Nairobi Metropolitan Area Commercial Office Report – 2020 "Supply-Driven Market"

Cytonn

Date: April 26th, 2020

Table of Contents

I. Overview of Real Estate in Kenya

Cytonn

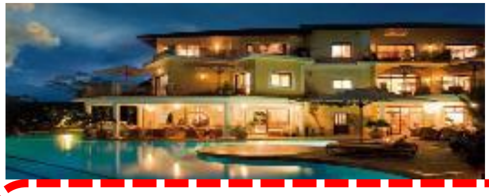
Introduction to Real Estate in Kenya

Real estate has consistently outperformed other asset classes in the last 5 years, generating returns of on average 20.1% p.a

Factor	Characteristics
Macro-economic Contribution	• In 2019, the real estate sector grew by 4.8% on average from Q1'2019 to Q3'2019, 0.3% points higher than the growth rate recorded over the same period in 2018, according to Kenya National Bureau of Statistics (KNBS) Quarterly Gross Domestic Product Report Q3'2019 • The growth was attributed to an improving macroeconomic environment in 2018 and 2019, with the country's GDP growing by 6.3% in 2018, 1.4% points higher than the 4.9% recorded in 2017 and expected to come in at 6.0% and 6.1% in 2019 and 2020, respectively as per the World Bank
High Returns	• Real estate has consistently outperformed other asset classes in the last 5 years, generating returns of on average 20.1% p.a., compared to an average of 8.7% p.a. in the traditional asset classes • In Q1'2020, the sector recorded rental yields of 7.8%, 7.7%, 7.6%, 7.3% and 5.2% in commercial office, retail, MUDs, serviced apartments, and residential sectors, respectively
Recent Developments	• Opening of business offices by multinational corporations: Cigna, a global health service company, MAC Mobile, a FMCG technology solutions company, and Mauritius Commercial Bank (MCB) Group at the UNON Complex in Gigiri, 3 Mzima Springs Road in Kileleshwa and Pramukh towers in Westlands, respectively • Other notable buildings completed in 2019 include: The Arch Place in Kilimani (120,000 SQFT), 19 Kabasarian Avenue (76,600 SQFT) in Lavington, The Address (243,000 SQFT) and Laxcon Plaza (100,000 SQFT) in Westlands
Market Outlook	• Our outlook for the sector is neutral as Coronavirus pandemic takes its toll on sectors such as hospitality and retail and the economic growth in general. Additionally, the sector also continues to be constrained by limited access to financing for both developers and off takers. However, we expect the market to be cushioned by the constant housing deficit, infrastructural development, and government efforts to improve processes in the built environment in a bid to improve Kenya's ease of doing business • The real estate sector has pockets of value especially housing for lower-middle to low-income earners in the residential sector, serviced apartments, and Mixed-Use Developments (MUDs)

Real Estate in Kenya –Contribution to GDP

Real Estate and construction sectors contribution to GDP increased by 0.9% points to 12.2% in Q3'2019 from 11.3% in Q'1 2019

	Sector	2010	2018	Q1'2019	Q3'2019
	Agriculture	24.8 %	34.2 %	40.2 %	36.5 %
	Manufacturing	11.3 %	7.7 %	7.5 %	7.7 %
	Wholesale & Retail Trade	7.7 %	7.4 %	6.3 %	6.8 %
	Hospitality & Tourism	1.7 %	1.3 %	0.7 %	0.5 %
	Real Estate & Construction	12.8 %	12.4 %	11.3 %	12.2 %

Source: KNBS

II. Nairobi Metropolitan Area Commercial Office Report

A. Introduction

Executive Summary

The Commercial Office sector's performance softened recording a 0.7% points decline in rental yields

- 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 2019
- In 2019, 1.5 mn SQFT of office space was delivered in Nairobi with an average occupancy level of 80.5%
- This resulted in a supply of 6.7 mn SQFT against a demand of 0.3 mn SQFT and thus an oversupply of 6.3 mn SQFT. The oversupply was 21.6% higher than in 2018 at 5.2 mn SQFT. Assuming current occupancy levels persist, we expect a 1.9% increase in oversupply to 6.5 mn SQFT in 2020
- The sector's overall performance softened recording a 0.7% points decline in average rental yields to 7.7% in 2019 from 8.3% in 2018. Occupancy rates declined by 3.3%-points to 80.5% in 2019, from 83.8%, in 2018
- In the submarket analysis, Gigiri, Karen and Westlands were the best performers in 2019 recording rental yields of 9.2%, 8.3%, and 8.3%, respectively, while Thika Road and Mombasa Road were the worst performers recording rental yields of 6.3% and 5.5%, respectively
- Grade B office spaces recorded the highest rental yields at 7.9% compared to Grade A and Grade C rental yields of 7.4% and 7.2%, respectively. Grade B offices were the most common in the market with a market share of 52.1%
- We have a negative outlook for investments in the commercial office market in 2020, due to the oversupply of office space and the uncertainty brought about by the novel Coronavirus 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 MUDs and serviced offices recording rental yields of up to 7.9% and 12.3%, respectively, to boost returns

NMA Commercial Office Report – "*Spurring Sectoral Growth*"

The opportunity lies in differentiated concepts in differentiated concepts such as MUDs and serviced offices recording rental yields of up to 7.9% and 12.3%, respectively

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. We expect the oversupply to increase by 1.9% to 6.5 mn SQFT in 2020	• Asking rents declined by 4.3% to an average of Kshs 97 per SQFT from Kshs 101 per SQFT in 2018.
Returns	• Rental yields and occupancy rates declined by 0.7% points and 3.3% points, respectively to 7.7% and 80.5% in 2019 from 8.3% and 83.8%, respectively in 2018 due to the reduced demand attributed to minimal private sector growth • The best performing nodes in the office sector were Gigiri, Karen and Westlands with rental yields of 9.2%, 8.3 and 8.3%, respectively, with Thika Road and Mombasa Road having the lowest yields at 6.3% and 5.5%, respectively	• The yields were less attractive at 7.7% compared to sector average at 8.9% • The current oversupply is expected constrain performance further with yields expected to soften
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 expected stagnation in performance in 2020 depending on how fast the Coronavirus is contained. • Investments should be made in zones with low supply and high returns such as Gigiri and in differentiated concepts such as MUDs and serviced offices recording rental yields of up to 7.9% and 12.3%, respectively	• A slowdown in building approvals and construction activities allowing the existing demand to absorb the current supply

The opportunity lies in in differentiated concepts such as MUDs and serviced offices recording rental yields of up to 7.9% and 12.3%, respectively

Key Factors **Driving** Office Market in Kenya

Nairobi as a Regional Hub, Devolution, and growth of SMEs are some of the factors driving the Office Market

Factor	Characteristics
Kenya's Growing Presence as a Regional Hub	• Kenya's ranking in the World Bank Ease of doing Business Report, has improved over time, improving by 19 positions to #61 in 2019, from #80 in 2018, and to #56 in 2020. The continued rise in ranking is attributed to continued strengthening of access to credit, protection of minority investors and ease of paying taxes by merging all permits into a single unified business permit • In 2020, Nairobi was ranked #4 in JLL's City Momentum Index, as world's most dynamic city economies attributable to favourable demographics, infrastructure investment, technology, tourism and retail. This was up 2 positions from #6 in 2019 and is set to attract foreign direct investments
Increased Entry of Multinational Corporations	• Demand for office spaces has persistently increased over time due to the entry of multinational corporations, therefore leading to increased development of commercial office spaces • Some of the multinational corporations that opened regional offices in 2019 include: Cigna, a global health service company, MAC Mobile, a FMCG technology solutions company, Mauritius Commercial Bank (MCB) Group and Abbott, a US-based healthcare company at the UNON Complex in Gigiri, 3 Mzima Springs Road in Kileleshwa, Pramukh towers in Westlands, and Watermark Business Park in Karen, respectively
Growth of Small and Medium Sized Enterprises (SMEs)	• SMEs contributed to approximately 45% of Kenya's GDP, 80% of employment in Kenya and constituted 98% of businesses locally according to a CNBC News Report 2014 and are thus a key driver for the commercial office sector.

Challenges Affecting Office Sector

Office space oversupply stood at 6.3 mn SQFT in 2019

Factor	Characteristics
Accessibility to Finance	• There was insufficient access to financing with private sector credit growth coming in at 7.1% in December 2019 compared to a 5-year (2013-2018) average of 14.0%. • Lack of proper funding for developments resulted in the use of expensive debts in the funding structure that affected the supply of office spaces due to its capital intensive nature
Oversupply	• Office space oversupply stood at 6.3 mn SQFT in 2019, 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
Delay in the Processing of Construction Permits	• Delays in the processing of construction permits by some county governments such as Nairobi and Kiambu, affected developers by prolonging project implementation timelines.
Insufficient Infrastructure	• The rate of real estate development and increased commercial activity has by far exceeded the rate of infrastructural improvement causing strains on the trunk infrastructure driving up real estate development costs as developers resort to financing any infrastructural inadequacies
Economic Slowdown	• Real GDP grew by an estimated 5.9% in 2019, driven by household consumption and investment on the demand side and services on the supply side (such as public administration, information technology, finance and insurance, and transport and storage) • GDP was down from 6.5% in 2018, caused mainly by unfavourable weather and reduced government investment

Highlights in the Commercial Office Sector - 2019

In 2019, I&M Bank relocated their head office from the Nairobi CBD to Parklands

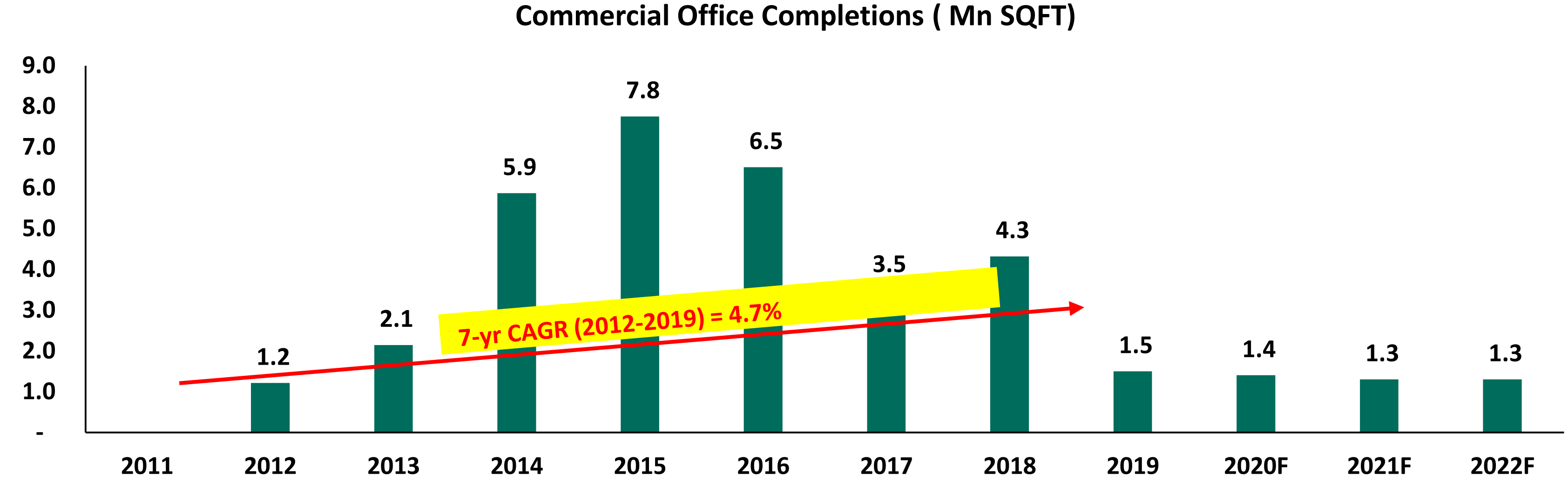
Highlight	Details
New Developments	• The market saw the opening of a number of office buildings including: The Arch Place in Kilimani (120,000 SQFT), 19 Kabasarian Avenue (76,600 SQFT) in Lavington, The Address (243,000 SQFT) and Laxcon Plaza (100,000 SQFT) both in Westlands; Merchant square (165,000 SQFT), Capital Square (101,000 SQFT) and Park Medical Centre in Parklands • Garden City, a mixed-use development on Thika Road opened their office development, dubbed 'The Garden City Business Park' with a total lettable space of approximately 134,000 SQFT • The market also witnessed the construction of more office blocks such as Kenya Institute of Supplies Management(KISM) Headquarters on Ngong Road which was completed during the review period. The 17-story development sits on half an acre of land comprises 105,000 SQFT of high quality office space, 148 car park bays
Business Relocations	• I&M Bank relocated their head office from the Nairobi CBD to 1 Park Avenue building located in Parklands and has a total lettable space of approximately 163,000 SQFT spread across eight floors • East African Breweries Limited (EABL), a local alcoholic beverages manufacturer, relocated from its Ruaraka offices to the Garden City business park

B. Commercial Office Supply in Nairobi

Cytonn

Commercial Office Space Supply-Nairobi

Total office stock in Nairobi increased by approximately 1.5 mn SQFT in 2019

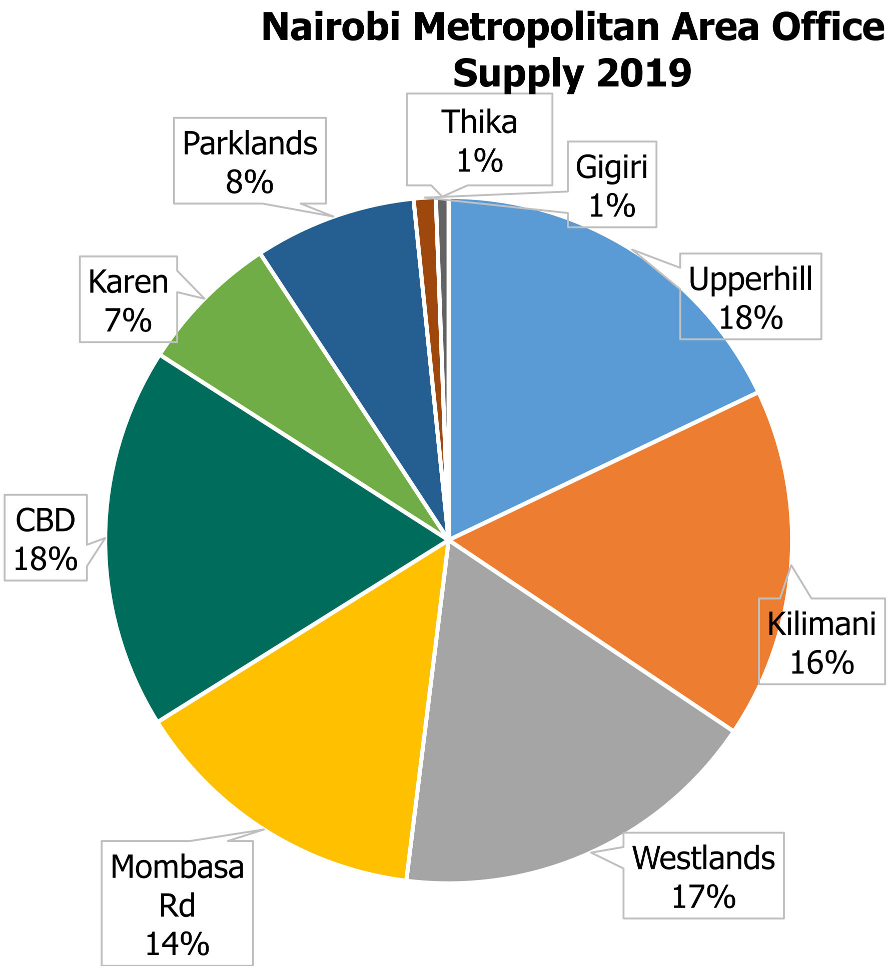


- The total office completions in Nairobi increased by approximately 1.5 mn SQFT in 2019, 65.1% lower than 4.3 mn SQFT in 2018, due to delay in issuance of approvals by the Nairobi County Government and a slowdown in construction activities
- Office space supply has grown at 7-year CAGR of 24.7% to 36.3 mn SQFT in 2019 from 7.7 mn SQFT in 2012 driven by the positioning of Nairobi as a regional hub, thus increased entrance of multinationals as well as the growth of Small and Medium Enterprises (SMEs)
- Over the next few years we expect reduced rate of supply to a 2-year CAGR of 6.9% attributed to a market correction as the forces of demand and supply come into play

Source: Nairobi Building Approvals Data from Nairobi City

Commercial Office Space Supply – Nairobi Continued…

Upperhill, CBD and Westlands had the largest supply, with market shares of 18.0%, 17.9% and 17.6%, respectively



- In 2019, the CBD, Upperhill and Westlands had the largest supply of office space in Nairobi with market shares of 18.0%, 17.9% and 17.6%, respectively, while Gigiri and Thika Road had the lowest supply with a market share of 1.0% and 0.6%, respectively
- Westlands and Kilimani have grown as business nodes as firms move away from the CBD and Upperhill due to traffic congestion and in search of better quality space, hence the high supply

Source: Cytonn Research

C. Commercial Office Market Performance

Cytonn

Commercial Office Market Performance Summary

The commercial office sector performance softened in 2019 recording 0.7% points and 3.3% points y/y decline in average rental yields and occupancy rates

Year	2013	2015	2016	2017	2018*	2019	y/y Δ 2018	y/y Δ 2019
Occupancy (%)	90.0%	89.0%	88.0%	82.6%	83.8%	**80.5%**	1.2% points	**(3.3%) points**
Asking Rents (Kshs/SQFT)	95.0	97.0	97.0	101.0	101.4	**97.2**	0.4%	**(4.1%)**
Average Prices (Kshs/SQFT)	12,433	12,776	12,031	12,649	12,407	**12,552**	(1.9%)	**1.2%**
Average Rental Yields (%)	**8.3%**	**8.1%**	**8.5%**	**7.9%**	**8.3%**	**7.7%**	0.4% points	**(0.7%) points**

**Average rental yields for 2018 restated to include additional 2018 office completions*

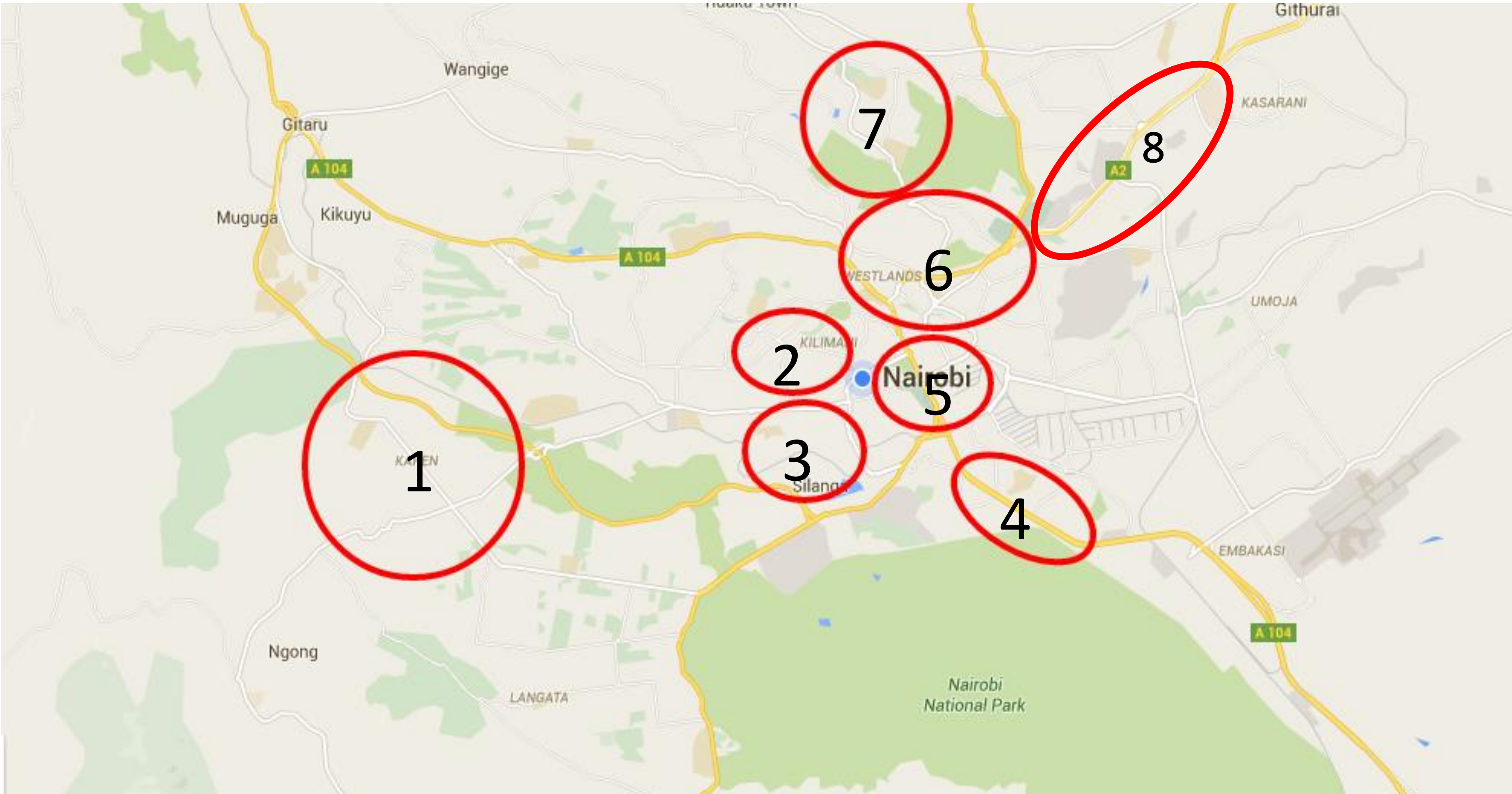
- The commercial office sector performance softened in 2019 recording a 0.7% points decline in average rental yields to 7.7% in 2019 from 8.3% in 2018. Occupancy rates declined by 3.3% points to 80.5% in 2019, from 83.8%, in 2018
- Asking rents and prices declined by 4.3% and 1.2%, respectively to an average of Kshs 97.2 and Kshs 12,552 per SQFT in 2019 from per SQFT from Kshs 103.0 and Kshs 12,719 per SQFT in 2018. The subdued performance was largely driven by:
  - An introduction of 1.5 mn SQFT office space to the market resulting to an oversupply of 6.3 mn SQFT which has created a bargaining chip for potential tenants, forcing developers and landlords to reduce or maintain prices and rents in order to remain competitive and attract occupants to their office spaces, and,
  - A decline in uptake of office space attributed to minimal growth in private sector credit, leading to downsizing or business closures, especially for small and medium-sized enterprises (SMEs)

Source: Cytonn Research 2019

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 2019 recording rental yields of 9.2%, 8.3%, and 8.3%, respectively,

Nodes	Price Kshs/ SQFT 2019	Rent Kshs/ SQFT 2019	Occupancy 2019(%)	Rental Yield (%) 2019	Price Kshs/ SQFT 2018	Rent Kshs/S QFT 2018	Occupancy 2018(%)	Rental Yield (%) 2018	Δ Rent Y/Y	Δ Occupancy Y/Y (% points)	Δ Rental Yields Y/Y (% points)
Gigiri	13,833	117	80.4%	9.2%	13,833	123	85.0%	10.0%	(5.1%)	(4.6%)	**(0.8%)**
Karen	13,665	111	85.3%	8.3%	13,666	118	88.6%	9.2%	(6.5%)	(3.2%)	**(0.9%)**
Westlands	12,370	104	80.3%	8.3%	12,050	110	82.1%	9.0%	(5.2%)	(1.8%)	**(0.7%)**
Parklands	12,369	97	83.1%	8.2%	12,494	102	86.0%	8.4%	(4.8%)	(2.9%)	**(0.2%)**
UpperHill	12,397	98	80.0%	7.5%	12,560	100	84.0%	8.2%	(1.3%)	(4.0%)	**(0.7%)**
Kilimani	12,680	91	80.9%	7.1%	13,173	99	88.3%	8.0%	(8.5%)	(7.4%)	**(0.9%)**
Nairobi CBD	12,425	89	85.6%	7.1%	10,875	82	88.3%	7.6%	(7.5%)	(2.7%)	**(0.5%)**
Thika Road	12,600	84	80.4%	6.3%	12,517	86	81.5%	6.7%	(2.4%)	(1.0%)	**(0.4%)**
Msa Road	11,400	73	66.5%	5.5%	11,400	79	65.6%	5.8%	(8.2%)	0.9%	**(0.3%)**
Average	**12,638**	**97**	**80.3%**	**7.5%**	**12,507**	**101**	**83.3%**	**8.3%**	**(4.3%)**	**(3.2%)**	**(0.7%)**

Source: Cytonn Research

- Gigiri, Karen and Westlands were the best performers in 2019 recording rental yields of 9.2%, 8.3%, and 8.3%, respectively, due to their superior locations and availability of quality Grade A offices, enabling them to charge a premium on rentals
- Thika Road and Mombasa Road were the worst performers recording rental yields of 6.3% and 5.5%, respectively, attributed to poor location as a result of traffic congestions, and lower quality office spaces, that are generally unattractive to firms

Nairobi Office Market Performance, Continued…

Gigiri, Karen and Westlands were the best performers recording rental yields of 9.2%, 8.3%, and 8.3%, respectively

Gigiri

- Gigiri recorded average rental yields of 9.2% in 2019, a 0.8% points decrease from the 10.0% recorded in 2018. The decline in performance was driven by a 5.1% and 4.6% points decline in rents and occupancy rates, respectively. Despite the drop in rental yields, the area remain 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 0.9% decline in performance driven by a 6.5% and 3.3% decline in rents and occupancy rates to Kshs 111 per SQFT and 85.3%, respectively, in 2019 from Kshs 118 per SQFT and 88.6% in 2018, respectively. This was attributed to reduction of rental rates by property managers in a bid to attract tenants and retain the existing ones

Westlands

- Westlands recorded average rental yields of 8.3% in 2019, a 0.7% points decrease from the 9.0% recoded in 2018. Rents and occupancy rates declined by 5.2% and 1.8% points to Kshs 104 and 80.3%, respectively, in 2019 from Kshs 109 and 82.1% in 2018 attributable to new supply of office space with the completion of the Address (243,000 SQFT) and Laxcon (100,000 SQFT). This adds to the existing oversupply in the area which comprises 17.6% of office space in the Nairobi Metropolitan Area

Nairobi Office Market Performance, Continued…

In 2019, Parklands, Upperhill and Kilimani recorded average rental yields of 8.2%, 7.5% and 7.1%, respectively

Parklands

- Parklands recorded an average rental yield of 8.2% in 2019, a 0.2% points decrease from the 8.4% recorded in 2018. This was driven by a 4.8% and 2.9% decline in rents and occupancy rates attributed to an influx of supply with the completion of Merchant square, Capital Square and Park Medical Centre. However, the area still remains attractive attributed to its proximity to the CBD and Westlands, ample infrastructure and favourable zoning regulations facilitating densification

Upperhill

- Upperhill recorded a 0.7% points decline in performance with rental yields averaging at 7.5% in 2019, from the 8.2% recorded in 2018. The decline in performance was driven by 1.3% and 4.0% points decline in rents and occupancy rates to Kshs 98.5 and 80.0% in 2019 from Kshs 99.8 and 84.0% in 2018 attributable to the existing an oversupply of office space in the market

Kilimani

- Kilimani recorded average rental yields of 7.1% in 2019, a 0.9% points decrease from the 8.0% recoded in 2018. Rents and occupancy rates also declined by 8.5% and 7.4% points to Kshs 91 and 80.9%, respectively, in 2019 from Kshs 98.9 and 88.3% in 2018 attributed to an oversupply of office space in the area. New buildings completed in 2019 include 19 Kabasarian Avenue (76,600 SQFT) and The Arch Place (120,000 SQFT)

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 0.5% point decline in performance recording average rental yields of 7.1% in 2019 from 7.6% in 2018. This was driven by 2.7% points decline in rental yields to 85.6% in 2019 from 88.3% in 2018 attributable to relocation by multinational firms to other nodes offering serene environment and quality office spaces

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 0.4% points marginal decline in performance recording rental yields of 6.3% in 2019 from 6.7% in 2018. The decline in performance was driven by a 2.4% and 1.0% points decline in asking rents and occupancy rates attributed to new supply including the recent completion of the Garden City Business park (134,160 SQFT)

Mombasa Road

- Mombasa Road registered a 0.3% point decline in performance recording average rental yield of 5.5% in 2019 from 5.8% in 2018. It was the worst performer, recording 2.2% points lower than the market average of 7.7% attributed to its zoning for industrial use and lower quality office space

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

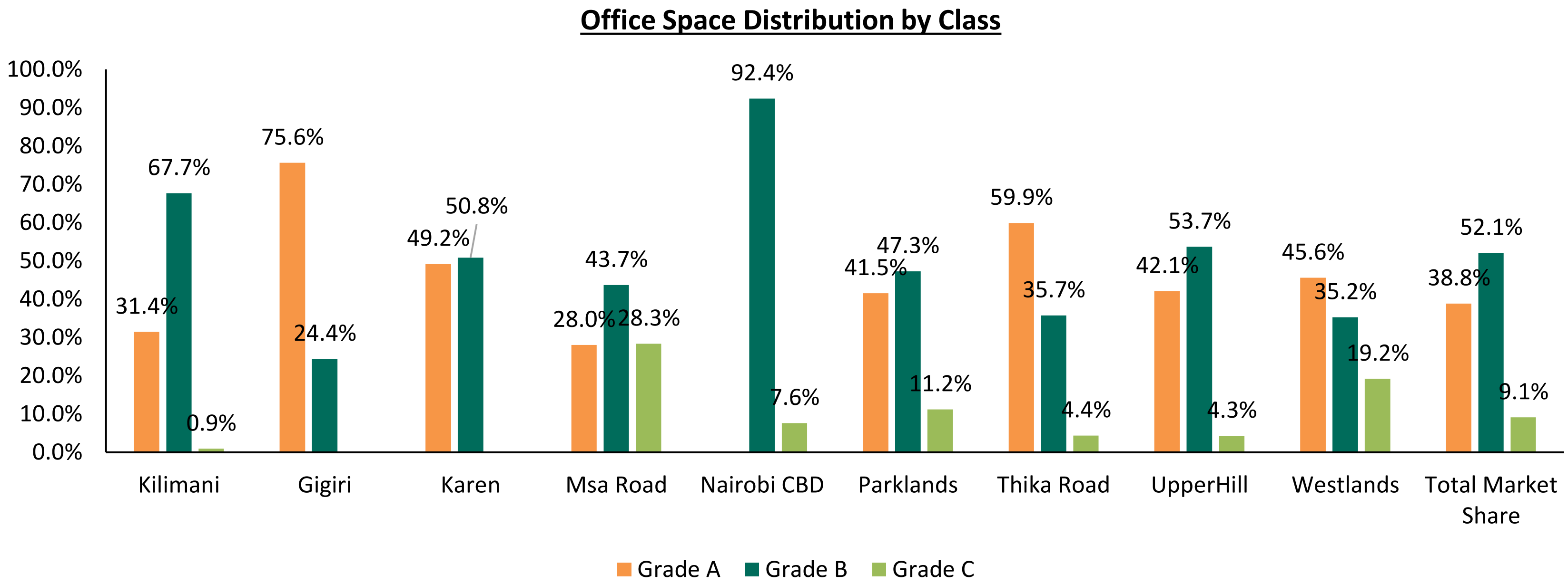
- For our research, we have used buildings with a total area ranging from 50,000 to 100,000 square feet. They have good (but lower than grade A) technical services and ample parking space

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

Distribution of Various Classes of Offices

Grade B offices are the most common, accounting for 50.2% of commercial offices in Nairobi



- **The market has witnessed an increase in Grade A office supply** with offices such as The Address (243,000 SQFT), 1 Park Avenue (133,000 SQFT) and The Arch Place (120,000 SQFT) coming into the market and therefore increasing the market share of Grade A offices from approximately 25.0% to approximately 41.6% of our sample size

- **From our sample, Grade B office spaces still account for a majority office spaces** in Nairobi with a market of 52.1%

- **For the individual nodes, Gigiri has the highest percentage of its offices being Grade A at 75.6%.** Nairobi CBD had the highest percentage of its offices being Grade B at 92.4% and no Grade A office space

Performance of the Various Offices by Class

Grade B office spaces had the highest rental yields at 7.9%

Office Grade	Price 2019 Kshs/ SQFT	Rent 2019 (Kshs/SQFT)	Occupancy 2019 (%)	Yield 2019(%)	Price 2018 Kshs/ SQFT	Rent 2018 (Kshs/SQFT)	Occupancy 2018(%)	Yield 2018 (%)	Δ Rent Y/Y	Δ Occupancy Y/Y (% points)	Δ Rental Yields Y/Y (% points)
Grade A	12,860	105	73.8%	7.4%	13,070	111	74.1%	7.9%	(6.3%)	(0.4%)	(0.6%)
Grade B	12,706	99	82.7%	7.9%	12,388	102	86.1%	8.5%	(3.3%)	(3.4%)	(0.7%)
Grade C	10,920	82	80.4%	7.2%	10,920	85	87.0%	7.9%	(3.5%)	(6.6%)	(0.7%)
Average	**12,552**	**97**	**80.5%**	**7.7%**	**12,407**	**101**	**83.8%**	**8.3%**	**(4.3%)**	**(3.2%)**	**(0.7%)**

- The performance of the commercial sector softened with declines recorded across all the grades. This is largely attributed to oversupply which stood at 6.3 mn SQFT
- Commercial offices recorded an average rental yield of 7.7% at an average occupancy of 80.5%, monthly rental charges of Kshs 97 per SQFT and price per SQFT of Kshs 12,552
- Grade B office spaces had the highest rental yields at 7.9% as tenants prefer them because of their cheaper rents as compared to grade A offices while having decent technical services (not as good as those of grade A) and ample security
- Despite declines recorded across all grades, grade A offices recorded the least declines in occupancy and rental yields at 0.4% points and 0.6% points respectively. Their performance was slightly cushioned by the entry of various multinationals in the country in 2019 who prefer grade A offices due to their quality finishes, ample parking space and high end technical services

iii. Performance by Nodes & Grades

Performance by Nodes and Grades

For Grade B spaces, Westlands and Karen offer the highest rental yield of 8.7% and 8.2%, respectively

Commercial Office Performance in 2019 by Nodes and Grades						
Typology	Grade A		Grade B		Grade C	
Location	Rental Yield (%)	Occupancy (%)	Rental Yield (%)	Occupancy (%)	Rental Yield (%)	Occupancy (%)
Gigiri	10.1%	81.3%	7.9%	79.0%		
Karen	8.8%	87.0%	8.2%	84.9%		
Parklands	7.3%	75.0%	8.1%	82.0%	9.0%	91.4%
Westlands	7.2%	72.6%	8.7%	81.2%	7.9%	86.4%
Upper Hill	6.9%	69.1%	7.9%	85.1%	6.6%	82.5%
Kilimani	7.2%	70.0%	7.2%	81.7%	6.2%	92.0%
Msa Road	6.0%	79.0%	6.3%	71.3%	4.8%	58.6%
Thika Road	4.9%	60.0%	6.5%	84.6%	6.6%	80.0%
Nairobi CBD			7.2%	86.7%	6.8%	79.5%

- For Grade A offices, in 2019, Gigiri and Karen offered the highest returns with average rental yields of 10.1% and 8.8%, respectively, as they enjoy a superior location characterized by serene environment and low-rise developments
- For Grade B, Westlands and Karen offer the highest rental yield of 8.7% and 8.2%, respectively, and hence offer an investment opportunity in the market
- For Grade C, Parklands and Westlands offer the best investment opportunity with average rental yields of 9.0% and 7.9%, respectively

iv. Serviced Offices Performance

Serviced Offices Performance

Serviced offices recorded yields of 12.3%, 4.3% points higher than the un-serviced offices' yield of 8.0%

Serviced and Un-serviced Office Performance Comparison 2019						
Location	**Revenue Per SQFT**		**Occupancy (%)**		**Yield**	
	Serviced Offices	**Un-serviced Offices**	**Serviced Offices**	**Un-serviced Offices**	**Serviced Offices**	**Un-serviced Offices**
Westlands	248	104	81.2%	80.3%	15.9%	8.3%
Upperhill	199	98	79.7%	80.0%	12.2%	7.5%
Karen	186	111	70.0%	85.3%	8.7%	8.3%
Average	**211**	**104**	**77.0%**	**81.9%**	**12.3%**	**8.0%**

- Serviced (or shared) office spaces refer to fully furnished and equipped office spaces that managed by a facility management company
- In 2019, serviced offices recorded yields of 12.3%, 4.3% points higher than the un-serviced offices' yield of 8.0%. This is attributed to the attractiveness of the office setup to small businesses, start-ups and freelancers due to; (i) flexibility of the leases as they could range for short periods, (ii) no set-up costs required, and, (iii) opportunities for collaboration with other individuals/businesses in a competitive working environment
- Westlands and Upperhill were the best performing nodes recording rental yields of 15.9% and 12.2%

D. Office Space Opportunity

Cytonn

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 gauge the supply situation in Nairobi, we used the **Gap Analysis**
- Gap analysis is a tool that measures the under or oversupply 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 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 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 assuming a 2 year lag between building approvals and completion of construction**
- Office space supply has grown at 7-year CAGR of 24.7% to 36.3 mn SQFT in 2019 from 7.7 mn SQFT in 2012 driven by the positioning of Nairobi as a regional hub, thus increased entrance of multinationals as well as the growth of Small and Medium Enterprises (SMEs)

Office Space Opportunity

In 2019, the commercial office sector had an oversupply of 6.3 mn SQFT

Commercial Office Space Supply Analysis												
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020F	2021F	2022F
Stock (Mn Sqft)	6.7	7.7	9.7	15.4	22.9	28.9	31.8	35.5	36.3	36.9	37.5	38.0
Completions (Mn Sqft)		1.2	2.1	5.9	7.8	6.5	3.5	4.3	1.5	1.4	1.3	1.3
Vacancy Rate (%)	9.0%	9.0%	10.0%	10.0%	11.0%	12.0%	16.8%	16.7%	19.5%	19.9%	20.2%	20.6%
Vacant Stock (Mn Sqft)	0.6	0.7	1.0	1.5	2.5	3.5	5.3	5.9	7.1	7.2	7.3	7.4
Occupied Stock (Mn Sqft)	6.1	7.1	8.8	13.9	20.3	25.4	26.5	29.6	29.2	29.7	30.2	30.6
Net Absorption		**1.0**	**1.7**	**5.1**	**6.5**	**5.1**	**1.0**	**3.1**	**(0.4)**	**0.5**	**0.5**	**0.4**
Demand (mn SQFT)		1.1	1.9	5.3	6.8	5.6	1.6	3.7	0.3	1.3	1.2	1.2
Available Supply, AS(T)		1.7	2.6	6.5	8.8	8.4	6.3	9.0	6.7	6.7	7.8	7.8
Under(Over)supply		**(0.5)**	**(0.8)**	**(1.2)**	**(2.1)**	**(2.9)**	**(4.7)**	**(5.2)**	**(6.3)**	**(6.5)**	**(6.6)**	**(6.7)**

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

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 7.9% against an average of 7.7% for single-use offices. Such developments will increase the occupancy rates of the building and hence the returns to the investor
Serviced Offices	• This refer to fully furnished and equipped office spaces continued to gain popularity over time. They also have attractive returns with average rental yields of 12.3% against an average of 7.7% for conventional offices • They will thus not only increase an investor's returns, but also diversify his 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 1.0% and a rental yield of 9.2% and are hence a good investment opportunity
New Markets	• Relaxation of zoning regulations is also paving way for development of office spaces in previously residential zones such as Thika road, 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 office supply ,differentiated concepts such as mixed-use developments and serviced offices

E. Office Market Conclusion and Outlook

Office Market Conclusion and Outlook

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

Nairobi Commercial Office Outlook				
Measure	**2018 Sentiment**	**2019 Sentiment and 2020 Outlook**	**2019 Review**	**2020 Outlook**
Supply	• We had an oversupply of 5.2 mn SQFT of office space in 2018, and it is expected to grow by 7.6% to 5.6 mn SQFT in 2019, compared to 10.8% in 2018, due to decreasing supply with completions expected to decrease by 21.4% from 4.3mn SQFT to 3.4mn SQFT in 2019	• We had an oversupply of 6.3 mn SQFT of office space in 2019, and it is 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	Negative	Negative
Demand	• There was increased demand for office space in Nairobi evidenced by the 0.7% y/y increase in occupancy mainly attributable to political stability that has led to increased economic activities, positioning of Nairobi as a regional hub and thus increased entrance of multinationals and Improving macroeconomic environment, with the GDP growing at 6.0% in Q3'2018, higher than the 4.7% recorded in Q3'2017, and expected to close at 5.8% for the year 2018	• 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 exists 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	Neutral	Neutral
Office Market Performance	• The performance of office market improved with yields increasing by 0.2% points to 8.1% in 2018 from 7.9% in 2017, and occupancy rates increased by 0.7% points from 82.6% in 2017 to 83.3% in 2018	• 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, respectively. We expect 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	Neutral	Negative

Cytonn