rise buildings are some of the key trends that characterized the the commercial office theme in Nairobi in 2017

Serviced Offices

- Serviced offices as well as smart offices are emerging concepts in the office theme. For service providers, it is attractive due to the high returns it offers with rental yields averaging at 13.4% against 9.2% for conventional office spaces and low supply accounting for 0.35% of the total office floor space in Nairobi
- For users due to the convenience and flexibility it offers as a business is able to operate on the go and gets just the amount of space it requires

High Rise Developments

- A number of high rise buildings as well as sky scrapers are redefining the skyline of Nairobi. Some of these landmark buildings include the 33 floor UAP Old Mutual Towers, the Britam Towers and the LeMac that boast of 32 and 24 floors, respectively
- Developments in the pipeline include 70 floor Pinnacle Towers expected to be the tallest building in Africa upon completion, 40 floor Montave, 43 Floor AVIC Towers in Westlands and 35 floor Cytonn Towers launched in 2017

Green Buildings

- Considered as developments that guarantee increased user productivity, enhanced efficiency and operational efficiency through lower maintenance costs, green buildings are an emerging trend in the commercial office sector
- Notable green buildings in Kenya include the Vienna Court, a development that attracts yields of upto 10.8% at Kshs 124 per SQFT per month, higher than the average rents for grade A buildings which attracts yields of 9.8% and charges Kshs 112 per SQFT per month

Trends in the Commercial Office Theme, Continued…

Semi fitted offices, home offices and new office districts will redefine the office market in 2018

Semi Fitted Offices

- Semi-fitted office spaces that have some already inbuilt fittings such as ceilings, cabling partitioning, kitchen fittings and tiling
- The spaces generate buy in from tenants since they eliminate some of the costs that could be incurred at the onset office set up

New Office Districts

- This includes areas such as Gigiri, Karen and Parklands. Firms that have been attracted to these areas due to high quality office space and availability of spaces allowing for ease of movement and parking
- The firms have become increasingly interested in the new office spaces as they seek high quality and convenient spaces away from the congested CBD

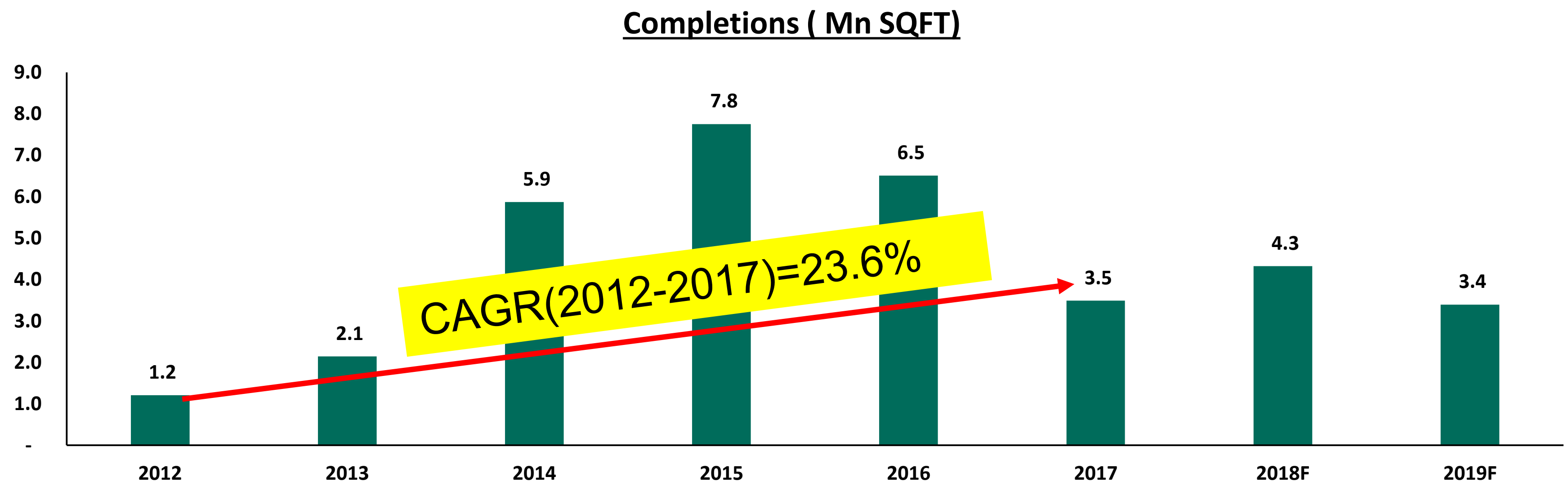
Home - Offices

- In a bid to reduce the operational costs involved in set up. Firm are increasingly adopting the home office concept where residential homes are being preferred as alternative office spaces
- The concept of home offices is supplemented by the use of an actual individual home as an office. The concept is common in nodes with relatively low office space supply of office such as Gigiri, Karen, Kileleshwa and Westlands and mainly serve SMEs and start up entities

c) Commercial Office Supply in Nairobi

Commercial Office Space Supply-Nairobi

Oversupply expected to result in reduced office development with office building completions expected to decline with a 2 year CAGR of 1.3% between 2017 and 2019, previously office completions had grown with a 5 year CAGR of 23.6%



- The supply of office space was on an upward trajectory between 2012 and 2016 with completions increasing with a 52.5% CAGR over this time and a 5 year CAGR of 23.6% between 2012 and 2017. This was driven by demand from multinationals setting up operations in the country such as Google and General Electric as well as a growing economy supporting the growth of SMEs
- The increased supply resulted in an oversupply which was 4.7mn SQFT in 2017 and thus a market correction, with completions declining by 46.3% between 2016 and 2017 from 6.5mn SQFT to average at 3.5mn SQFT
- Over the next two years, office space completion is expected to decline with a 2 year CAGR of 1.3%

Source: Nairobi Building Approvals Data from Nairobi City County, Cytonn Research

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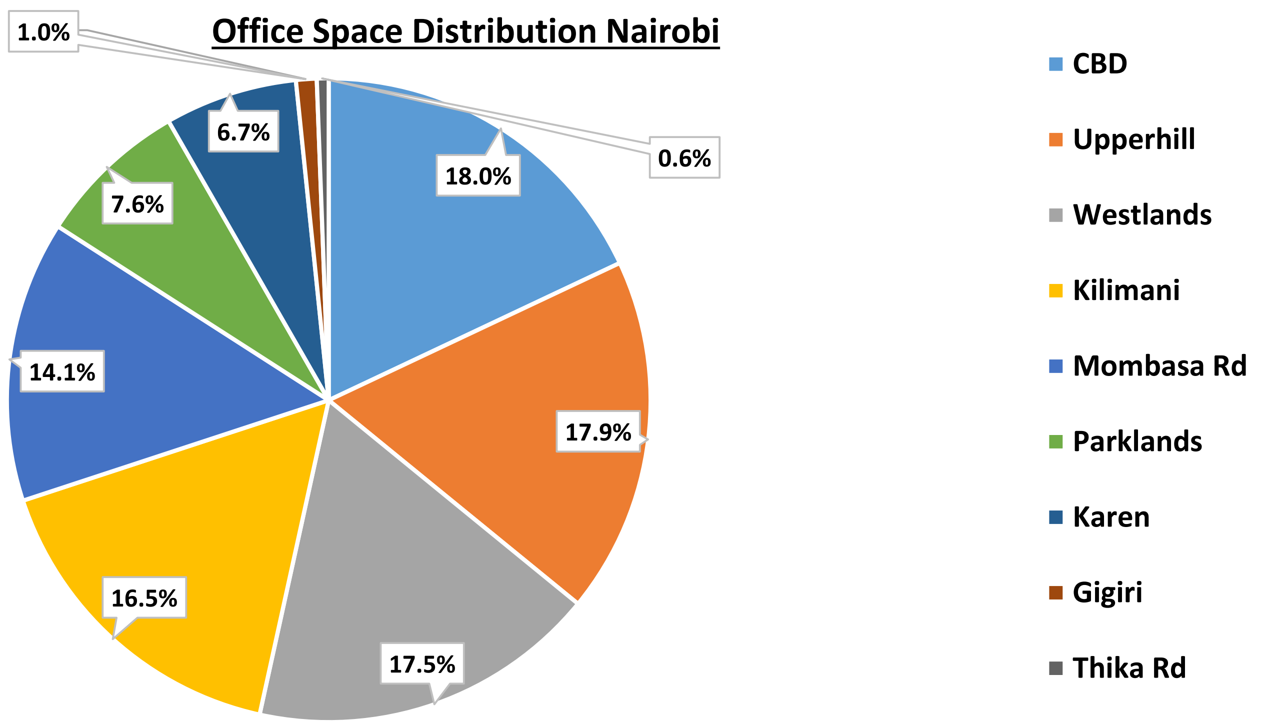
Commercial Office Space Supply – Nairobi Continued…

CBD, Upperhill and Westlands have the largest supply, with market shares of 18.0%, 17.9% and 17.5%, respectively with a cumulative market share of 53.4%



- In 2017, as in 2016, Upperhill, CBD and Westlands had the largest supply of office space in Nairobi with a market share of the total office supply of 18.0%, 17.9% and 17.5%, respectively and a cumulative market share of the total office supply of 53.4%, while Gigiri and Thika Road have the lowest supply with market share of the total office space of 1.0% and 0.6%, respectively
- Upperhill, Westlands and Kilimani have grown as business nodes as firms move away from the CBD in search of better quality space and hence the high supply

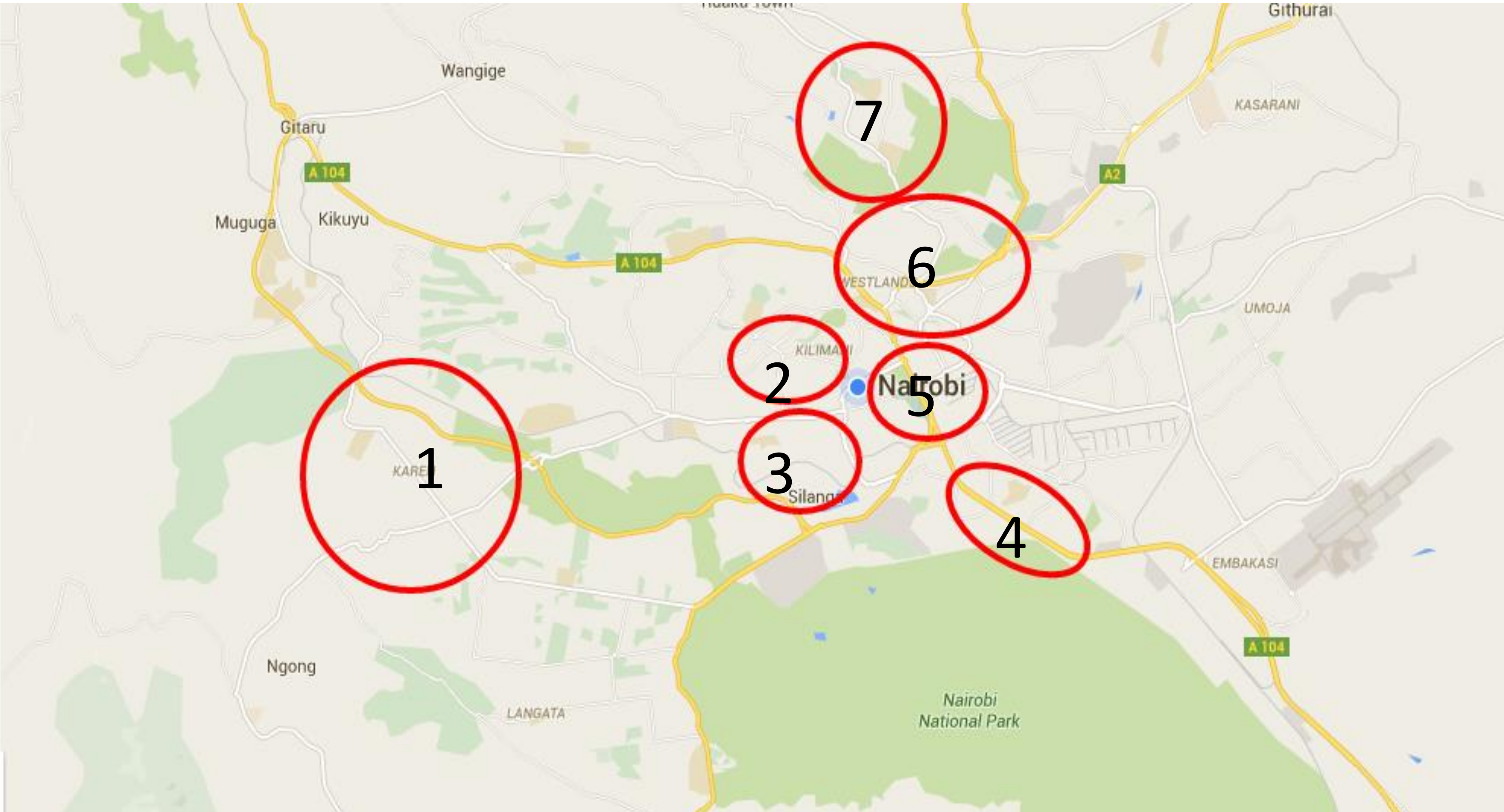
Source: Cytonn Research

d) Commercial Office Market Performance

i. Performance by Nodes

Nairobi Office Market

The key nodes of focus are in Karen, Kilimani, Westlands, Msa Rd, Nairobi CBD, Parklands and Gigiri



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

Nairobi Office Market Performance

Parklands and Karen are the best performing nodes with average rental yields of 9.7% and 9.5%, respectively

Area	Price Kshs/ SQFT	Rent 2017 (Kshs/SQFT)	Occupancy 2017(%)	Yield 2017(%)	Price 2016 (Kshs/SQFT)	Rent 2016 (Kshs/SQFT)	Occupancy 2016(%)	Yield 2016 (%)	% Change in Rents Y/Y
Parklands	12,729	103	85.7%	**9.7%**	11,771	102	80.0%	10.0%	**1.3%**
Karen	13,167	113	89.2%	**9.5%**	13,500	107	90.0%	9.7%	**5.8%**
Kilimani	12,901	101	84.5%	**9.5%**	12,667	99	90.5%	9.3%	**2.2%**
Westlands	12,872	103	88.5%	**9.4%**	12,482	102	92.1%	9.2%	**1.1%**
UpperHill	12,995	99	82.0%	**9.0%**	12,529	102	89.8%	9.0%	**(3.0%)**
Nairobi CBD	12,286	88	84.1%	**8.7%**	11,750	92	92.7%	9.0%	**(4.2%)**
Thika Road	11,500	82	73.6%	**8.5%**	11,700	91	80.3%	8.8%	**(10.3%)**
Mombasa Road	11,641	82	74.2%	**8.5%**	10,720	80	86.1%	8.5%	**2.1%**
Average	**12,679**	**99**	**83.9%**	9.2%	**12,053**	**100**	**88.9%**	9.2%	(0.6%)

- Location and quality of office space continue to be the main factors determining office performance in Nairobi with Parklands and Karen recording the highest yields due to the above factors. The two areas had average rental yields of 9.7% and 9.5%, respectively
- Areas affected by traffic snarl ups, low quality office space and are not necessarily primary business nodes such as Mombasa Rd, Thika Rd and Nairobi CBD had the lowest returns with average rental yields of 8.5% for Mombasa and Thika Road, and 8.7% for Nairobi CBD

Source: Cytonn Research

Nairobi Office Market Performance, Continued…

Offices in prime locations, with low supply and high quality offices had the highest returns with on average rental yields of more than 9.5%, these include, Karen, Parklands and Kilimani

Parklands

- Parklands recorded an average rental yield of 9.7% in 2017, a 0.3% points decline from the 10.0% recorded in 2016. The decline was mainly as a result of increased supply with an extra 568,000 SQFT coming to the market through offices such as Westpark Suites, and completion from better quality office spaces in Westlands. The area, is still attractive for investments mainly driven by the proximity to CBD and Westlands, ample infrastructure and favourable zoning regulations facilitating densification. In the short to medium term we expect to continue witnessing an increase in development activities in the area

Karen

- In 2017, Karen had average rental yields of 9.5% a slight decline form the 9.7% recorded in 2016. The returns are still attractive and given the i) availability of development at relatively low prices of on average Kshs 50mn an acre facilitating development of Grade A offices with ample spaces attractive to multinational companies ii) relaxation of zoning regulations we may witness an increase in development activities in Karen. Unilever for instance, established their regional headquarters in Watermark Business Park in Karen

Kilimani

- Kilimani is increasingly replacing Upperhill and Westlands as the business address of choice boosted by its proximity to CBD and an upper middle income neighbourhood, improved infrastructure, lower land prices, relaxed zoning regulations and sufficient accommodation. In 2017, the area recorded a rental yield of 9.5%, 0.2% points higher than in 2016. Going forward, we expect returns in the market to soften as result of the increase in supply with a notable building in the pipeline being Cytonn Towers

Nairobi Office Market Performance, Continued…

Westlands and Upperhill still attractive though returns are affected by high supply in the nodes

Westlands

- In 2017, Westlands recorded average rental yields of 9.4%, a 0.2% points increase from the 9.2% recoded in 2016. The node's, attractive performance is mainly as a result of high demand by business due to ease of access, high quality office space and as it is a prime business district housing the headquarters of several multinationals including google and C- Squared. Investments in the node, should however, be made sparingly as the node has a high supply with the third largest market share at 17.5%, only behind CBD and Upperhill and thus developing in the market has significant market risk

Upperhill

- For the third year in a row, Upperhill's performance remained flat, with rental yields averaging at 9.0%. The market is undergoing a price correction that saw the rents reduce by 3.0% y/y. The reduction is attributable to the fact that the area is losing its appeal due to traffic congestion and an oversupply of office space even as developers expand to seemingly more attractive nodes such as Karen and Kilimani. We expect the downward pressure on rents and yields to persist in Upperhill given that the area has an oversupply of approximately 700,000 SQFT

Nairobi Office Market Performance, Continued…

Upperhill, the CBD, Mombasa Rd and Thika Rd areas generated yields of below 9.0%

Nairobi CBD

- Previously the main business district, it is being relegated to playing a retail function with offices moving out of the zone in search of better environments and better quality office spaces. This has resulted in a 8.6% points decline in occupancy rates from 92.7% to 84.1%. The rental yield averaged at 8.7% in 2017 a 0.3% decline from the 9.0% recorded in 2016

Thika Road

- A fairly new office zone, the node suffers from low quality office space and perception of being a middle income residential area and hence low rents which averaged at Kshs 82 Per SQFT per month with an average rental yield of 8.5%. High quality office space such as the incoming easily accessible Garden City Business Park will boost the profile of the area and consequently lead to better results

Mombasa Road

- As has been the case in the past, Mombasa Road recorded the lowest rental rates in the market averaging at Kshs 82 per SQFT resulting in average yields of 8.5%. The area attracts low rents due to traffic congestions and zoning for industrial use though newly built high quality office space such as in Next Gen mall can attract higher yields and occupancy rates

Nairobi Office Market 2017 Summary

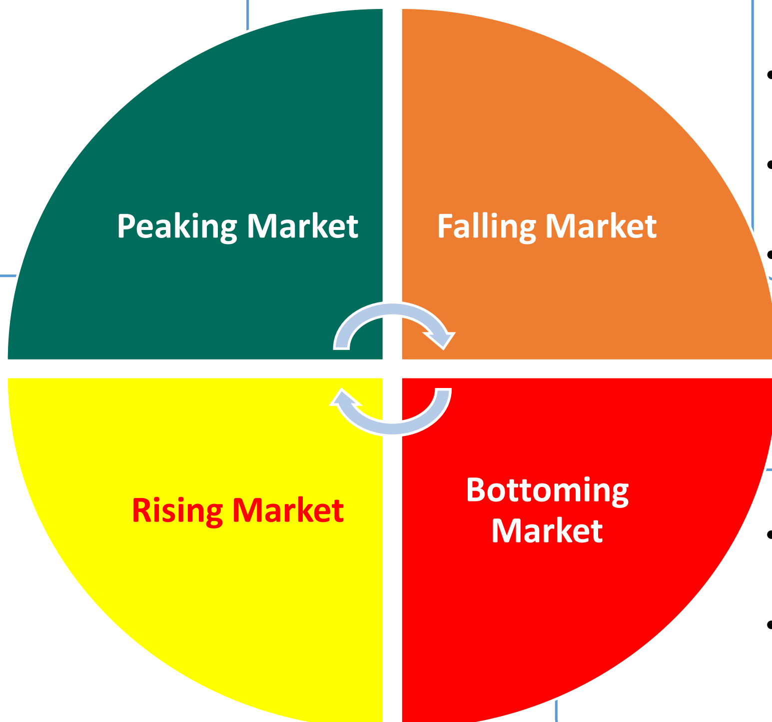
As in 2016, the market is a buyers market with Karen and Gigiri being in the peaking phase, Upperhill, Westlands, Parklands and Kilimani in the falling phase and the CBD and Mombasa Rd bottoming out

Developers Market

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

Tenants Market

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



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

Rising Market:
- Strong demand
- High pricing
- Limited Supply

Peak Market
- Strong demand spurs new supply
- Strong pricing above replacement costs
- Supply underway

Bottoming Market
- Stagnant demand
- High Vacancies
- Very low pricing

Falling Market
- Low demand
- Vacancies and supply
- Low Pricing

The market is fully a buyers market with six out of the eight nodes being buyers/ tenants market and only two being developers market

Source: Cytonn Research using JLL Clock

ii. Performance by Grades

Classification of Offices in Nairobi

Kenya has various types of offices according to the Global classification

GRADE A

- Ideally Grade A buildings should occupy more than 200,000 square feet. Very few buildings in Nairobi meet this threshold. Therefore for our research, we have used office buildings with a total area ranging from 100,000-300,000 square feet that are pace setters in establishing rents and that generally have ample natural good lighting, good views, prestigious finishing and on-site undercover parking
- Grade A buildings provide state of the art technical services such as high quality elevators, fittings and automation systems. They provide ample parking at a minimum ratio of 3:1000

GRADE B

- For our research, we have used buildings with a total area ranging from 50,000 to 100,000 square feet. They have good (but lower than grade A) technical services and ample parking space

GRADE C

- These are buildings of any size, usually older and in need of renovation, they lack lobbies and may not have on site parking space. They charge below average rental rates

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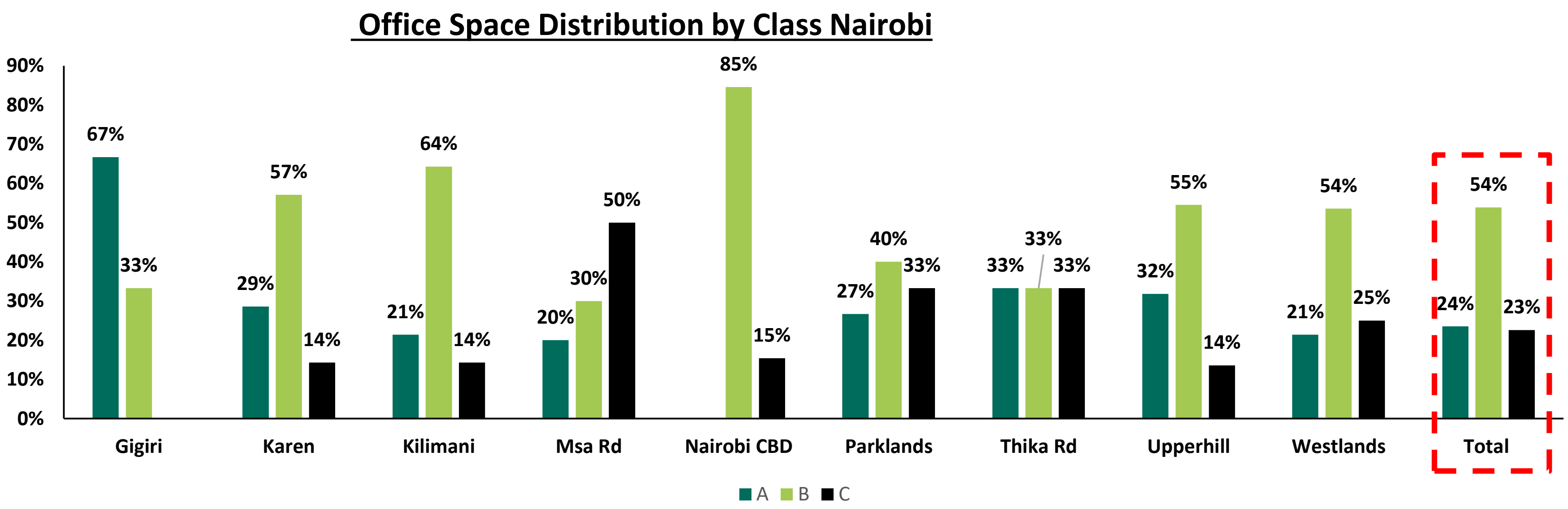
Distribution of Various Classes of Offices

Grade B offices are the most common, accounting for 54% of commercial offices in Nairobi



- **The market has witnessed an increase in Grade A office supply** with offices such as UAP Old Mutual Towers, KCB Towers and Britam Towers coming into the market and therefore increasing the market share of Grade A offices from approximately 10% to approximately 24% of our sample size

- **From our sample, Grade B office spaces still account for a majority office spaces** in Nairobi with a market of 54%

- **For the individual nodes, Gigiri has the highest percentage of its offices being Grade A at 67%,** Nairobi CBD has the highest percentage of its offices being Grade B at 85% and no Grade A office space, while Mombasa Road has the highest percentage of its offices being Grade C at 50%

Source: Cytonn Research

Performance of the Various Offices by Class

Grade A Offices have the highest returns with average rental yields of 9.8%

Typology	Price Kshs/ SQFT	Rent 2017 (Kshs/SQFT)	Occupancy 2017(%)	Yield 2017(%)	Price 2016 (Kshs/SQFT)	Rents 2016 (Kshs/SQFT)	Occupancy 2016 (%)	Rental Yields 2016(%)	y/y Change in yields (% points)
Grade A	13,053	112	81.5%	9.8%	12,889	112	85.7%	10.0%	(0.2%)
Grade B	12,804	99	85.1%	9.3%	11,959	98	90.6%	9.2%	0.1%
Grade C	11,929	84	83.1%	8.4%	11,245	82	87.5%	8.6%	(0.2%)
Average	**12,595**	**99**	**83.2%**	**9.2%**	**12,031**	**97**	**88.0%**	**9.3%**	**(0.1%)**

Source: Cytonn Research

- The increase in supply as well as the slowdown in economic activities as a result of the extended electioneering period constrained performance across all the class with occupancy declining by 4.2% for Grade A to average at 81.5%, 5.5% points for Grade B to average at 85.1% and 4.4% points for Grade C to average at 83.1%
- The yields for Grades A and C declined by 0.2% points each to average at 9.8% and 8.6%, respectively. Grade B office yields bucked the trend increasing by 0.1% points from 9.3% to 9.2%
- Despite the decrease in returns, grade A offices still offer the highest returns in he market and thus a good opportunity for investment in the right market

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iii. Performance by Nodes & Grades

Performance by Nodes and Grades

Kilimani has the highest yields for Grade A and C offices with rental yields of 9.9% and 9.1%, respectively while Parklands the highest yields for Grade B offices with rental yields of 9.9% on average

Commercial Office Performance in 2017 by Nodes and Grades						
Typology	Grade A		Grade B		Grade C	
Area	Yield	Occupancy	Yield	Occupancy	Yield	Occupancy
Karen	9.4%	92.9%	9.7%	86.7%		
Kilimani	**9.9%**	**69.6%**	9.4%	86.4%	**9.1%**	**98.3%**
Msa Road	10.1%	84.9%	9.7%	79.8%	7.3%	67.6%
Parklands	9.7%	59.8%	**9.9%**	**87.8%**	8.9%	90.0%
UpperHill	9.4%	74.9%	9.1%	83.5%	8.2%	92.5%
Westlands	9.7%	90.7%	9.4%	89.5%	9.1%	85.0%
Thika Road			9.1%	65.3%	8.0%	81.8%
Nairobi CBD			8.7%	83.7%	8.3%	86.1%

Source: Cytonn Research

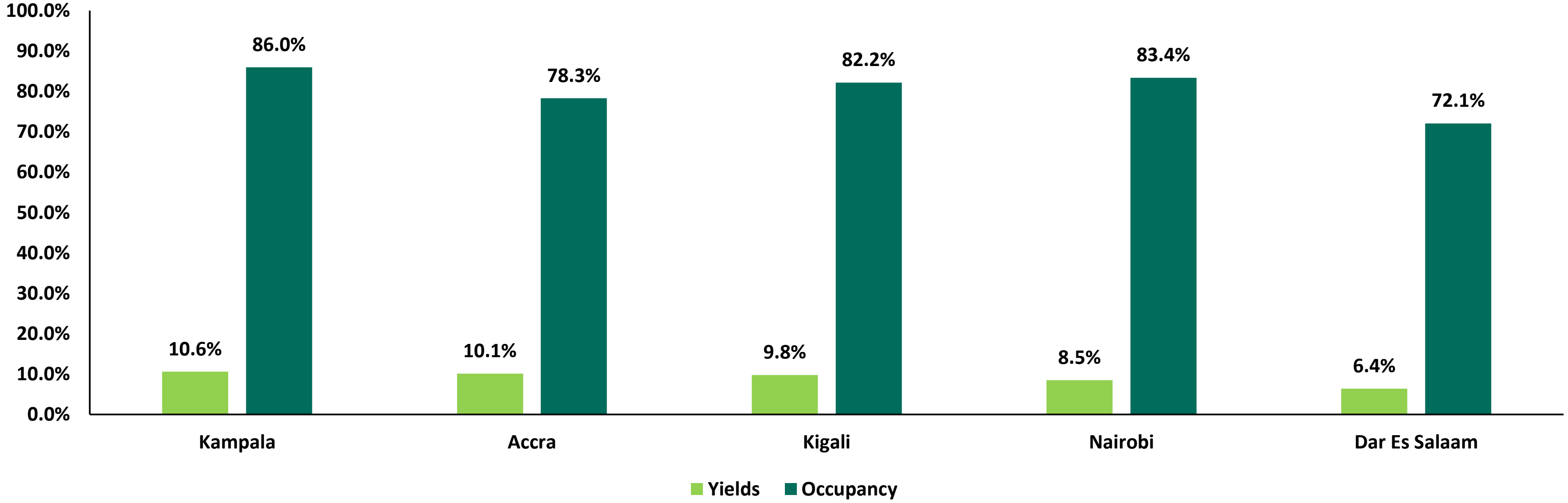
- For Grade A offices, in 2017, Kilimani offered the highest returns with average rental yields of 9.9%, in 2016 Karen offered the highest returns but this declined by 1.0% to average at 9.4%
- For Grade B, despite a 0.3%-point decline in yields from 10.2% in 2016 to 9.9% in 2017, Parklands offers the best returns and hence an investment opportunity in the market
- For Grade C, similar to 2016, Kilimani offers the best investment opportunity with average rental yields of 9.0% a 0.1% point increase from the 9.0% recorded in 2016

iv. Regional Comparison

Regional Comparison: Nairobi vs Selected Cities in SSA

Nairobi outperforms Dar Es Salaam in the commercial office sector but Accra, Kigali and Kampala have higher yields

Comparison of Commercial Office Performance between Nairobi and Selected Cities in SSA



- In the commercial office sector, Nairobi out performs Dar Es Salaam with average rental yields of 8.5% against an average of 6.4%, but Accra, Kigali and Kampala have higher yields of on average 10.6%, 9.8% and 10.7%, respectively

Source: Cytonn Research

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iv. Parking Data

Parking Analysis

Average rent per bay is Kshs 9,500 per month with the selling price ranging from Kshs 850,000 to Kshs 2,500,000

Node	Min Price Per Bay	Max Price per Bay	Average Price per Bay
Nairobi CBD	12,000	12,500	12,167
Karen	8,500	12,500	10,862
Parklands	10,000	13,000	10,500
Gigiri	10,000	10,000	10,000
UpperHill	8,000	10,000	9,500
Westlands	6,000	12,500	8,714
Kilimani	7,500	11,000	8,700
Msa Road	4,000	6,000	5,560
Average Rent	**8,250**	**10,938**	**9,500**
Highest Sale Price			**2,500,000**
Lowest Sale Price			**850,000**

Source: Cytonn Research

- Tenants are charged parking fees of Kshs 9,500 per bay per month on average
- Rates range from as low as Kshs 4,000 in low quality grade C offices in poor location such as Mombasa Rd to highs of Kshs 13,000 in areas such as Parklands
- Offices in the CBD have high parking rates as the area generally has inadequate parking space
- The highest sale price for parking recorded was Kshs 2.5mn, the lowest Kshs 850,000 with an average of Kshs 1,250,000 per unit
- Parking thus has an average yield of 9.1% at 100% occupancy in Nairobi

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e) Office Space Opportunity

Office Space Opportunity – Methodology

GAP Analysis used to estimate over/undersupply situation in the market, supply is subtracted from demand and if a positive figure the market is undersupplied with a negative figure indicating an oversupply

- To estimate the supply situation in Nairobi, we used Gap Analysis
- Gap analysis is a tool that measures the under or over supply situation of an office market using demand and supply dynamics
- **Demand** is calculated by adding up net absorption (space taken up in a market in a year) by the space required to replenish depreciated office stock
- We used a depreciation rate of 2% p.a for office buildings
- **Supply** is calculated by summing up the completed office stock in a given year and the vacant stock from the previous year
- To get the over/undersupply in the market, the supply is subtracted from the demand
- If its is a positive figure then the market has an under supply that is demand is more than supply and if it is a negative figure then the market has an oversupply that is supply is more than demand
- **Based on building plan approvals data, in 2017, the market had a supply of 6.3mn SQFT against a demand of 1.6mn SQFT resulting in an oversupply of 4.7mn SQFT**

Office Space Opportunity

Based on building approvals data we had an oversupply of 4.7mn SQFT in 2017

Year	2011	2012	2013	2014	2015	2016	2017	2018F	2019F
Stock (Mn Sqft)	6.7	7.7	9.7	15.4	22.9	28.9	31.8	35.5	38.2
Completions (Mn Sqft)		**1.2**	**2.1**	**5.9**	**7.8**	**6.5**	**3.5**	**4.3**	**3.4**
Vacancy Rate (%)	9.0%	9.0%	10.0%	10.0%	11.0%	12.0%	16.8%	16.8%	16.8%
Vacant Stock (Mn Sqft)	0.6	0.7	1.0	1.5	2.5	3.5	5.3	6.0	6.4
Occupied Stock (Mn Sqft)	6.1	7.1	8.8	13.9	20.3	25.4	26.5	29.5	31.8
Net Absorption		**1.0**	**1.7**	**5.1**	**6.5**	**5.1**	**1.0**	**3.1**	**2.2**
Demand		1.1	1.9	5.3	6.8	5.6	1.6	3.7	2.9
Available Supply, AS(T)		1.7	2.6	6.5	8.8	8.4	6.3	9.0	8.6
Under(Over)supply		**(0.5)**	**(0.8)**	**(1.2)**	**(2.1)**	**(2.9)**	**(4.7)**	**(5.3)**	**(5.7)**

Demand= Net absorption + space required to replace depreciated stock

Over(Under)supply= Demand - Available supply

Source: KNBS, NCG Completions data, Cytonn Research

Office Space Opportunity

Cautious investments can be made in the commercial office theme for long tem gains. Opportunity in the sector is in Grade A office space, in serviced offices, in zones with low supply and in new markets such as county headquarters with low supply of office space

Grade A Office Space in Markets with Low Supply

- Grade A Office space offer an attractive investment opportunity due to:
- Low supply – Grade A offices have a market share of 24% compared to 54% for grade B office space
- High Returns – **They have the highest returns in the market with average rental yields of 9.8% against a market average of 9.2% and are hence an attractive investment opportunity in markets with low supply such as Karen and Gigiri**

Differentiated Concepts

- This include; Green Buildings which are gaining traction in the market, smart offices, semi fitted offices as well as offices with design incorporating affirmative action will increase the occupancy rates of the building and hence the returns to the investor

Serviced Offices

- This is a new concept in the market that is experiencing rapid growth. They also have attractive returns with average rental yields of 13.4% against an average of 9.2% for conventional offices
- They will thus not only increase an investors returns, but also diversify his portfolio

Low Supply Zones

- Despite the oversupply in the market, some zones still have relatively low supply such as Gigiri with a market share of 1.0% and are hence a good investment opportunity

New Markets

- Devolution has created opportunity for development of office space in county headquarters most of which have low quality office spaces and in short supply
- Relaxation of zoning regulations is also paving way for development of office spaces in previously residential zones such as Parklands and Gigiri

Cautious investments can be made in the commercial office theme for long term gains when the market picks up in 3-5 years. Investments should be geared towards zones with low supply such as Grade A offices in and differentiated concepts such as green buildings, smart offices and serviced offices

f) Office Market Conclusion and Outlook

Office Market Conclusion and Outlook

Opportunity for investment in the theme lies in specific pockets of value such as in Grade A office and in differentiated concepts such as and in serviced offices and green buildings but for investments with a long term horizon

Nairobi Commercial Office Outlook				
Measure	**2016 Sentiment**	**2017 Sentiment**	**2017 Outlook**	**2018 Outlook**
Supply	• We had an oversupply of 2.9 mn SQFT of office space in 2016 and it was expected to grow by 10.3 % to 3.2mn SQFT by 2017	• We had an oversupply of 4.7 mn SQFT of office space in 2017, and it is expected to grow by 12.8% to 5.3 mn SQFT in 2018, with buildings such as One Africa Place in Westlands, and Kings Prism in Upperhill expected to come into the market thus increasing vacancy rates in the market, and lowering commercial office performance	Negative	Negative
Demand	• A decline in demand for office spaces was expected mainly as investors were expected to adopt a wait and see attitude over the 2017 elections	• There was reduced demand for office space in Nairobi evidenced by the 4.8% y/y decline in rental yields mainly attributable to a tough operating environment characterized by low credit supply and political uncertainty as a result of the protracted electioneering period. • With the elections concluded and normalcy restored, economic activities are expected to pick up translating to a GDP growth of 5.3%-5.5% in 2018, from the expected 4.7% in 2017 and as Nairobi continues to position itself as regional hub with companies such as Peugeot and Isuzu establishing regional offices here we therefore expect to witness increased demand in the market	Negative	Positive

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Office Market Conclusion and Outlook

Opportunity for investment in the theme lies in specific pockets of value such as in Grade A office and in differentiated concepts such as and in serviced offices and green buildings but for investments with a long term horizon

Nairobi Commercial Office Outlook				
Measure	**2016 Sentiment**	**2017 Sentiment**	**2017 Outlook**	**2018 Outlook**
Office Market Performance	• Increased supply was constraining performance with rents and yields stagnating at the levels they were in, in 2015, as occupancy rates declined by 1.0% point from 89.0% in 2015 to 88.0% in 2016 the trend was expected to continue before the market picked up • Despite this, the sector offered attractive returns in selected markets of up to 12.0% yields, with 90.0% occupancy	• The performance of office market softened, with yields reducing by 0.1% points to 9.2% in 2017 from 9.3% in 2016, and occupancy rates reducing by 4.8% points from 88.0% in 2016 to 83.2% in 2017, the largest y/y decline over the last five years and a 7.8%-point decline since the 91.0% peak in occupancy recorded in 2011 • For 2018, we expect the yields to soften further to an average of 9.0% from the 9.2% yields recorded in 2017	**Neutral**	**Negative**
General Outlook and Opportunity	**• We have a negative outlook for the commercial office theme in Nairobi and thus investment in the commercial office theme should be geared to the long-term horizon for gains when the market picks up in 3-5 years** **• Investments should be made in zones with low supply and high returns such as Karen and in differentiated concepts such as serviced offices and green buildings to boost returns**			

Thank You!

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