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Cytonn Q1'2019 Real Estate Market Review

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Executive Summary

Residential Sector: In Q1'2019, the detached market residential segment registered subdued performance, with an annual price depreciation of 1.5%, 2.4% and 1.4% for the high-end, upper mid-end, and, lower mid-end markets, respectively. This is in comparison to apartments, which posted average annual appreciation of 4.9%, 1.2% and 2.2% for upper mid-end suburbs, lower mid-end suburbs, and Satellite Towns, respectively. Overall, apartments recorded an annual uptake of 23.6%, in comparison to detached market's 18.1%, as a result of increasing demand for affordable homes where apartments are more affordable to home buyers as compared to low rise properties

Commercial Office Sector: In Q1'2019, the commercial office sector recorded a marginal decline in performance recording a 0.1% and 0.9% points decline in average rental yields and occupancy rates, to 8.0% and 82.4% in Q1'2019, from 8.1% and 83.3%, respectively, in FY'2018. Asking rents decreased by 1.7% to an average of Kshs 100 per SQFT, from Kshs 102 per SQFT in 2018, while asking prices remained stable at Kshs 12,574 per SQFT;

Commercial Retail Sector: In Q1'2019, the retail sector's performance softened, recording 0.5% points decline in rental yield to 8.5% in Q1'2019, from 9.0% in FY'2018. This is attributed to an increase in supply, which saw average occupancies drop by 3.0% points from 79.8% in FY'2018 to 76.8% in Q1'2019, and average rents declined by 3.9% to Kshs 174.3 per SQFT/month from Kshs 178.2 per SQFT/month in 2018, as property managers and owners reduced rental charges to attract tenants;

Hospitality Sector: During the Quarter, the Kenya National Bureau of Statistics (KNBS) released their December 2018 issue of Leading Economic Indicators 2018, highlighting a 13.0% growth in the number of tourist arrivals at the Jomo Kenyatta International Airport (JKIA) and the Moi International Airport Mombasa from 0.86 mn during the period between January and November 2017, to 0.97mn during the same period in 2018;

Land: During Q1'2019, the land sector recorded an overall annualized capital appreciation of 0.5%, with site and service schemes in areas such as Thika and Ruai recording the highest annualized capital appreciation at 2.2%;

Infrastructure: The Kenya National Highways Authority (KeNHA) announced the start of the construction of the Western Bypass starting from Gitaru, linking to Southern Bypass and terminating at Ruaka, in Kiambu County;

Listed Real Estate: Stanlib Fahari I-REIT released their FY'2018 earnings, registering a 13.1% growth in earnings to Kshs 1.07 per unit from Kshs 0.95 per unit in FY'2017, attributable to a 10.9% growth in rental income to Kshs 309.8 mn from Kshs 279.4 mn in FY'2017. Net profit in 2018 grew by 13.1% to Kshs 193.5 mn, from Kshs 171.1 mn in FY'2017. The REIT recommended a Kshs 135.7 mn dividend to its unitholders at Kshs 0.75 per unit, realizing an 8.1% yield on its market price of Kshs 9.2 as at 29th March 2019.

Q1'2019 Real Estate Markets Review

In Q1'2019, the real estate sector recorded an array of activities across all themes supported by (i) continued demand for investment property from multinational individuals, firms and the growing middle class, (ii) the Kenyan Government's efforts towards provision of affordable housing as part of its Big 4 Agenda, and (iii) continued infrastructural improvement, which is opening up new areas for development.

The key challenges that continue to face developers and end users include: (i) access to financing with private sector credit growth coming in at 4.4% in October 2018, compared to a 5-year (2013-2018) average of 14.0%, (ii) high land and construction costs, especially in the Nairobi Metropolitan Area, and (iii) increased supply in selected sectors such as the commercial office and retail sectors with a surplus of 5.2mn SQFT and 2.0mn SQFT, respectively, as at 2018.

In this note, we have reviewed notable activities and the performance of the residential, commercial, hospitality, land and listed real estate sectors during the quarter.

I. Residential Sector

In Q1'2019, we continued to witness an increase in investor interest in the residential sector, particularly due to the ongoing focus on bridging the affordable housing shortage in Kenya. Residential projects unveiled during the quarter are as shown below:

Residential Projects in Q1'2019						
Name of Developer	**Name of Project**	**Location**	**Typology**	**Number of Units**	**Project Stage**	**Price Points (Kshs)**
Karibu Homes	Riverview Estate	Athi River	1, 2, and 3 BR Apartments	288	Completed	2.5 mn – 5.8 mn
Erdemann Properties	River Estate	Ngara	1 & 2 BR Apartments	2,720	Under construction	3.0 mn -8.5 mn
Sprinter Real Estate Investment	Tigoni View	Ndenderu	2 & 3 BR Apartments	300	Launch	5.2 mn – 5.9 mn
Actis	Garden City Apartments Phase II	Thika Rd		600	Launch	Unspecified
Cytonn Real Estate	Applewood	Karen, Miotoni	5 BR Villas	19	Under Construction	135 mn – 180 mn

Online Sources

On the affordable housing initiative, major developments during the quarter were:

i. The Government of Kenya announced the relaxation of affordable housing regulations to include high income-earners of Kshs 100,000 and above. For more information, please see Cytonn Weekly #04/2019,
ii. The Kenyan Government launched the bomayangu.go.ke portal, which will allow citizens to register and apply for affordable housing units online,
iii. Central Bank released Kenya Mortgage Refinance Company (KMRC) draft regulations for public participation, showing momentum for the actualization of the much-awaited mortgage facility.

Market Performance

The detached market registered subdued performance with an annual price depreciation of 1.5%, 2.4% and 1.4% for high-end, upper mid-end, and, lower mid-end markets, respectively. This is in comparison to apartments, which posted average annual appreciation of 4.9%, 1.2% and 2.2% for upper mid-end suburbs, lower mid-end suburbs, and Satellite Towns, respectively. Overall, apartments recorded an annual uptake of 23.6% in comparison to detached market's 18.1%. This is as a result of increasing demand for affordable homes where apartments are more affordable to home buyers as compared to low rise properties.

A. Detached

The lower mid-end market registered the highest annual average returns of 2.7% in comparison to the high-end and upper mid-end markets, which posted 1.9% and 1.7%, respectively. The subdued performance is as a result of select markets experiencing price depreciations due to a decline in demand for upmarket properties particularly due to high cost of financing and relatively low mortgage affordability in the market.

i. High-End

The high-end market registered an annual price depreciation of 1.5% as a result of decline in asking prices in markets such as Kitisuru and Lower Kabete as developers attempt to attract buyers. Karen registered the highest annual returns in the high-end market with 7.3%, in comparison to other high-end markets, with an average of 1.9%. This is evidenced by the relatively high uptake during the quarter of 20.0% on average in comparison to the high-end market average of 18.0%. Karen's demand is driven by its vibrancy especially due to the social amenities it hosts in comparison to markets like Runda and Kitisuru.

(All Values in Kshs Unless Stated Otherwise)

Detached Housing: High-End Markets Performance Q1'2019

Area	Average Price Per SQM Q1'2019	Average Rent Per SQM Q1'2019	Average Annual Uptake Q1'2019	Average Occupancy Q1'2019	Average Rental Yield Q1'2019	Q/Q Price Change	Annual Price Appreciation	2018/2019 Total Returns
Karen	203,968	764	20.0%	76.6%	3.4%	1.3%	3.9%	7.3%
Runda	249,748	851	12.1%	83.8%	3.0%	0.0%	3.4%	6.4%
Rosslyn	179,671	775	19.1%	84.3%	4.4%	0.0%	(5.0%)	(0.6%)
Kitisuru	235,445	906	19.9%	83.3%	3.6%	(0.9%)	(4.5%)	(0.9%)
Lower Kabete	175,160	477	19.0%	89.5%	2.8%	0.0%	(5.2%)	(2.4%)
Average	**208,798**	**755**	**18.0%**	**83.5%**	**3.4%**	**0.1%**	**(1.5%)**	**1.9%**

- *Karen registered the highest annual returns in the high-end market with 7.3%, in comparison to other high-end markets, with an average of 1.9%. This is evidenced by the relatively high annual uptake of 20.0% in comparison to the high-end market average of 18.0%. Occupancy rates in Karen were the lowest in the market, at 76.6%, attributable to an increase in new real estate developments*

Source: Cytonn Research 2019

ii. Upper Mid-End

The upper mid-end market posted average annual uptake of 18.7% and a price depreciation of 2.4% on average. This is owing to select markets such as South C and Langata posting a decline in asking prices at 9.3% and 13.3%, respectively, attributable to a general market correction in these sub-markets.

(All Values in Kshs Unless Stated Otherwise)

Detached Housing: Top 5 Upper Mid-End Markets Performance Q1'2019

Row Labels	Average Price Per SQM Q1'2019	Average Rent Per SQM Q1'2019	Average Annual Uptake Q1'2019	Average Occupancy Q1'2019	Average Rental Yield Q1'2019	Q/Q Price Change	Annual Price Appreciation	2018/2019 Total Returns
Redhill & Sigona	105,285	354	21.1%	77.5%	3.5%	0.8%	7.5%	11.1%
Runda Mumwe	137,654	599	26.1%	83.6%	4.6%	0.0%	2.0%	6.6%
Loresho	146,041	570	17.5%	94.6%	4.4%	1.7%	1.3%	5.7%
South C	120,928	494	16.3%	92.5%	4.6%	(1.4%)	(9.3%)	(4.7%)
Langata	127,778	401	12.4%	87.1%	3.3%	(0.4%)	(13.3%)	(10.0%)
Average	**127,537**	**484**	**18.7%**	**87.1%**	**4.1%**	**(0.1%)**	**(2.4%)**	**1.7%**
• *In the upper mid-end market for detached units, Redhill posted the best returns at 11.1% attributable to an annual price appreciation of 7.5% in asking prices. Runda Mumwe prices remained flat largely attributable to increased development in the area. Langata had the least investor returns due to a decline in asking prices. This is attributable to increased densification of the area making it less attractive to investors seeking low rise homes*								

Source: Cytonn Research 2019

iii. Low Mid-End

Ruiru had the highest returns in the lower mid-end market with 6.7% and an annual price appreciation of 2.1%, as a result of relatively high demand particularly from lower mid-income class working in Nairobi seeking a serene and easily accessible environment that is also in close proximity to commercial nodes.

(All Values in Kshs Unless Stated Otherwise)								
Detached Housing: Top 5 Lower Mid-End Markets Performance Q1'2019								
Location	**Average Price Per SQM Q1'2019**	**Average Rent Per SQM Q1'2019**	**Average Annual Uptake Q1'2019**	**Average Occupancy Q1'2019**	**Average Rental Yield Q1'2019**	**Q/Q Price Change**	**Annual Price Appreciation**	**2018/2019 Total Returns**
Ruiru	98,503	365	17.1%	94.4%	4.5%	1.6%	2.1%	6.7%
Donholm & Komarock	87,539	343	21.1%	88.0%	4.3%	0.8%	0.0%	4.3%
Athi River	93,516	390	19.5%	72.2%	3.7%	0.6%	(0.4%)	3.4%
Ngong	56,464	239	15.0%	72.8%	3.9%	(0.9%)	(3.5%)	0.4%
Juja	77,136	222	15.0%	61.9%	3.9%	0.0%	(5.3%)	(1.4%)
Average	**82,632**	**312**	**17.5%**	**77.9%**	**4.1%**	**0.4%**	**(1.4%)**	**2.7%**
• *Ruiru had the highest returns in the lower mid-end market with 6.7% and an annual price appreciation of 2.1%, as a result of relatively high demand particularly from lower mid-income class working in Nairobi seeking a serene and easily accessible environment that is also in close proximity to commercial nodes. Juja's prices remained flat during the quarter but recorded an Annual decline of 5.3% in asking prices, largely attributable to competition from areas like Ruiru while Ngong posted a decline in prices which could be attributable to its location as well as insufficient infrastructure*								

Source: Cytonn Research 2019

B. Apartments

Apartments performed better compared to detached units with annual price appreciation averaging at 2.2% - 4.9%. This is due to increased demand for these units as they are more affordable in comparison to low rise units. Evidently, annual uptake for high rise units was relatively high averaging at 23.7%, 26.0%, and 21.1% for upper mid-end suburbs, lower mid-end suburbs, and Satellite Towns, respectively.

i. Upper Mid-End Suburbs

(All Values in Kshs Unless Stated Otherwise)
Apartments: Top 5 Upper Mid-End Suburb Markets Performance Q1'2019

Location	Average Price Per SQM Q1'2019	Average Rent Per SQM Q1'2019	Average Annual Uptake Q 1'2019	Average Occupancy 2019	Average Rental Yield Q1'2019	Q/Q Price Change	Annual Price Appreciation	2018 /2019 Total Returns
Riverside	138,125	793.2	20.2%	88.4%	6.0%	1.7%	8.8%	14.8%
Kilimani	124,197	598.4	28.2%	70.2%	3.9%	1.6%	8.8%	12.6%
Kileleshwa	115,634	819.7	24.2%	71.0%	5.2%	0.8%	0.8%	5.9%
Parklands	112,931	465.8	25.0%	94.4%	4.5%	0.8%	1.9%	6.4%
Westlands	147,374	744.4	21.2%	89.7%	5.2%	(1.6%)	4.3%	9.5%
Average	**127,652**	**684.3**	**23.7%**	**82.8%**	**4.9%**	**0.7%**	**4.9%**	**9.8%**

- *Riverside and Kilimani posted the highest Annual returns of 14.8% and 12.6% driven by an increase in asking prices of 8.8% for both markets. This is as both sub-markets continue to experience demand for serviced and furnished apartments. Westlands posted a decline in asking prices during the quarter owing to increased commercialization of the area.*

Source: Cytonn Research 2019

ii. Lower Mid-End Suburbs

Lower mid-end suburbs registered the highest average annual uptake at 26.0% and occupancy rates of 84.1% with suburbs such as Donholm/Komarock registering 96.7% occupancy rates, a result of Nairobi's growing urbanization and emerging middle-income class.

(All Values in Kshs Unless Stated Otherwise)

Apartments: Top 5 Lower Mid-End Suburb Markets Performance Q1'2019

Location	Average Price Per SQM Q1'2019	Average Rent Per SQM Q1'2019	Average Annual Uptake Q1'2019	Average Occupancy 2019	Average Rental Yield Q1'2019	Q/Q Price Change	Annual Price Appreciation	2018/2019 Total Returns
Kahawa West	85,523	426.3	18.5%	71.4%	5.0%	1.0%	9.2%	14.2%
Donholm & Komarock	84,095	406.6	20.7%	96.7%	5.7%	0.5%	5.7%	11.3%
Waiyaki Way	86,783	409.9	26.8%	86.2%	4.9%	0.1%	2.9%	7.8%
South C	103,199	617.4	29.2%	82.8%	5.9%	0.8%	1.4%	7.4%
Lang'ata	110,706	524.6	27.5%	83.5%	4.9%	(0.2%)	(5.1%)	(0.2%)
Average	**96,196**	**490**	**26.0%**	**87.3%**	**5.4%**	**0.3%**	**1.2%**	**6.6%**

- *Kahawa West recorded the highest average returns at 14.2%, in comparison to the lower mid-end market average of 6.6%, owing to new developments' increasing asking prices. Langata recorded a price depreciation as its average asking prices reach a ceiling as well as competition from surrounding markets such as South C.*

Source: Cytonn Research 2019

iii. Satellite Towns

Thindigua registered the highest annual returns amongst Satellite Towns, owing to an annual price appreciation of 4.1% driven by demand from young population working in the CBD as well as expats working in surrounding international organizations. However, Thindigua and Kikuyu also posted quarterly price depreciation of 0.7% resulting from price discounts offered by developers during the season in a bid to attract clientele amidst increasing market competition.

(All Values in Kshs Unless Stated Otherwise)

Apartments: Top 5 Satellite Towns Performance Q1'2019

Location	Average Price Per SQM Q1'2019	Average Rent Per SQM Q1'2019	Average Annual Uptake Q1'2019	Average Occupancy 2019	Average Rental Yield Q1'2019	Q/Q Price Change	Annual Price Appreciation	2018/2019 Total Returns

Thindigua	99,119	456.9	20.9%	97.9%	5.6%	(0.7%)	4.1%	9.7%
Athi River	66,156	356.4	17.6%	84.8%	5.0%	1.7%	1.7%	6.7%
Ruaka	104,997	430.1	27.2%	80.3%	4.3%	0.4%	2.1%	6.4%
Ruiru	91,629	439.2	17.9%	62.3%	3.3%	1.0%	1.0%	4.3%
Kikuyu	79,112	369.8	21.8%	85.4%	5.1%	(0.7%)	2.1%	7.3%
Average	**88,203**	**410**	**21.1%**	**82.1%**	**4.6%**	**0.4%**	**2.2%**	**6.9%**

- *Thindigua had the highest Annual returns amongst Satellite Towns, owing to an Annual price appreciation of 4.1% driven by demand from young population working in the CBD. However, Thindigua and Kikuyu posted price depreciation of 0.7% each as a result of price discounts offered by developers during the season in a bid to attract clientele amidst increasing competition,*
- *Athi River posted the highest price appreciation among the Satellite Town with 1.7% q/q, in comparison to the Satellite Towns market average of 0.4%, owing to increased demand from investors and home buyers. This is as Athi River currently hosts majority of affordable investment grade projects thus attracting both investors and actual home buyers.*

Source: Cytonn Research 2019

We expect the residential market to continue recording modest performance due to factors such as finance which continues to be elusive for home buyers, and developers as well. However, we expect the lower mid-end markets to continue experiencing increased demand and uptake as home buyers seek affordability.

II. Commercial Sector

A. Office

In Q1’2019, the commercial office sector recorded a marginal decline in performance recording 0.1% and 0.9% points decline in average rental yields and occupancy rates, to 8.0% and 82.4% in Q1’2019, from 8.1% and 83.3%, respectively, in FY’2018. The negative performance was largely driven by a reduction in asking rents by property managers to attract tenants as a result of a surplus of office space that stood at 5.2 mn SQFT as at 2018 giving tenants a higher bargaining power. Asking rents decreased by 1.7% to an average of Kshs 100 per SQFT from Kshs 102 per SQFT in 2018, while asking prices remained stable at Kshs 12,574 per SQFT.

The table below highlights the performance of the commercial office sector in Nairobi over time:

(All values in Kshs unless stated otherwise)

Summary of Commercial Office Returns in Nairobi– Q1’2019

Year	Q1'2018	H1'2018	Q3'2018	Q4'2018	Q1’2019	Δ Y/Y	Δ Q1'2019
Occupancy (%)	80.5%	84.6%	87.3%	83.3%	**82.4%**	1.9% points	**(0.9%) points**
Asking Rents (Kshs/SQFT)	98	102	102	102	**100**	2.29%	**(1.7%)**
Average Prices (Kshs/SQFT)	12,718	12,527	12,202	12,573	**12,574**	(1.14%)	**0.0%**
Average Rental Yields (%)	9.2%	9.3%	9.5%	8.1%	**8.0%**	(1.2%) points	**(0.1%) points**

- *Occupancy rates declined by 0.9% points to 82.4% in Q1’2019 from 83.3% in FY’2018 attributed to the surplus of 5.2 mn SQFT office space as at 2018*
- *Rental rates dropped by 1.7% to Kshs 100/SQFT/Month from Kshs 102/SQFT/Month in FY’2018 as developers reduce rents in order to remain competitive and attract tenants*

Source: Cytonn Research 2019

In terms of Nairobi submarket analysis, Gigiri, Westlands and Parklands were the best performers in Q1’2019 recording rental yields of 9.6%, 9.1%, and 9.1%, respectively, as a result of their superior locations hosting multinational companies and offering quality Grade A offices, enabling them to charge a premium on rentals.

Areas affected by traffic snarl ups, low quality office space and are not necessarily primary business nodes such as Mombasa Road and Thika Road had the lowest returns with average rental yields of 5.8% and 6.2%, respectively.

Nairobi CBD's performance improved as rental yields rose by 0.6% points, to 8.2% in Q1'2019 from 7.6% in FY'2018 driven by 1.4% and 5.3% points increase in rental rates and occupancy rates respectively attributed to the node's attractiveness to Small and Medium Enterprises (SMEs) as a result of its affordable rental rates and large customer base present in the Central Business District.

(All values in Kshs unless stated otherwise)											
Nairobi Commercial Office Submarket Performance - Q1'2019											
Location	**Price Kshs/ SQFT Q1'2019**	**Rent Kshs/SQFT Q1'2019**	**Occupancy Q1'2019(%)**	**Rental Yield (%) Q1'2019**	**Price Kshs/ SQFT FY 2018**	**Rent Kshs/SQFT FY 2018**	**Occupancy FY 2018(%)**	**Rental Yield (%) FY 2018**	**Q1'2019 Δ in Rent**	**Q1'2019 Δ in Occupancy (% points)**	**Q1'2019 Δ in Rental Yields (% points)**
Gigiri	13,833	126.3	80.8%	9.6%	13,833	141.0	88.3%	10.5%	(10.5%)	(7.6%)	(0.9%)
Westlands	12,334	110.0	83.3%	9.1%	12,050	109.7	82.1%	9.0%	0.3%	1.2%	0.1%
Parklands	12,369	103.1	90.6%	9.1%	12,494	102.1	86.0%	8.4%	1.0%	4.6%	0.8%
Karen	13,666	113.7	90.5%	9.0%	13,666	118.3	88.6%	9.2%	(3.9%)	1.9%	(0.2%)
Nairobi CBD	12,425	90.0	93.6%	8.2%	12,425	88.8	88.3%	7.6%	1.4%	5.3%	0.6%
UpperHill	12,593	100.9	83.5%	7.9%	12,560	99.8	84.0%	8.2%	1.1%	(0.5%)	(0.3%)
Kilimani	12,734	92.3	80.9%	7.2%	13,525	98.9	88.3%	8.0%	(6.7%)	(7.4%)	(0.8%)
Thika Road	12,517	86.7	74.6%	6.2%	12,517	86.3	81.5%	6.7%	0.4%	(6.8%)	(0.5%)
Msa Road	11,400	79.7	64.1%	5.8%	11,400	78.8	65.6%	5.8%	1.2%	(1.5%)	0.0%
Average	**12,574**	**100.3**	**82.4%**	**8.0%**	**12,573**	**102.2**	**83.8%**	**8.1%**	**(1.7%)**	**(1.4%)**	**(0.1%)**

Gigiri area covers Gigiri and Limuru Road

- *Nairobi Metropolitan area recorded a 0.1% point q/q decrease in rental yields to 8.0% in Q1'2019 from 8.1% in 2018, attributable to reduced rental rates driven by a 1.4% decrease in office occupancy rates*
- *Gigiri, Westlands and Parklands were the best performing offices sub markets recording average rental yields of 9.6%, 9.1%, and 9.1%, respectively and occupancy rates of 80.8%, 83.3% and 90.6%, respectively. The high returns are as a result of high-quality office spaces in these areas and their prime locations enabling developers to charge prime rents*
- *Performance in Gigiri declined by 0.9% points to 9.6% in Q1'2019 from 10.5% in FY'2018 as a result of expanded coverage of the node to include Limuru Road which included new buildings charging less rent and having low occupancy rates*
- *Thika Road and Mombasa Road were the worst performing markets due to poor quality offices and also affected by high traffic snarl ups that have made them generally unattractive to firms*

Source: Cytonn Research 2019

The main highlights in the commercial office sector during Q1'2019 include; (i) the opening of Park Medical Centre in 3rd Parklands Avenue in Parklands, and (ii) FMCG technology solutions company, MAC Mobile, and Mauritius Commercial Bank (MCB) Group announced their plans for opening offices in Nairobi in 2019.

We retain a negative outlook on the performance of the commercial office sector attributable to an oversupply of 5.2mn SQFT of office space thereby reducing occupancy rates translating to a decline in rental yields. Investments opportunities in the sector are in differentiated concepts such as serviced offices that attract yields of 13.4% such as Westlands, as well as areas with low supply of office space such as Gigiri.

B. Retail

The retail sector's performance softened recording 0.5% points decline in rental yield to 8.5% in Q1' 2019 from 9.0% in FY' 2018. This is attributed to an increase in supply which saw average occupancies drop by 3.0% points from 79.8% in FY'2018 to 76.8% in Q1' 2019 and average rents declined by 3.9% to Kshs 174.3 per SQFT/month from Kshs 178.2 per SQFT/month in 2018 as property managers and owners reduced rental charges to attract tenants.

The performance of the retail sector in Nairobi over time is as shown below;

(All values in Kshs unless stated otherwise)							
Summary of Retail Sector Performance Q1'2018 - Q1'2019							
Item	**Q1' 2018**	**H1' 2018**	**Q3' 2018**	**FY' 2018**	**Q1' 2019**	**Δ Y/Y**	**Δ Q1'2019**
Average Asking Rents (Kshs/SQFT)	188.0	190.4	178.2	178.2	174.3	(7.3%)	(2.2%)
Average Occupancy (%)	80.1%	82.7%	83.7%	79.8%	76.8%	(3.3%) points	(3.0%) points
Average Rental Yields	9.4%	9.7%	9.4%	9.0%	8.5%	(0.9%) points	(0.5%) points

- *The retail sector's performance softened, recording an average rental yield of 8.5%, a 0.5%-point decline from FY' 2018. Occupancy rates as well declined by 3.0% points, while the rental charges decreased by 2.2% over the quarter.*
- *The decline in performance is attributable to surplus mall space supply in Nairobi, currently at 2.0mn SQFT, with the opening of malls such as Waterfront, The Well and Coholo*

Source: Cytonn Research 2019

In terms of submarket analysis in Nairobi, Westlands and Kilimani were the best performing retail nodes with average rental yields of 11.5% and 10.7%, respectively, as the areas are affluent neighborhoods hosting middle – high-end income earners with high consumer purchasing power and thus tenants are willing to pay higher rents for retail space in the area. Mombasa Road and Satellite Towns were the worst performing nodes recording rental yields of 6.8% and 6.3%, respectively. The poor performance is attributable to low rental charges as a result of traffic congestion along Mombasa road and competition from informal retail space in Satellite Towns.

Karen, Mombasa Road, and Thika Road nodes recorded the largest declines in rental yield q/q, of 1.7%, 1.1%, and 1.0% points, respectively. The decline in performance is attributable to a 15.2%, 6.4%, and 4.2% points decline in occupancy rates for Karen, Mombasa Road, and Thika Road, respectively due to increasing retail space with the opening of malls such as Waterfront and The Well in Karen and Coholo in Mlolongo.

(All values in Kshs unless stated otherwise)									
Summary of Nairobi's Retail Market Performance 2018 – Q1'2019									
Location	**Rent Ksh/SQFT Q1' 2019**	**Occupancy Q1' 2019**	**Rental Yield Q1' 2019**	**Rent Ksh/SQFT 2018**	**Occupancy 2018**	**Rental Yield 2018**	**Q1'2019 Δ in Rent**	**Q1'2019 Δ in Occupancy (% points)**	**Q1'2019 Δ in Rental Yields (% points)**
Westlands	218	85.0%	11.5%	219	82.2%	12.2%	0.4%	2.8%	(0.7%)
Kilimani	173	90.8%	10.4%	167	97.0%	10.7%	(3.4%)	(6.2%)	-0.3%
Ngong Road	173	90.0%	9.8%	175	88.8%	9.7%	1.6%	1.2%	0.1%
Karen	225	73.6%	9.3%	225	88.8%	11.0%	0.1%	(15.2%)	(1.7%)
Eastlands	154	72.7%	7.7%	153	64.8%	6.8%	0.4%	7.9%	0.9%
Kiambu Road	169	69.8%	7.5%	183	69.5%	8.1%	8.3%	0.3%	(0.6%)
Thika road	168	70.8%	7.3%	177	75.0%	8.3%	5.3%	(4.2%)	(1.0%)
Mombasa Road	153	66.0%	6.8%	159	72.4%	7.9%	3.6%	(6.4%)	(1.1%)
Satellite Towns	135	72.2%	6.3%	142	73.7%	6.7%	4.9%	(1.5%)	(0.4%)
Average	174	76.8%	8.5%	178	79.8%	9.0%	2.1%	(3.0%)	(0.5)%

- *Performance softened, with yields declining by 0.5% points q/q as a result of an oversupply of retail space, currently at 2.0mn SQFT leading to a 2.4% points q/q decline in occupancy levels and a 2.1 % q/q decline in rental charges in Q1' 2019,*
- *Westlands and Kilimani were the best performing submarkets, with a yield of 11.5% and 10.7% respectively, driven by relatively higher rental rates as they are affluent neighbourhoods hosting middle – high end income earners with high consumer purchasing power and thus investors are willing to pay higher rents for retail space in the area*

- *Karen recorded the highest change in rental yield, a reduction of 1.7% points, attributed to a 15.2% point decrease in average occupancy from 88.8% in FY' 2018 to as a result of an increase in retail space supply in the area with the opening of Waterfront and The Well malls*

Source: Cytonn Research 2019

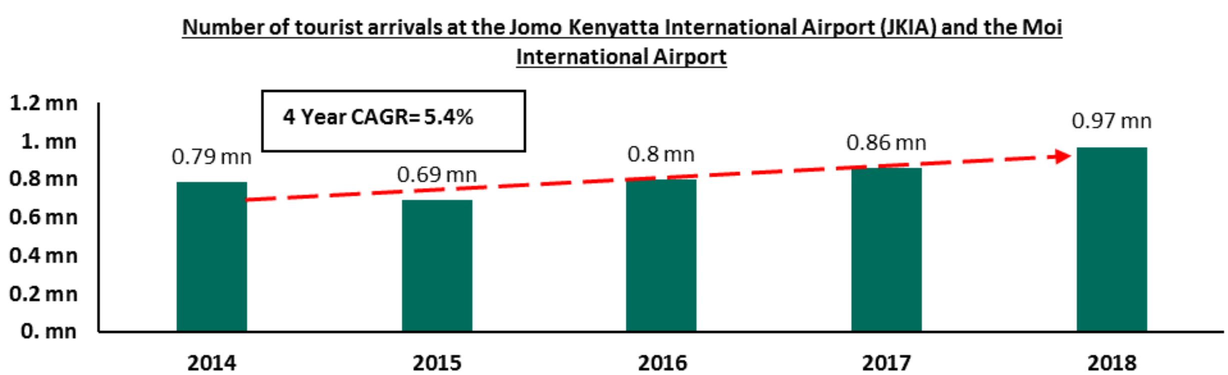
The main highlights in the retail sector in Q1 2019 include;

i. South Africa retailer, Shoprite, opened a second shop in Kenya at the Garden City Mall, along the Thika Superhighway, Nairobi, taking up a space of 40,000 SQFT, previously occupied by Nakumatt Holdings,
ii. Quickmart Supermarket opened its first 24-hour outlet at Lavington's Valley Arcade, bringing its total branches in the country to 10,
iii. Swiss-owned shoemaker, Bata Shoe Company, opened its latest outlet at The Hub Mall, in Karen, and,
iv. Fast food Chain, Grill Shack, opened its first restaurant in Africa at the Westgate Mall in Westlands.

We retain a neutral outlook for the retail sector, with the continued entry of international retailers and expansion of local retailers expected to cushion the retail real estate sector's performance through increased occupancy rates. The opportunity is in county headquarters in some markets such as Mombasa and Mt. Kenya regions that have retail space demand of 0.3mn and 0.2mn SQFT, attractive yields at 8.3% and 9.9% and occupancy rates at 96.3% and 84.5%, respectively.

III. Hospitality Sector

In the hospitality sector, Kenya National Bureau of Statistics (KNBS) released their December 2018 issue of Leading Economic Indicators 2018, highlighting a 13.0% growth in the number of tourist arrivals at the Jomo Kenyatta International Airport (JKIA) and the Moi International Airport Mombasa from 0.86 mn during the period between January and November 2017 to 0.97mn during the same period in 2018. In our view, this was driven by the improved security and political stability, which have continued to boost tourists' confidence in the country thus making it a preferred travel destination for both business and holiday travelers. As per Cytonn Market Outlook 2019, we expect the number of arrivals to increase to 1.5 mn during the same period in 2019, supported by factors mentioned above in addition to the improving air transport operations. We, however, note that the sector experienced a setback earlier in the year following the Riverside-based Dusit Hotel terrorist attack, that saw the United Kingdom and United States (US) state department caution its nationals to be vigilant in Nairobi, resulting in fewer arrivals during that period. However, with improved security measures in the country, we expect continued demand for hospitality services, with serviced apartments expected to record relatively high occupancies of above 80.0% in 2019, according to our Cytonn 2019 Markets Outlook, and hotels at approximately 55% according to JLL's Nairobi City Report 2019.



Source: Kenya National Bureau of Statistics

Other highlights during the quarter;

i. Local airlines, Kenya Airways and Silverstone Air, announced plans to introduce daily direct flights from Nairobi to Seychelles, and from Nairobi to Lodwar, respectively. In our view, the improving air transport operations, political stability and continued marketing of Kenya as an experience destination, will result in increased tourist arrivals. For more information, please see our Cytonn Weekly #03/2019,

ii. Hospitality chain, Superior Hotels Limited, opened its third hotel in Naivasha town in January 2019, in an expansion move that has seen its portfolio grow to 6 hotels among them, Sweet Lake Resort and Masada Hotel in Naivasha, Pearl Palace and Hadassa in Nairobi and West Wood Hotel in Westlands Nairobi. The resort, which is located along Naivasha Moi South Road, brings to the market 96 rooms organized in cottages, 16 conference rooms, a business center and an amphitheater with a capacity of 1,200 people. In our view, the hotel will be a destination for meetings, incentives, conferencing and exhibitions tourism, as Naivasha town is preferred by corporates and government institutions for out-of-office meetings,

iii. Concord Hotels, a local hotel group, is set to open Shelly Beach Hotel in Mombasa after a US 10.0 mn makeover. The hotel chain also owns Concord and Cloud Hotel in Nairobi and Bahari Dhow in Diani and bought Shelly Beach in 2000. The phase 1 of the refurbishment will include restaurants, swimming pools, bar and 36 rooms and is set for completion by the end of 2019. In our view, the refurbishment will result in the improvement of hospitality services and thus the give the hotel competitive advantage in the wake of competition from other international brands such as the Hilton Hotel and Radisson *Hotel Group,*

iv. Tourism Cabinet Secretary Hon. Najib Balala announced plans to rehabilitate Kisumu's Sunset Hotel into a conference center. The center, set to be complete by 2021, will have a 10,000 pax-capacity with an estimated cost of Kshs 300.0 mn. In our view, the move will buck the growth of both local and international conferencing with demand being driven by national and county government officials, corporates, political parties and international delegates looking to hold meetings in the county. According to KNBS Economic Survey 2018, local conferences and delegates in Kenya increased by 2.4% and 17.1%, respectively, in 2017, partly because of numerous political strategy meetings held, creating demand for conference centers especially away from Nairobi CBD. For more information, please see our Cytonn Weekly #08/2019.

We expect the hospitality sector to record improved performance in 2019, supported by; i) the improving air transport operations, ii) continued marketing of Kenya as an experience destination, iii) improved security, and iv) political stability, which have continued to boost tourists' confidence in the country and thus making it a preferred travel destination for both business and holiday travelers.

IV. Land

During Q1'2019, the land sector recorded an overall annualized capital appreciation of 0.5%, with site and service schemes in areas such as Thika and Ruai recording the highest annualized capital appreciation at 2.2%, attributable to the growing demand for site and service schemes as they are relatively affordable at an asking price of approximately Kshs 14.4 mn per acre compared to urban areas with relatively high asking prices of up to Kshs 488.3 mn per acre and also due to the provision of infrastructure by developers.

The table below shows the performance of the sector during the quarter:

Summary of Nairobi Metropolitan Area Performance Across the Nodes			
NODES	FY'2018	Q1'2019	Annualized Capital Appreciation
Site and service schemes	14,319,805	14,392,364	2.2%
Satellite Towns	22,663,698	22,862,719	2.1%
Low Rise Residential Areas	86,339,124	86,722,858	1.8%
High Rise Residential Areas	134,984,148	135,400,750	(0.1%)
Commercial Zones	492,634,539	488,260,628	(3.5%)
Average			**0.5%**

Source: Cytonn Research 2019

i. Serviced land in satellite towns recorded a 2.2% annualized capital appreciation, 1.7% points higher than the market average of 0.5%, and 0.1% points higher than unserviced land in the same location. The appreciation is attributed to increased demand due to relatively affordable land at approximately Kshs 14.4 mn asking price per acre and provision of infrastructure by the developers,
ii. Unserviced land in satellite towns recorded a relatively high annualized capital appreciation at 2.1% compared to the market average of 0.5%. This is attributed to; i) high demand due to affordability in comparison to Nairobi's suburbs, and ii) improving infrastructure such as roads and sewerage systems. The best performing sub-markets were Athi River and Limuru, recording a capital appreciation of 6.3% and 6.2%, respectively, with the average price per acre coming in at Kshs 3.8 mn and Kshs 17.4 mn, respectively,
iii. Low-rise residential areas such as Karen and Runda recorded an average capital appreciation of 1.8%. Karen was the best performing submarket with a capital appreciation of 5.0%, and an average asking price of Kshs 56.5 mn. We attribute the relatively high appreciation of land in low rise residential areas compared to high-rise areas which recorded a 0.1% decline, to the continued demand for housing, as they are relatively sparsely populated, are deemed favorable for families mainly as they enhance privacy, and are relatively affordable at an average asking land price of Kshs 86.7 mn, compared to high-rise areas at Kshs 135.4 mn per acre on average,
iv. On overall, asking land prices in high-rise residential areas recorded a 0.1% correction, attributed to the relatively high land prices at approximately Kshs 135.4 mn per acre, thus developers are not able to achieve a favorable return on investment from developments in those submarkets, and therefore decreased demand for development land,
v. Commercial zones such as Kilimani and Upperhill recorded a 3.5% correction in asking prices, with Kilimani recording 0.8% points decline and thus an average land price of Kshs 386.6 mn per acre. We attribute the decline in asking land prices to the decreased demand for development land in the submarkets given the relatively high asking land prices of Kshs 488.3 mn per acre on average thus developers are not able to achieve favorable returns from the investments.

The opportunity in the sector lies in markets such as Karen and Kileleshwa which recorded a relatively high annualized capital appreciation of 5.0% and 3.0%, respectively, and satellite town such as Athi River and Limuru for Unserviced land and Thika and Ruai for site and service schemes which were the best performing with an average annualized capital appreciation of 6.3%, 6.2%, 6.9% and 6.6%, respectively.

Other highlights during the quarter:

The Ministry of Lands in 2018 announced plans to digitize the processes in the ministry, in order to speed up the same, thus enhancing time saving, cost reduction and transparency in the registration of land and thus encourage property development. In line with the same;

1. In March 2019, the Government of Kenya announced plans to incorporate blockchain technology into the land's digitization process in a bid to end human interference in the Lands Ministry. Blockchain technology refers to a decentralized public ledger that records transactions across many different computers across the internet with no central point. This makes it hard for any one individual to interfere with the data. This will help to track all land transactions in the country, leading to an efficient, transparent and fair system in a country where issues of land fraud have been rampant,
2. The Ministry of Lands announced that the Lands Information Management System (LIMS) is expected to go live on 1st April 2019. The system is expected to shorten the lands registration process by 61-days, to 12-days, from 73-days required by the manual system and this is likely to enhance time saving, cost reduction and transparency in the registration of land and thus encourage property development. For more details on this see Cytonn Weekly 11/2019 .

We expect the land sector to record improved performance going forward, fueled by; (i) the continued demand for development land especially in satellite towns where it is more affordable and available in bulk, (ii) improving infrastructure such as the road network and sewer connections, and iii) the digitalization of the Ministry of Lands which will enhance development of property and thus increased demand for the same.

V. Infrastructure

In Q1' 2019, we noted the following activities in the infrastructure sector;

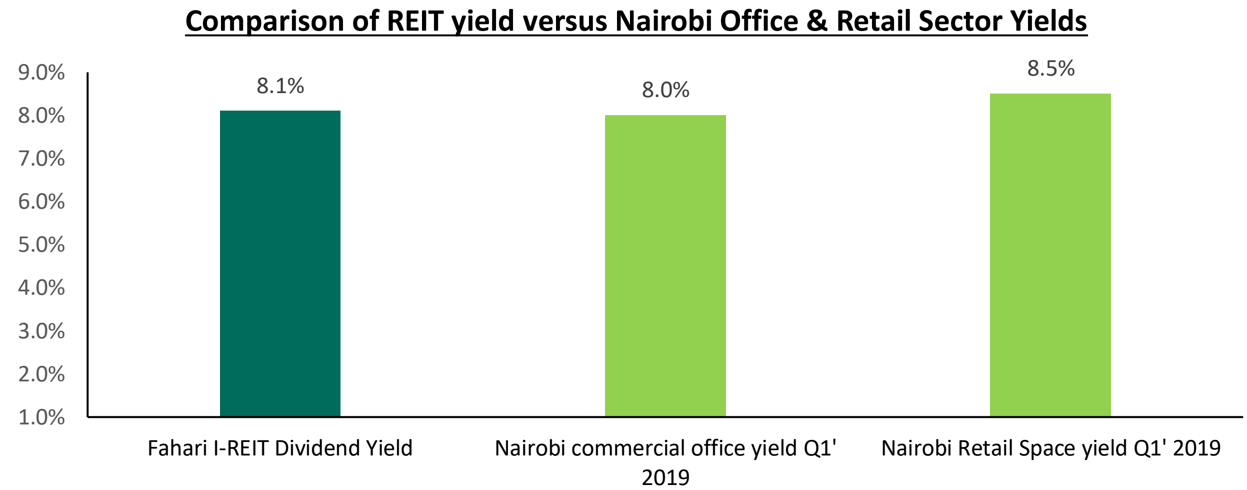
1. The Kenya National Highways Authority (KeNHA) announced the start of the construction of the Western Bypass starting from Gitaru linking to Southern Bypass and terminating at Ruaka, in Kiambu County. This road will include 17.4 km of service lanes, seven interchanges at the major junctions of Wangige, Kihara, Ndenderu, Ruminyi, Kabete, Banana and Ruaka, five underpasses and three-foot bridges. The project is financed by the Exim Bank of China and is being undertaken by the China Road and Bridge Corporation, at a cost of Kshs 17 bn,
2. China Road and Bridge Corporation (CRBC), a Chinese engineering and construction firm, is set to secure a Kshs 2.5 bn contract to refurbish the Nairobi commuter railway network. For more information, please see Cytonn Weekly #11_2019.

The planned improvement and construction of new roads and railway system will lead to better accessibility and reduce traffic congestion that is usually rampant during peak hours. Consequently, we expect this to result in increased demand for property in satellite towns with increased provision of infrastructure.

VI. Listed Real Estate

Stanlib Fahari I-REIT released their FY'2018 earnings, registering a 13.1% growth in earnings to Kshs 1.07 per unit from Kshs 0.95 per unit in FY'2017, attributable to a 10.9% growth in rental income to Kshs 309.8 mn from Kshs 279.4 mn in FY'2017 as a result of the rental income contribution from the Grade A office - 67 Gitanga Place that was acquired in May 2018, and a 40.2% increase in fair value gains on revaluation of investment property bolstered by the construction of a modern 3-screen Cinema at one its properties, the Greenspan Mall. Notable, net profit in 2018 grew by 13.1% to Kshs 193.5 mn, from Kshs 171.1 mn in FY'2017. The REIT manager recommended a Kshs 135.7 mn dividend to its unitholders at Kshs 0.75 per unit, realizing an 8.1% yield on its market price as at 29th March 2019, translating to a 70.1% pay-out ratio. The REIT recorded 1.6% points increase in dividend yield to 8.1% in 2018 from 6.5 % in 2017. The I-REIT's performance in terms of dividend yield at 8.1% is in line with the commercial real estate market average of 8.3%, with 8.5% rental yield for retail space and 8.0% yield for office space. However, the high yield is attributable to its declining stock price closing at Kshs 9.2 per unit as at 29th March 2019 in comparison to Kshs 11.6 as at 29th March 2018, representing a 20.3%

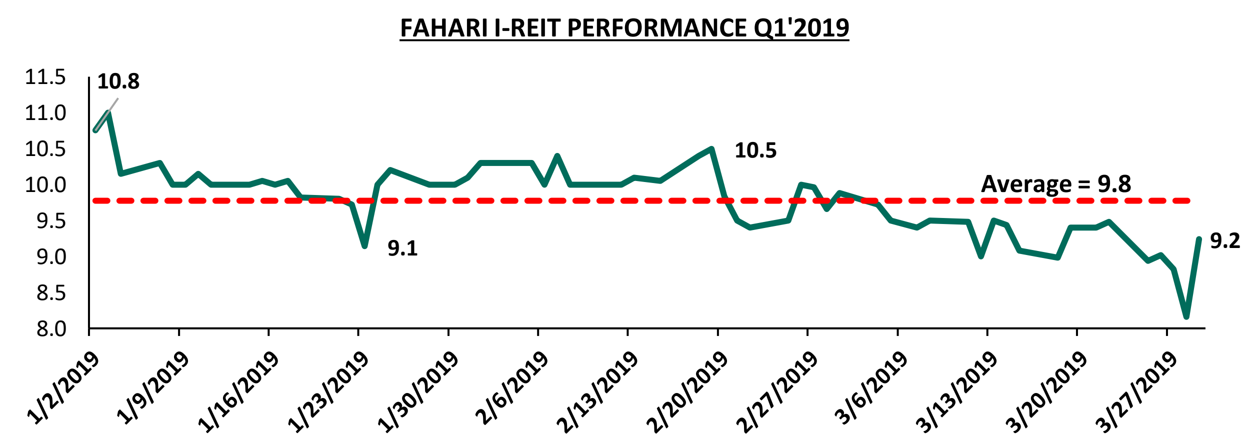
loss of value. The graph below highlights the performance of REIT compared to commercial real estate brick and mortar;



Source: Cytonn Research 2019

For a more comprehensive analysis on the REIT FY'2018 performance, see our Stanlib Fahari I-REIT Earnings Note - 2019.

During Q1'2019, the Stanlib's Fahari I-REIT share price declined by 14.8% closing at Kshs 9.2 per share, from Kshs 10.8 per share at the beginning of the year. The REIT traded at an average unit price of Kshs 9.8 in Q1'2019, 51.0% lower than its listing price of Kshs 20.0 in November 2015. In addition, Fahari I-REIT is trading at 55.1% discount to its net asset value of Kshs 20.6 as per FY'2018 reporting and we attribute this to the negative market sentiments around REITs performance.



Source: Bloomberg

Our outlook for Stanlib's listed real estate is negative as the performance is constrained by the continued lack of investor appetite for the instrument.

We retain a neutral outlook for the real estate sector mainly constrained by increased supply in the market and limited access to financing for both developers and off takers. The real estate sector <u>however</u> has pockets of value in themes such as housing for lower-middle to low-income earners in the residential sector, differentiated concepts such as serviced offices that attract yields of 13.4% such as Westlands, as well as areas with low supply of office space such as Gigiri and county headquarters driven by positive demographics, devolution and sustained infrastructural development.