Nairobi Metropolitan Area Commercial Office Report – 2021 "Market Under a Pandemic"

Cytonn

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I. Overview of Real Estate in Kenya

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Introduction to Real Estate in Kenya

Real estate has been adversely hit by the pandemic resulting in declining yields for investors

Factor	Characteristics
Macro-economic Contribution	• In 2020, the real estate sector grew by 4.0% on average from Q1'2020 to Q3'2020, which is 0.8% lower than the growth in the similar period of 4.8% in 2019, according to Kenya National Bureau of Statistics (KNBS) Quarterly Gross Domestic Product Report Q3'2020. The overall declines in the growth is attributed to the COVID-19 pandemic which impacted various sectors of the real estate coupled by declines in real estate activities
Recent Developments	• Notable buildings completed in 2020 include: The Millennium Business park (23,000 SQFT) in Lang'ata, Templeton House (33,132 SQFT) Westlands, Majani House (54,551 SQFT) in CBD, Capital Square in Westlands (101,000 SQFT), Delta Chambers in Westlands (132,979 SQFT), Central Bank Pension Building in CBD (180,000 SQFT) as well as Upperhill Chambers in Upperhill (270,000 SQFT) • On the affordable housing front, the governments initiative continues to take shape with the expected launch of the Buxton Project in Mombasa.
Real Estate Market outlook	• The overall outlook for the real estate sector is **NEUTRAL**, supported by; positive demographics, improving infrastructure, continued focus on the affordable housing font, and improved access to mortgages. The performance of the sector is likely to be constrained by the existing oversupply in the commercial office font and the retail sector, reduced consumer purchasing power brought about by the tough economic environment and reduced demand as businesses downsize especially in the commercial office sector and the retail sector.

Real Estate in Kenya –Contribution to GDP

Real Estate sector contribution to GDP increased by 1.1% points to 9.1% in Q3'2020 from 8.0% in Q'1 2020

	2018	2019	Q1'2020	Q3'2020
Agriculture	34.2%	34.1%	26.0%	19.7%
Manufacturing	7.8%	7.5%	10.0%	9.5%
Wholesale & Retail Trade	7.4%	7.6%	6.9%	8.7%
Hospitality & Tourism	0.8%	0.7%	1.3%	0.6%
Real Estate	7.0%	6.9%	8.0%	9.1%

Source: KNBS

II. Nairobi Metropolitan Area Commercial Office Report

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A. Introduction

Executive Summary

The Commercial Office sector's performance in 2020 softened recording a 0.5% points decline in rental yields to 7.0% from 7.5% in 2019

- 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 sector in Nairobi in 2020

- There was an over supply in office space in 2020 of 7.3mn SQFT an increase from the 6.3 mn SQFT that was recorded in 2019 attributed to reduced demand of physical office spaces as people embrace the working from home in bid to reduce the spread of the Coronavirus as well as business restructuring thus scaling down their operations

- The sector's overall performance softened recording average rental yields of 7.0%, 0.5% points lower than 7.5% recorded in 2019. Occupancy rates declined by 2.6% points to 77.7% in 2020, from 80.3%, in 2019

- In the submarket analysis, Gigiri, Westlands, Karen and Parklands were the best performers in 2020 recording rental yields of 8.5%, 7.8%, 7.8% and 7.6%, respectively, while Thika Road and Mombasa Road were the worst performers recording rental yields of 5.8% and 4.8%, respectively

- Grade B office spaces recorded the highest rental yields at 7.5% compared to Grade A and Grade C rental yields of 6.8% each. Grade B offices were the most common in the market with a market share of 57.8% in 2020 an increase of 5.7% from 52.1% in 2019

- We have a negative outlook for investments in the commercial office market in 2020, due to the oversupply of 7.3mn SQFT office space and the uncertainty brought about by the pandemic. Investments in the sector should, therefore, be aimed towards long-term gains when the market picks up

- Pockets of value in the sector exist in in zones with low supply and high returns such as Gigiri and in differentiated concepts such as the serviced offices with rental yields of 11.2% expected to boost the sector

NMA Commercial Office Report – Overview of the sector

The opportunity lies in differentiated concepts such as serviced offices recording rental yields of up to 11.2% compared to 7.0% for Unserviced offices

Value Area	Summary	Effect on The Office Market
Oversupply	• In 2019, the market had a supply of 6.7 mn SQFT against a demand of 0.3 mn SQFT resulting in an oversupply of 6.3 mn SQFT. The oversupply increased by 15.9% to 7.3 mn SQFT in 2020 as additional projects were completed but the demand reduced especially due to the effect of the pandemic	• Asking rents declined by 3.0% to an average of Kshs 93 per SQFT in 2020 from Kshs 96 per SQFT in 2019.
Returns	• Rental yields and occupancy rates declined by 0.5% points and 2.6% points, respectively to 7.0% and 77.7% in 2020 from 7.5% and 80.3%, respectively in 2020 due to the reduced demand due to the effects of the pandemic • The best performing nodes in the office sector were Gigiri, Westlands, Karen and Parklands with rental yields of 8.5%, 7.8, 7.8% and 7.6%, respectively, with Thika Road and Mombasa Road having the lowest yields at 5.8% and 4.8%, respectively	• The yields declined by 0.5% to 7.0% from 7.5% in 2019 • The current oversupply is expected constrain performance further with yields expected to soften even with the ongoing vaccinations of Corona Virus
Opportunity & Outlook	• We have a negative outlook for the commercial office theme in the Nairobi Metropolitan Area (NMA) given the increased office space supply and decline in performance in 2020 • Investments should be made in zones with low supply and high returns such as Gigiri and in differentiated concepts such as serviced offices recording rental yields of up to 8.3% in Q1'2020 compared to a market average of 7.0%	• A decline in occupancy rates by 2.6% points from 2019 and increased uptake in low supply areas due to landlords ability to negotiate prices as evidenced by a high occupancy of 80.4% in Gigiri compared to the market average of 77.7% in 2020

Key Factors Driving Office Market in Kenya

Nairobi's Strategic geo-positioning will enhance the growth of businesses in Kenya

Factor	Characteristics
Reinvention of commercial spaces	• Since the emergence of the pandemic in early 2020 which was followed by lockdown measures, companies restructured and adopted remote working which led to a decrease in occupancy levels in the commercial office sector. • There was also a need to redesign offices to open spaces so as to adhere to social distancing regulations as well as maximize the space thus bringing about the need for more office spaces. • In addition, the popularity of co-working office spaces is picking up as they are offering companies spaces on flexible terms,
Rise of Serviced Offices	• Serviced offices are becoming a trend in the modern market with clients since they offer furnished spaces for both long term and in the short term clients
Nairobi's recognition as a regional hub	• Nairobi's strategic geo-positioning and improving infrastructure sets it apart as a preferable regional hub for the East African Community and this has continued to enhance the growth of business and foreign investors who require office space to establish their businesses hence encouraging the demand for office spaces.

Challenges Affecting Office Sector

Office space oversupply stands is 7.3 mn SQFT as

Factor	Characteristics
The COVID-19 pandemic	• The Covid-19 Pandemic: The pandemic has adversely affected the growth of office sector as it led to reduced occupancies and uptake of spaces. During the year, occupancies dropped by 2.6% points, while yields dropped by 0.5% to 77.7% and 7.0% from 7.5% and 80.3% respectively, majorly attributable to the effects of the pandemic as businesses restructured hence scaling down,
Reduced Space Demand and Prices	• Office space oversupply stood at 7.3 mn SQFT in 2020, which has created a bargaining chip for tenants forcing developers to reduce or maintain prices and rents in order to remain competitive and attract occupants to their office spaces. • Covid-19 restrictions have led to reduced demand for space as firms lay off employees and adopt work from home measures which has subsequently caused a reduction in prices as landlords seek to negotiate in the existing circumstances,
Reduced Occupancy rates	• The restructuring of offices which incorporated remote working has led to reduced occupancy levels as companies sought to reduce the sizes of their offices to minimize spending on rental charges
Limited accessibility of funds	• Lack of proper funding for developments resulted in the use of expensive debts in the funding structure of most real estate developments with no exception of the commercial office sector. However, accessing loans for development has been a challenge as creditors are exercising a more conservative underwriting approach as a strategy to cushion themselves against the pandemic which is marked by high loan default rates.

Highlights in the Commercial Office Sector - 2021

Promenade Building received EDGE certification from GBCI in 2020

Highlight	Details
New Developments	• The market saw the opening of a number of office buildings including: Millennium Business Park in Lang'ata (23,000 SQFT), Upperhill Chambers (270,000 SQFT) in Upperhill, Majani House (54,551 SQFT) and Central Bank Pension Building (180,000 SQFT) both in CBD; Templeton House (33,132 SQFT), Capital Square (101,000 SQFT) and Delta Chambers (132,979 SQFT) all in Westlands • There is growing popularity of green developments with one major event in 2020 was that the Promenade, an office building based in Westlands received its EDGE Certification from GBCI (Green Business Certification Inc.) and has now incorporated resource-efficient design features and technologies aimed at supporting sustainability and efficient energy use even within the office environments

Source: Knight Frank, Cytonn Research

B. Commercial Office Supply in Nairobi

Commercial Office Space Supply-Nairobi

The commercial market was supplied with extra 0.8 mn SQFT of space in 2020

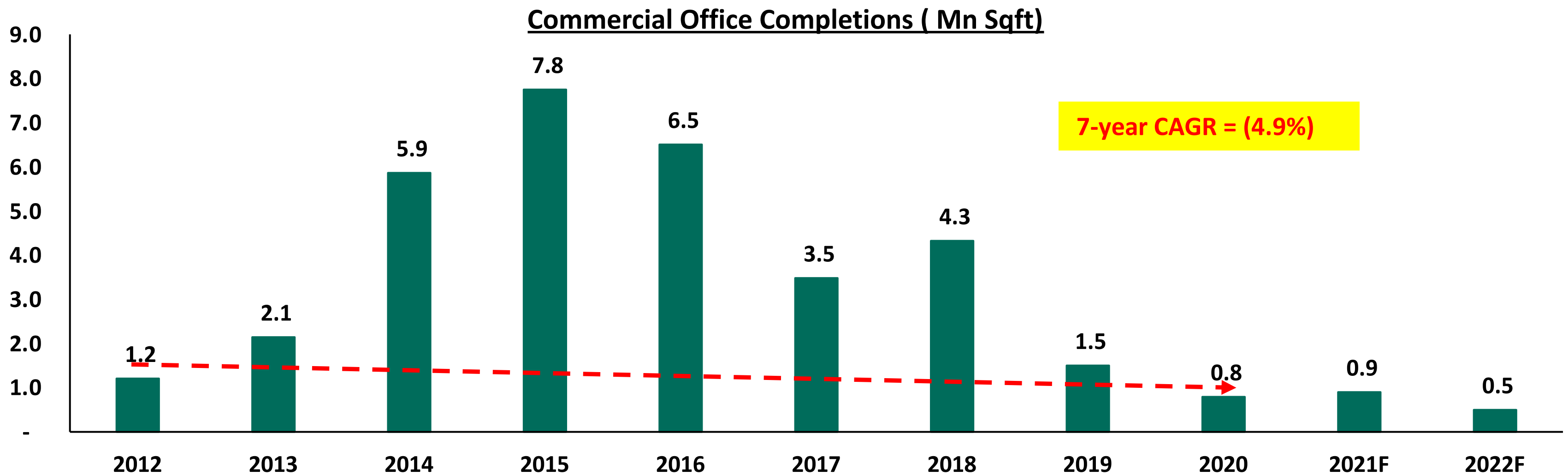
Major Commercial Office Completion in 2020			
#	**Office Development**	**Location**	**Size (SQFT)**
1	Millennium Business Park	Lang'ata	23,000
2	Templeton House	Westlands	33,132
3	Majani House	CBD	54,551
4	Capital Square	Westlands	101,000
5	Delta Chambers	Westlands	132,979
6	Central Bank Pension Building	CBD	180,000
7	Upperhill Chambers	Upperhill	270,000
Total			**794,662**

- The supply of new commercial space continued to rise in 2020 despite the pandemic with the completion of 7 buildings offering up to 0.8 mn SQFT of extra space in to the commercial market
- Three developments are in Westlands, two are in the CBD while Lang'ata and Upperhill had one commercial development for each
- This office supply is expected to increase going forward with few developments in the Pipeline with another expected 0.9 mn SQFT of space expected in 2021 from developments such as Global Trade Centre in Westlands, Riverside Square in Riverside and China Road and Bridge Corporation in Lang'ata

Source: Knight Frank, Cytonn Research

Commercial Office Space Supply-Nairobi

The commercial market was supplied with an extra 0.8 mn SQFT space in 2020

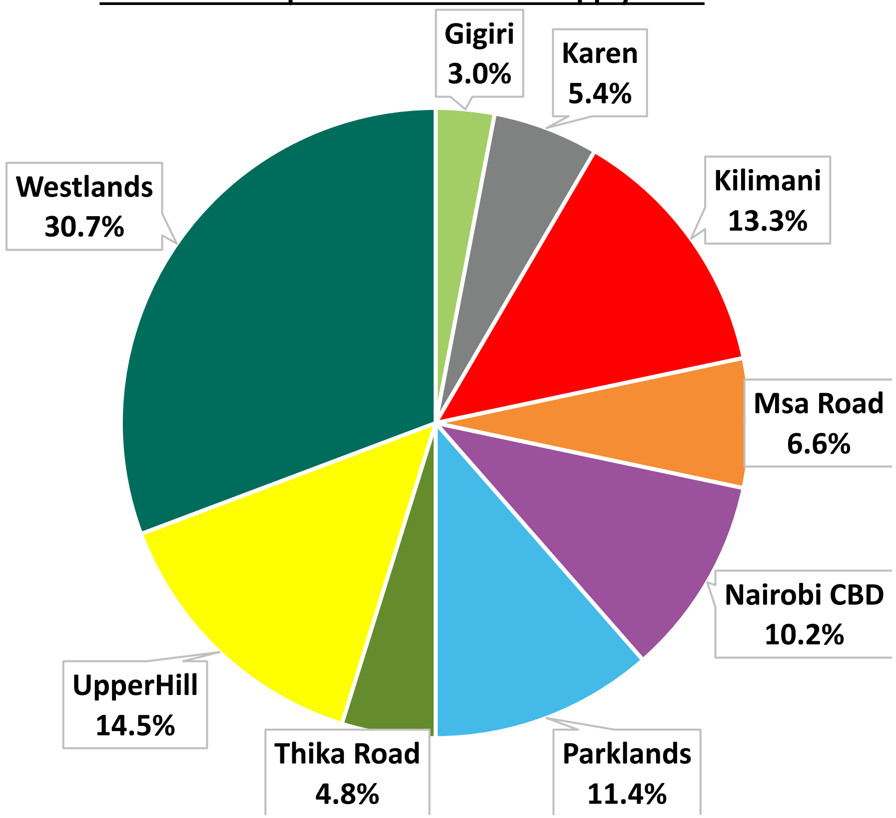


- The total office completions in Nairobi increased by approximately 0.8 mn SQFT in 2020, 46.7% lower than 1.5 mn SQFT in 2019,due to slowdown in construction activities due to limited access to credit as banks have been limiting their lending's to real estate due to high levels of loan defaults and restructuring
- Office space supply in 2020 saw a 7-year CAGR decline by 4.9% from 1.2 mn in 2012 to 0.8 mn in 2020 due to reduced activities and developers holding it back as they await the absorption of the current office spaces

Commercial Office Space Supply – Nairobi Continued…

Westlands and Upperhill had the highest office supply with market shares of 30.7% & 14.5%, respectively

Nairobi Metropolitan Area Office Supply 2020



Source: Cytonn Research 2021

- In 2020, Westlands, Upperhill and Kilimani had the largest supply of office space in Nairobi with market shares of 30.7%, 14.5% and 13.3%, respectively.
- Gigiri and Thika Road had the lowest supply with a market share of 3.0% and 4.8% respectively
- Westlands and Upperhill have grown as business nodes as firms move away from the CBD due to traffic congestion and in search of better quality space, hence the high supply
- Westlands, Mombasa Road, Upperhill and Nairobi CBD experienced completions of new office buildings in 2020

C. Commercial Office Market Performance

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Commercial Office Market Performance Summary

The commercial office sector performance softened in 2020 recording 0.5% points and 2.6% points y/y decline in average rental yields and occupancy rates

Year	2013	2015	2016	2017	2018*	FY' 2019	FY' 2020	y/y Δ 2019	y/y Δ 2020
Occupancy (%)	90.0%	89.0%	88.0%	82.6%	83.8%	80.3%	**77.7%**	(3.3%) points	**(2.6%) points**
Asking Rents (Kshs/SQFT)	95	97	97	101	101	96	**93**	(4.1%)	**(3.0%)**
Average Prices (Kshs/SQFT)	12,433	12,776	12,031	12,649	12,407	12,638	**12,280**	1.2%	**(2.8%)**
Average Rental Yields (%)	**8.3%**	**8.1%**	**8.5%**	**7.9%**	**8.3%**	7.5%	**7.0%**	(0.6%) points	**(0.5%) points**

- The commercial office sector performance softened in 2020 recording a 0.5% points decline in average rental yields to 7.0% from 7.5% in 2019. Occupancy rates declined by 2.6% points to 77.7% in 2020, from 80.3%, in 2019

- Asking rents and prices declined by 3.0% and 2.8% respectively to an average of Kshs 93 and Kshs 12,280 per SQFT in 2020 from per SQFT from Kshs 96 and Kshs 12,638 per SQFT, respectively in 2019. The subdued performance was largely driven by:
  - Increased supply with the introduction of 0.8 mn SQFT office space to the market resulting to reduced occupancies and hence an oversupply of 7.3 mn SQFT which has forced developers and landlords to reduce or maintain prices and rents in order to remain competitive and attract occupants to their office spaces, and,
  - The Covid -19 lockdown measures leading businesses to restructure their operations leading to lower demands for office space

Source: Cytonn Research 2020

i. Performance by Nodes

Major Commercial Office Nodes in the Nairobi Metropolitan Area

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

- *Key: 1. Karen 2. Kilimani 3. Upper Hill 4. Mombasa Road 5. CBD 6. Westlands & Parklands 7. Gigiri 8. Thika Road*

Nairobi Office Sub-Market Performance

Gigiri, Karen and Westlands were the best performers in 2020 recording rental yields of 8.5%, 7.8%, and 7.8%, respectively

Nodes	Price Kshs/SQFT 2020	Rent Kshs/SQFT 2020	Occupancy 2020 (%)	Rental Yields (%) 2020	Price Kshs/ SQFT 2019	Rent Kshs/SQFT 2019	Occupancy 2019(%)	Rental Yield (%) 2019	Δ in Rent	Δ in Occupancy (% points)	Δ in Rental Yields (% points)
Gigiri	13,401	116	82.5%	**8.5%**	13,833	117	80.4%	**9.2%**	(0.9%)	2.1%	**(0.7%)**
Karen	13,567	106	83.6%	**7.8%**	13,665	111	85.3%	**8.3%**	(4.6%)	(1.7%)	**(0.5%)**
Westlands	11,975	104	74.4%	**7.8%**	12,370	104	80.3%	**8.3%**	(0.3%)	(5.9%)	**(0.5%)**
Parklands	10,958	93	79.9%	**7.6%**	12,369	97	83.1%	**8.2%**	(4.9%)	(3.2%)	**(0.6%)**
Upperhill	12,684	92	78.5%	**6.9%**	12,397	98	80.0%	**7.5%**	(6.3%)	(1.5%)	**(0.6%)**
Nairobi CBD	11,889	82	82.4%	**6.8%**	12,425	89	85.6%	**7.1%**	(8.3%)	(3.2%)	**(0.3%)**
Kilimani	12,233	93	79.1%	**6.8%**	12,680	91	80.9%	**7.1%**	1.6%	(1.8%)	**(0.3%)**
Thika Road	12,500	80	76.1%	**5.8%**	12,600	84	80.4%	**6.3%**	(5.0%)	(4.3%)	**(0.5%)**
Msa Road	11,313	73	63.0%	**4.8%**	11,400	73	66.5%	**5.5%**	(0.2%)	(3.5%)	**(0.7%)**
Average	**12,280**	**93**	**77.7%**	**7.0%**	**12,638**	**96**	**80.3%**	**7.5%**	**(3.2%)**	**(2.6%)**	**(0.5%)**

Source: Cytonn Research 2021

- In 2020, Gigiri, Karen and Westlands were the best performers recording an average rental yield of 8.5%, 7.8%, and 7.8%, respectively, due to their superior locations leading to the possibility of charging premium rents and the availability of quality Grade A offices
- Thika Road and Mombasa Road were the worst performing nodes recording rental yields of 5.8% and 4.8%, respectively, attributed to poor location as a result of traffic congestions, and lower quality office spaces, that are generally unattractive to many businesses

Nairobi Office Market Performance, Continued…

Gigiri, Karen and Westlands were the best performers recording rental yields of 8.5%, 7.8%, and 7.8%, respectively

Gigiri

- Gigiri recorded average rental yields of 8.5% in 2020, a 0.7% points decrease from the 9.2% recorded in 2019. The decline in performance was driven by a 0.9% decline in rents. Despite the drop in rental yields, the area remains the best-performing node driven by its low supply of office space as well as its serene environment, security and quality Grade A offices making it attractive to multinational companies

Karen

- Karen recorded a 0.5% decline in the rental yields to 7.8% driven by a 4.6% and 1.7% points decline in rents and occupancy rates to Kshs 106 per SQFT and 83.6%, in 2020 from Kshs 111 per SQFT and 85.3% in 2019, respectively. This was attributed to reduction of rental rates by property managers in a bid to attract tenants and retain the existing ones amid the covid-19 pandemic

Westlands

- Westlands recorded average rental yields of 7.8% in 2020, a 0.5% points decrease from the 8.3% recorded in 2019. Rents declined by 0.3% to Kshs 103.7 in 2020 from Kshs 104.0 in 2019 and occupancy declined by 5.9% points from 80.3% in 2019 to 74.4% in 2020. This is attributable to new supply of office space with the completion of Delta Chambers (132,979 SQFT), Capital Square (101,000 SQFT) and Templeton House (33,132 SQFT) and the negative economic effects of the pandemic that led to lower occupancies

Nairobi Office Market Performance, Continued…

In 2020, Parklands, Upperhill and Kilimani recorded average rental yields of 7.6%, 6.9% and 6.8%, respectively

Parklands

- Parklands recorded an average rental yield of 7.6% in 2020, a 0.6% points decrease from the 8.2% recorded in 2019. This was driven by a 4.9% and 3.2% points decline in rents and occupancy rates mainly attributable to the adverse effects of the pandemic. However, the area still remains attractive due to its proximity to the CBD and Westlands, ample infrastructure and favourable zoning regulations facilitating densification

Upperhill

- Upperhill recorded a 0.6% points decline in the average rental yields which came in at 6.9% in 2020, from the 7.5% recorded in 2019. The decline in performance was driven by 6.3% and 1.5% points decline in rents and occupancy rates to Kshs 92 and 78.5% in 2020 from Kshs 98 and 80.0% in 2019 attributable to the existing oversupply of office space in the market and the completion of Upperhill Chambers (270,000 SQFT) which further increased supply in the area. The pandemic had negative economic effects on businesses which also led to increased vacancies leading to the decline in performance

Kilimani

- Kilimani recorded average rental yields of 6.8% in 2020, a 0.3% points decrease from the 7.1% recoded in 2019. Occupancy rates declined by 1.8% points to 79.1% in 2020 from 80.9% in 2019 attributed to declines in the occupancy rates in the area as the area faces competition from other office nodes such as Upperhill and Westlands

Nairobi Office Market Performance, Continued…

Mombasa Rd's rental yield was 2.2% points lower than the market average making it the worst performing node

Nairobi CBD

- The Nairobi CBD recorded a 0.3% point decline the average rental yields to 6.8% in 2020 from 7.1% in 2019. This was driven by 3.2% points decline in occupancy to 82.4% in 2020 from 85.6% in 2019 attributable to the adverse effects of the pandemic that led to businesses closing down and relocation by multinational firms to other nodes offering serene environment and quality office spaces. Rents also declined by 8.3% to Kshs 82 from Kshs 89 in 2019 attributable to the decreased occupancy rates that led to downward price adjustments

Thika Road

- Over the last three years, Thika Road has established itself as an upcoming office zone offering quality grade B offices. The node, however, recorded a 0.5% points decline in performance recording rental yields of 5.8% in 2020 from 6.3% in 2019. The decline in performance was driven by a 5.0% and 4.3% points decline in asking rents and occupancy rates respectively mainly attributable to the adverse economic effects of the pandemic

Mombasa Road

- Mombasa Road registered a 0.7% point decline in performance recording average rental yield of 4.8% in 2020 from 5.5% in 2019. It was the worst performer, recording 2.2% points lower than the market average of 7.0% attributed to its zoning for industrial use and lower quality office space as well as the impact of the pandemic in 2019. The increased traffic snarl-ups has also affected the performance of the area

ii. Performance by Grades

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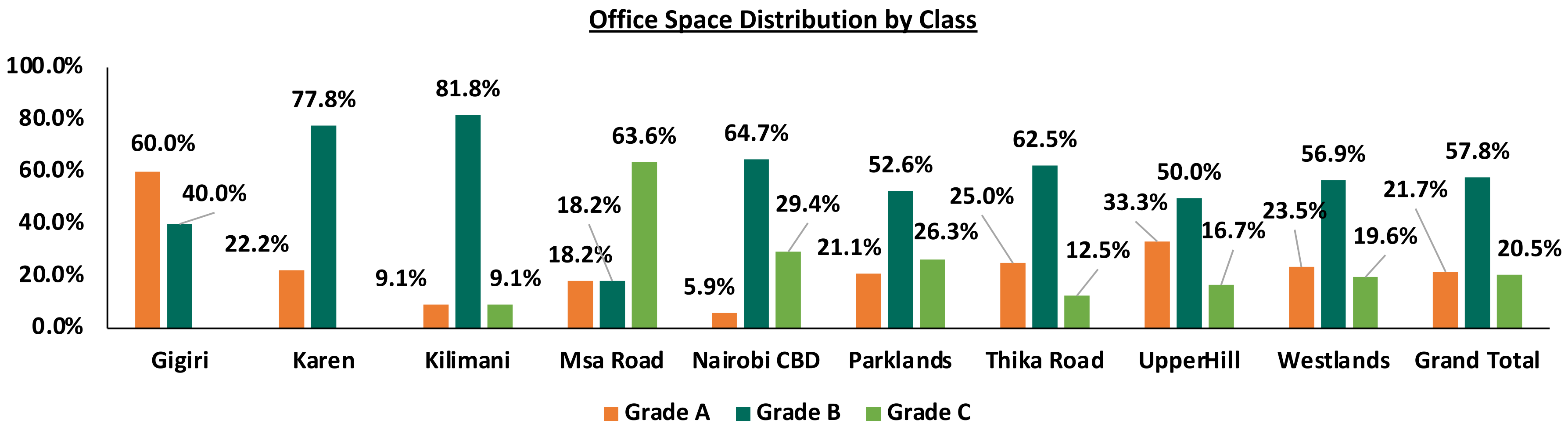
Classification of Offices in Nairobi

Kenya has various types of offices according to the global classification

- **Grade A:** Office buildings with a total area ranging from 100,001 - 300,000 SQFT that are pacesetters in establishing rents and that generally have ample natural good lighting, good views, prestigious finishing, and on-site undercover parking, and a minimum parking ratio of 3:1000 SQFT,
- **Grade B:** Office buildings with a total area ranging from 50,000 to 100,000 SQFT. They have good (but lower than Grade A) technical services and ample parking space, and,
- **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

Distribution of Various Classes Offices

Grade B offices are the most common within the NMA, accounting in 57.8%



- **The market has witnessed an increase in Grade A office supply** with offices such as Capital Square (101,000 SQFT), Delta Chambers (132,979 SQFT), Central Bank Pension Building (180,000 SQFT) and Upperhill Chambers (270,000 SQFT) coming into the market. The current market share of Grade A offices is 21.7%, a 17.1% decrease from 2019 when the market share was 38.8%

- **From our sample, Grade B office spaces still account for a majority office spaces** in Nairobi with a market of 57.8%, an increase of 5.7% from 2019 when the market share was 52.1%

- **For the individual nodes, Gigiri has the highest percentage of its offices being Grade A at 60.0%.** Kilimani has the highest percentage of its offices being Grade B at 81.8%

Performance of the Various Offices by Class

Grade B office spaces had the highest rental yields at 7.5%

Office Grade	Price 2020 Kshs/SQFT	Rent 2020 Kshs/SQFT	Occupancy 2020 (%)	Rental Yield 2020	Price 2019 Kshs/ SQFT	Rent 2019 (Kshs/SQFT)	Occupancy 2019 (%)	Rental Yield 2019(%)	Δ Rent Y/Y	Δ Occupancy Y/Y (% points)	Δ Rental Yield Y/Y (%points)
Grade A	13,628	101	76.3%	**6.8%**	12,860	105	73.8%	**7.4%**	(3.8%)	2.5%	**(0.6%)**
Grade B	12,202	96	78.7%	**7.5%**	12,706	99	82.7%	**7.9%**	(3.1%)	(4.0%)	**(0.4%)**
Grade C	10,721	85	74.3%	**6.8%**	10,920	82	80.4%	**7.2%**	3.1%	(6.1%)	**(0.4%)**
Average	**12,167**	**95**	**77.4%**	**7.2%**	**12,552**	**97**	**80.5%**	**7.7%**	**(1.5%)**	**(2.5%)**	**(0.5%)**

- The performance across the three offices grades declined with the average yields on the Grade A, Grade B and Grade C decline to 6.8%, 7.5% and 6.8% from 7.4%, 7.9% and 7.2% respectively.
- Grade B office spaces had the highest rental yields at 7.5% as tenants prefer them because of their cheaper rents as compared to grade A office while having decent technical services (not as good as those of grade A) and ample security
- Grade A offices recorded an overall increase in occupancy rates by 2.5% points in 2020 to 76.3% from 73.8% in 2019. Grade A offices recorded the largest drop in the average rental rates by 3.8% points which led to the largest drop in rental yields by 0.6% points compared to grade B and C offices which both recorded declines of 0.4% points.

iii. Performance by Nodes & Grades

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Performance by Nodes and Grades

For Grade B spaces, Gigiri and Parklands offer the highest rental yield of 8.6% and 8.5%, respectively

Commercial Office Performance in 2020 by Nodes and Grades						
Typology	Grade A		Grade B		Grade C	
Location	Rental Yield (%)	Occupancy (%)	Rental Yield (%)	Occupancy (%)	Rental Yield (%)	Occupancy (%)
Gigiri	8.4%	80.5%	8.6%	85.6%	8.5%	82.5%
Karen	7.6%	85.0%	7.9%	83.1%	7.8%	83.6%
Kilimani	7.4%	79.0%	6.7%	78.9%	6.8%	79.1%
Msa Road	3.9%	60.0%	6.0%	70.0%	4.8%	63.0%
Parklands	7.3%	76.7%	8.5%	78.1%	7.6%	79.9%
Thika Road	6.7%	85.0%	5.5%	73.6%	5.8%	76.1%
UpperHill	6.4%	72.1%	6.9%	81.2%	6.9%	78.5%
Westlands	6.3%	76.3%	8.2%	75.7%	7.8%	74.4%
Nairobi CBD			6.8%	84.5%	6.8%	82.4%

- In 2020, Grade A offices in Gigiri and Karen offered the highest returns with average rental yields of 8.4% and 7.6%, respectively, as they enjoy a superior locations characterized by serene environment attracting high-end clients and premium rental rates.
- The Grade B offices in Gigiri and parklands had the highest rental yields of 8.6% and 8.5%, respectively. In the Grade C category, Gigiri, had the best returns with average rental yields being 8.5% while Westlands and Karen came in at the second place with both offering average rental yields of 7.8%.

iv. Serviced Offices Performance

Serviced Offices Performance

Serviced offices recorded yields of 11.2%, 4.4% points higher than the un-serviced offices' yield of 7.0%

Location	Revenue Per SQFT		Occupancy (%)		Yield	
	Serviced Offices	Un-serviced Offices	Serviced Offices	Un-serviced Offices	Serviced Offices	Un-serviced Offices
Westlands	**204**	93	**81.2%**	79.9%	**15.9%**	7.6%
Karen	**186**	104	**70.0%**	74.4%	**14.8%**	7.8%
Parklands	**174**	106	**68.6%**	83.6%	**13.2%**	7.8%
Gigiri	**181**	116	**80.0%**	82.5%	**12.4%**	8.5%
Upperhill		92		78.5%		6.9%
Kilimani	**190**	82	**65.0%**	82.4%	**10.8%**	6.8%
Nairobi CBD	**160**	93	**59.3%**	79.1%	**8.5%**	6.8%
Msa Rd	**105**	73	**50.0%**	63.0%	**7.0%**	4.8%
Thika Rd	**116**	80	**52.5%**	76.1%	**6.6%**	5.8%
Average	**161**	**93**	**65.8%**	**77.7%**	**11.2%**	**7.0%**

- In 2020, serviced offices recorded yields of 11.2%, 4.2% points higher than the un-serviced offices' yield of 7.0%. This is attributed to the attractiveness of the office setup to small businesses, start-ups and freelancers due to; (i) flexibility of the leases, (ii) no set-up costs required, and, (iii) opportunities for collaboration with other individuals/businesses in a competitive working environment.
- Westlands and Karen were the best performing nodes recording rental yields of 15.9% and 14.8%, compared to 7.6% and 7.8% for Unserviced offices respectively in the same areas.

D. 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

- Gap analysis is a tool that measures the under or oversupply situation of an office market using demand and supply dynamics
- To gauge the supply situation in Nairobi, we used the **Gap Analysis**
- **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 it 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 2020, the market had a supply of 7.1 mn SQFT against a demand of (0.2) mn SQFT resulting in an oversupply of 7.3 mn SQFT assuming a 2 year lag between building approvals and completion of construction**
- Office space supply has grown at 9-year CAGR of 21.3% to 36.4 mn SQFT in 2020 from 6.7 mn SQFT in 2011

Office Space Opportunity

In 2020, the commercial office sector had an oversupply of 7.3 mn SQFT

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022 F	7 year CAGR
Stock (Mn Sqft)	6.7	7.7	9.7	15.4	22.9	28.9	31.8	35.5	36.3	**36.4**	37.2	38.1	**21.3%**
Completions (Mn Sqft)		**1.2**	**2.1**	**5.9**	**7.8**	**6.5**	**3.5**	**4.3**	**1.5**	**0.8**	**0.9**	**0.5**	**(5.1%)**
Vacancy Rate (%)	9.0%	9.0%	10.0%	10.0%	11.0%	12.0%	16.8%	16.7%	19.5%	**22.3%**	23.9%	25.6%	**12.0%**
Vacant Stock (Mn Sqft)	0.6	0.7	1.0	1.5	2.5	3.5	5.3	5.9	7.1	**8.1**	9.0	9.5	**35.9%**
Occupied Stock (Mn Sqft)	6.1	7.1	8.8	13.9	20.3	25.4	26.5	29.6	29.2	**28.3**	28.3	28.1	**18.9%**
Net Absorption		**1.0**	**1.7**	**5.1**	**6.5**	**5.1**	**1.0**	**3.1**	**(0.4)**	**(1.0)**	**(0.2)**	**(0.3)**	
Demand		1.1	1.9	5.3	6.8	5.6	1.6	3.7	0.4	**(0.2)**	0.9	1.0	
Available Supply, AS(T)		1.7	2.6	6.5	8.8	8.4	6.3	9.0	6.7	**7.1**	8.8	9.2	**19.9%**
Gap, GAP(T)		**(0.5)**	**(0.8)**	**(1.2)**	**(2.1)**	**(2.9)**	**(4.7)**	**(5.2)**	**(6.3)**	**(7.3)**	**(7.9)**	**(8.2)**	**38.5%**

Over(Under)supply= Demand - Available supply

Source: KNBS, NCG Completions data, Cytonn Research

Office Space Opportunity

Opportunity in the sector is in serviced offices, in zones with low supply and in new markets such as county headquarters with low supply of office space

Concept/Market Niche	Characteristics
Mixed-Use Developments	• Mixed-Use Development (MUD) refers to a real estate development containing more than one real estate theme • They have attractive returns with average rental yields of up to 7.1%. Such developments will increase the occupancy rates of the building and hence the returns to the investor
Serviced Offices	• In 2020, serviced offices recorded yields of 11.2%, 4.2% points higher than the un-serviced offices' yield of 7.0% • They will not only increase investor's returns, but also diversify their portfolio
Low Supply Zones	• Despite the oversupply in the market, some zones still have relatively low supply and high returns such as Gigiri with a market share of 3.0% and a rental yield of 8.5% and are hence a good investment opportunity
New Markets	• New Markets to invest in are Gigiri and parklands that have continued to perform well amid the relaxation of zoning regulations paving way for development of office spaces as these are regarded as residential zones

E. Office Market Conclusion and Outlook

Office Market Conclusion and Outlook

We have a negative outlook for the commercial office sector with the current oversupply of 7.3 mn affecting the demand

Nairobi Commercial Office Outlook				
Measure	**2019 Sentiment**	**2020 Sentiment and 2021 Outlook**	**2020 Review**	**2021 Outlook**
Supply	• We had an oversupply of 6.3 mn SQFT of office space in 2019, which was expected to grow by 1.9% to 6.5 mn SQFT in 2020, due to reduced activity as a result of the COVID-19 pandemic and delay of approvals by the Nairobi County Government	• We had an oversupply of 7.3 mn SQFT of office space in 2020, and it is expected to grow by 1.1% to 8.0 mn SQFT in 2021, due to educed occupancy rates brought about by reduced demand as people adopt the working from home alongside the incoming supply which is expected to affect the occupancy rates	Negative	Negative
Demand	• There was reduced demand for office space in the Nairobi Metropolitan Area (NMA) evidenced by the 3.3% y/y decline in occupancy mainly attributable to an oversupply and minimal growth in private sector credit. However, there existed demand in differentiated concepts such as serviced offices from start-ups and multinational firms due to their ability to offer flexible lease agreements and office space	• There was reduced demand for office space in the Nairobi Metropolitan Area (NMA) evidenced by the 1.3% y/y decline in the average occupancy rates mainly attributable to an oversupply. investment opportunity lies in differentiated concepts such as serviced offices offering yields of up to 11.2% compared to 7.0% average rental yields of Unserviced materials	Neutral	Neutral
Office Market Performance	• Performance softened in 2019 recording 0.7% points and 3.3% points y/y decline in average rental yields and occupancy rates, to 7.7% and 80.5% in 2019, from 8.3%and 83.8%, in 2018	• The commercial office sector performance softened in 2020 recording a 0.5% points decline in average rental yields to 7.0% in 2020 from 7.5% in 2019. The average occupancies also declined in 2020 coming in at 77.7%, a 2.6%points decline from 80.3% in 2019. In 2020, we expect average rental prices to drop slightly over the short term due to downward pressure arising from the decline in effective demand from the existing oversupply in the market, and the COVID-19 effects that has caused decline in occupancy rates and yields	Negative	Negative

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