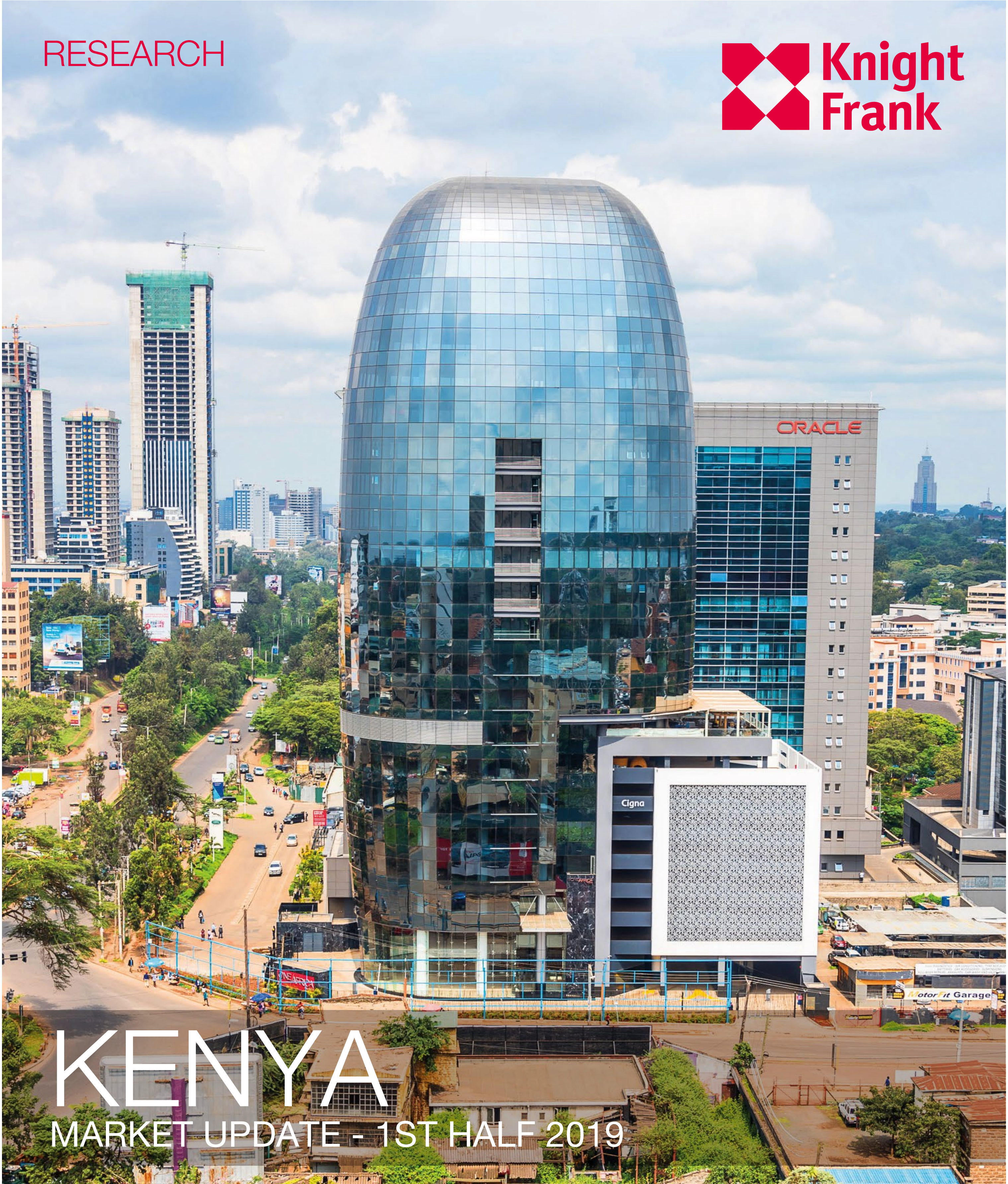
RESEARCH

KENYA

MARKET UPDATE - 1ST HALF 2019

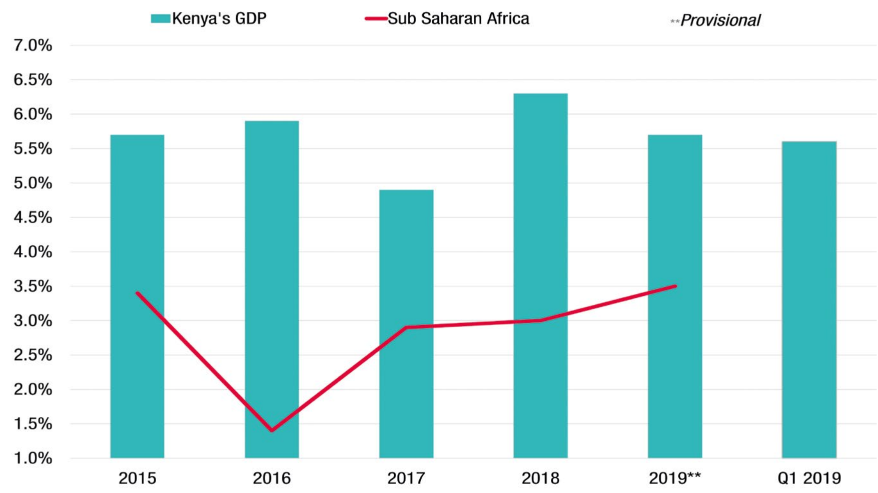


One Africa Place, Westlands, Nairobi

HIGHLIGHTS

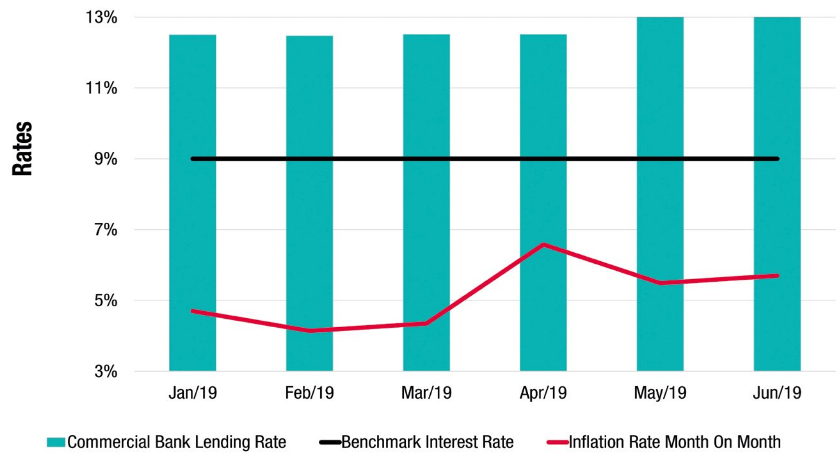
- Kenya's economy slows down
- Interest rate cap to be lifted
- Stanlib Fahari I-REIT profit grows
- Housing Levy Fund put on hold
- Capital Gains Tax to rise to 12.5%
- International retailers expand local footprint
- Office space absorption slows
- Prime residential prices and rents decline
- Kenya picked as World Travel Awards 2020 host
- GEMS Education acquires Hillcrest International School

FIGURE 1:
GDP Rates



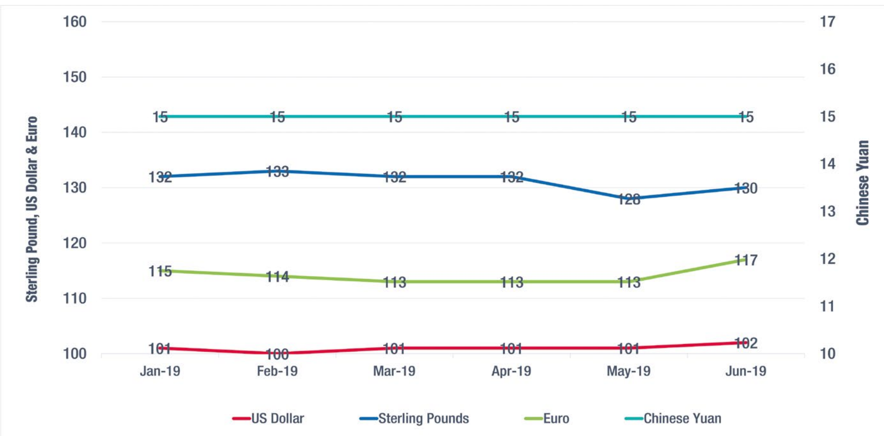
Source: Kenya National Bureau of Statistics (KNBS) & World Bank

FIGURE 2:
Benchmark Economic Rates



Source: Central Bank of Kenya

FIGURE 3:
Foreign Currency Exchange Rates



Source: Central Bank of Kenya

The Economy

Kenya's economic growth slowed down to 5.6% in the first quarter of 2019 compared to 6.5% over the same period in 2018, according to the Kenya National Bureau of Statistics (KNBS). The Gross Domestic Product (GDP) decline is attributed to less money in circulation and underperformance from the agricultural sector, which is one of Kenya's strongest sectors historically, due to unfavourable weather conditions. Prolonged drought earlier in the year led to food shortages in several counties, resulting in additional expenditure through government intervention. The agricultural sector's growth slowed to 5.3% in the first quarter of 2019 compared to 7.5% over the same period in 2018. The World Bank predicts that the country's GDP growth will reduce to 5.7% in 2019.

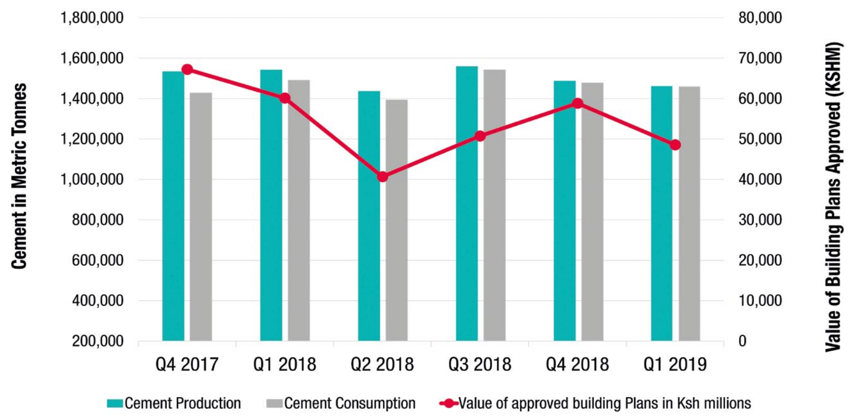
It is estimated that Sub-Saharan Africa's (SSA) growth will expand by 3.5% in 2019 compared to 3.0% in 2018. This is mainly attributed to investments in large economies and robust growth in non-resource intensive countries.

The Monetary Policy Committee (MPC) maintained the Central Bank Rate (CBR) at 9.0% in June as the economy operated close to its potential. The inflation rate has remained within the government's target range but April recorded the highest spike in 2019 at 6.58%. This is the highest rate recorded since September 2017 and was a result of the prolonged drought that lasted till April, resulting in an increase in food prices. Commercial banks' interest rates remained capped at circa 13% during the first half of 2019.

Cement production decreased to 1.46 million metric tonnes (MT) in the first quarter of 2019, a 5.8% drop from 1.55 million MT over the same period in 2018. Similarly, cement consumption decreased to 1.46 million MT in the first quarter of 2019, a 2.7% drop from 1.50 million MT over the same period in 2018. The value of building plans approved in Nairobi County decreased to Ksh 48.54 billion in the first quarter of 2019, a 19.2% drop from Ksh 60.11 billion in a comparable period in 2018.

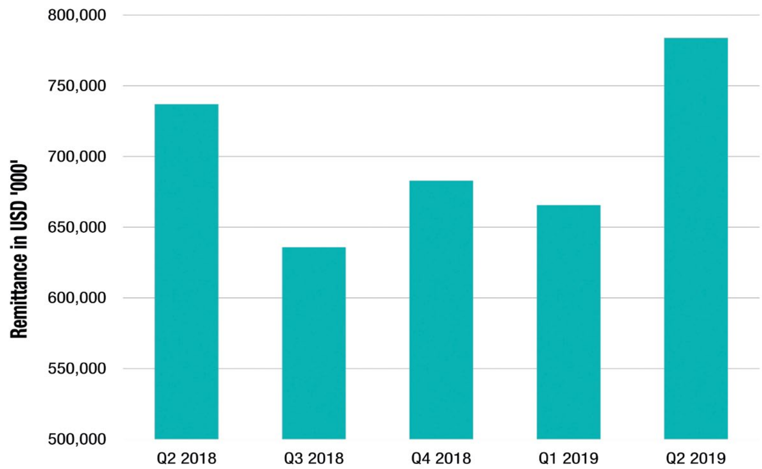
The continued decrease in cement production, consumption and the value of building plans approved is indicative of a slowdown in the real estate sector, which is mainly due to the current oversupply, low transactions and the interest rate cap which has resulted in reduced lending to the private sector. However, this scenario could potentially improve in the near future due to the recent announcements by the government during the review period regarding the Affordable Housing Programme (AHP). Additionally, if Parliament amends the interest rate cap as instructed by the High Court in March, and as proposed by the Treasury

FIGURE 4:
Value of Building Plans Vs Cement Consumption



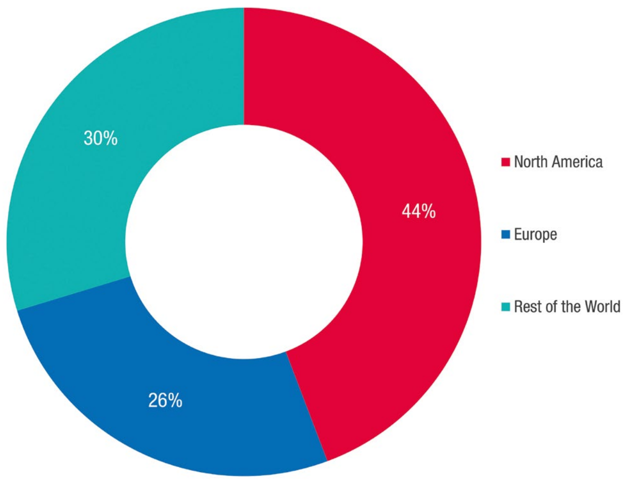
Source: KNBS

FIGURE 5:
Quarterly Diaspora Remittances



Source: Central Bank of Kenya

FIGURE 6:
Remittance Inflow Share by Source, Q2 2019



Source: Central Bank of Kenya

in June, this is expected to boost lending to the private sector thus giving real estate developers the financial ability to commence new developments.

According to KNBS data, the real estate sector experienced a reduction in growth to 4.2% in the first quarter of 2019, compared to 5.3% over a similar period in 2018.

Diaspora remittances increased by 5% in the review period compared to the first half of 2018. North America remained the largest source market in June, generating 44% of the total cash inflows with circa US$ 113 million.

Listed Real Estate Companies

Listed Real Estate Investment Trust, Stanlib Fahari I-REIT, in March announced a 13% increase in net profit to Ksh 193 million for the financial year 2018. However, earnings from operations declined by 14% to Ksh 127.9 million due to an increase in vacancies in the I-REIT's properties. Fahari I-REIT, which is listed on the Nairobi Securities Exchange, announced in April it planned to acquire additional properties from pension funds and insurance companies by way of issuing new units. The asset-for-shares swap will help the I-REIT to purchase additional properties whilst helping it increase the number of income-generating buildings without having to raise large sums of capital. By holding stakes in the I-REIT, pension funds and insurers will benefit from the liquidity brought about by the tradability of the units on the NSE whilst diversifying their property investment risks.

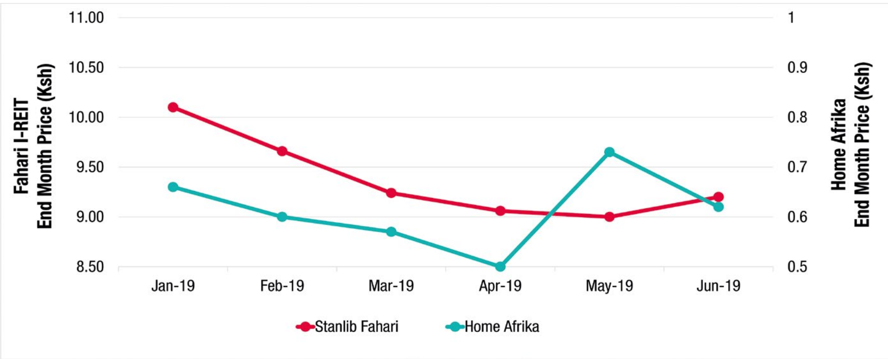
The Finance Bill 2019 proposed that the companies owned by Real Estate Investment Trusts (REITs) be Income Tax-exempt. This is due for approval in August.

Stanlib Fahari I-REIT's unit price closed at Ksh 9.20 in June, which was 54% lower than its initial listing price of Ksh 20.00. Home Afrika's share price closed in June at Ksh 0.62, which was 95% lower than its initial listing price of Ksh 12.00.

Infrastructure & Policy

Several major Infrastructural developments were announced in the first half of 2019. The Kenya Urban Roads Authority (KURA), in a move to expand the Eastern and Northern bypasses from two lanes to four lanes, requested bids during the review period. Construction of the 16.7-kilometre Western Bypass commenced in January. The bypass is being built by China Road and Bridge Corporation at an estimated cost of Ksh 17 billion. It will run from Gitaru to Ruaka on the Northern Bypass.

FIGURE 7:
Real Estate-Related Listings



Source: Nairobi Securities Exchange

The Waiyaki Way-Red Hill dual carriageway opened in May. The 5-km link road, which links Waiyaki Way to Limuru Road, passes through major residential areas such as Kyuna, Spring Valley, Nyari, Kitisuru and Peponi. It was aimed at reducing traffic congestion and improve accessibility.

Over the review period, several infrastructure projects commenced in Lamu County and are expected to boost shipping in the region. The 15-km, Ksh 1.1 billion Mokowe Urban Road in the county is expected to be completed in the second half of 2019. The 135-km Lamu-Garsen Road, costing circa Ksh 10.8 billion, was contracted to H-Young Company and is also expected to be completed in the second half of 2019. Construction of the 530-km Lamu-Garissa-Isiolo Road, costing Ksh 60 billion, begun in January. Construction of the first berth at the new Lamu Port-South Sudan-Ethiopia Transport (LAPSSET) Corridor, which had been delayed, is also expected to be completed by the end of this year. The remaining two of the proposed 32 berths will be completed in 2020, upon which the port is expected to commence operations. The Ksh 48 billion new port is being constructed by China Communication Construction Company (CCCC).

These infrastructural projects are expected to transform the region both economically and socially.

The Kenya Government in April signed two Private Public Partnerships (PPPs) with various Chinese corporations worth Ksh 67.5 billion. One was a Ksh 17.5 billion agreement with the Chinese telecommunications company Huawei to construct the Konza Data Centre and Smart City. The technopolis and innovation city once completed is expected to contribute towards Kenya's economic growth through job creation and revenues from the establishment of high-tech companies. The second PPP, entered into in April, was with China Road and Bridge Corporation (CRBC) for the construction of the Jomo Kenyatta International Airport (JKIA)-Westlands expressway worth Ksh 50 billion. CRBC will invest its own money which it shall recover from the toll money to be charged on motorists who use the expressway. Construction of the 18.59-km road project is expected to commence four months after CRBC and Kenya National Highways Authority (KNHA) sign the PPP deal. The expressway will be a dual carriageway comprising four lanes each way.

Construction of Phase 2A of the standard gauge railway (SGR), which was meant to be completed in June, has been pushed back to August due to the ongoing compensation wrangle with Ngong residents. The 120-km railway being constructed by CCCC begins in Nairobi and ends in Suswa, Naivasha. Due to funding challenges, the SGR will now be linked to the old line at Naivasha.

There were several steps taken by the Kenyan Government towards achieving the construction of 500,000 affordable houses by 2022, in line with its Big Four agenda. In May, the government launched the Kenya Mortgage Refinancing Corporation (KMRC), the country's first secondary mortgage financier that is expected to provide long term funding to mortgage lenders for onward lending to low-income earners at rates below 10% as opposed to the current rates of circa 13%. The KMRC is 20% owned by the National Treasury and 80% by the private sector, and supervised by the Central Bank of Kenya (CBK). It will also receive additional funding through international financers. The World Bank in May approved a US$ 250 million affordable housing loan for Kenyans who don't have access to housing finance. The World Bank's Kenya Affordable Housing Finance Project (KAHFP) will provide additional finance through the KMRC as well as support operations of the institution. Pan-African financial institution Shelter Afrique invested Ksh 200 million in KRMC in May. The International Finance Corporation (IFC) in June announced plans to also invest into KRMC. IFC is interested in investing US$2 million in equity, which will be transferred as common shares in KRMC.

The 2018/2019 Budget Statement issued in June announced measures expected to impact the real estate sector such as raising the Capital Gains Tax to 12.5% from the current rate of 5%. The move is expected to further reduce the number of transactions in the sector which had already declined because of the tight liquidity situation. The Treasury announced an allocation of Ksh 3.0 billion towards the construction of affordable housing units undertaken by the government, Ksh 1.5 billion for construction of housing units for the Kenya Police and Kenya Prisons, and Ksh 1.5 billion for the Civil Servants Housing Scheme Fund to support the housing developments' take-off.

The Treasury also allocated Ksh 115.9 billion for on-going road construction projects, Ksh 74.7 billion for the construction of Phase 2A of the Standard Gauge Railway (SGR) and Ksh 2.7 billion for the Mombasa Port Development Project.

In the review period, the Judiciary suspended several sections of various statutes affecting the financial sector. The High Court in March declared that Section 33B of the Banking Act passed by Parliament in 2016 capping interest rates to four percentage points above the Central Bank Rate (CBR) was unconstitutional. However, it postponed the implementation of this ruling due to the existing contractual relationships between financial institutions and customers and to allow Parliament to reconsider its position. In addition, in June the Treasury proposed that parliament abolishes the current interest rate capping regime. Since the introduction of the interest rate cap, financial institutions have shied away from lending to high risk borrowers. In April, the Labour Court for a second time suspended the implementation of the Housing Levy Fund which was meant to come into effect in May. The Housing Levy Fund is part of the Finance Act 2018.

Retail

Rents for prime retail shops decreased by approximately 5.9% to US$ 4.8 per square foot per month in the first half of 2019, while service charges across retail malls in Kenya ranged from Ksh 45 to Ksh 60/sq ft/month. The decline in rentals is mainly attributed to the current economic situation and less money in circulation, resulting in reduced spending by consumers. Additionally, oversupply of retail space in certain locations has resulted in pressure on landlords to provide concessions and other incentives to attract new or retain existing tenants, making the sub-sector a tenants' market.

Over the review period, occupancy levels for established malls remained high at 90%. New retail centres recorded occupancy levels of between 45% and 55%. The occupancy levels are mainly attributed to the current oversupply and established malls expanding their current spaces by opening new phases. As a result, current and new tenants are opting to move to the new phases in the established malls to tap into the existing clientele rather than open shop in new retail centres. There was a general increase in footfall in the malls over the review period due to the presence of fully operational anchor tenants in certain retail centres.

Over the review period, French retailer Carrefour fully opened in both The Junction Mall and Sarit Centre having previously operated temporary outlets in the two malls.

Carrefour announced that in line with its expansion plans, it expects to open an additional store in the second half of 2019 on Uhuru Highway by taking over the space vacated by Nakumatt Mega.

New retail developments that opened for trading in the first half of 2019 included Sarit Centre Phase III (323,000 sq ft) and ENA Hub in Nakuru County (116,000 sq ft). Evidence of dwindling confidence in the mall sector can be seen in the number of new properties currently coming online and the reduction in the number of new developments launched especially in and around Nairobi. From a development perspective, the unprecedented supply of formal retail space in 2017 means that developers are still reeling from the aftershocks of oversupply in the form of longer letting periods for new developments. The oversupply, coupled with other market disruptions such as e-commerce, has resulted in a tenants' market with a downward pressure on rentals especially in certain neighbourhoods where the supply is not supported by robust catchment areas. Major retail developments in the pipeline include Comesa Mall in Eastleigh (280,000 sq ft) and Phase III of City Mall in Nyali (50,000 sq ft).

Over the review period, international retail brands continued to expand in the Kenyan market, with Turkish fashion brand LC Waikiki opening new outlets at The Junction, TRM and Sarit Centre. The new phase of Sarit Centre also attracted other major international brands such as Swarovski and Miniso.

The retail market is expected to record improvement in consumer spending over the second half of 2019 following the Central Bank of Kenya's announcement on 1st June to demonetise the old Ksh 1,000-note, which is anticipated to boost money circulation in the market as one of the effects. However, prime rents are expected to continue stagnating as the market slowly absorbs the current supply of retail space. From the developer's perspective, scrapping of the interest rate cap is hoped to boost lending, which in the long term will aid resumption of retail development construction.

Office

Prime commercial office rents in Nairobi remained unchanged in the first half of 2019 at US$ 1.3/sqft/month. Absorption of Grade A and B office space in Nairobi declined by 8% in the period compared to the second half of 2018. The decline in office uptake and stagnation of rental prices is mainly attributed to the continued oversupply of commercial space in some locations and the current economic slowdown. As a result, some landlords are providing concessions such as longer fit-out periods, partial contributions towards tenant fit-outs, or giving discounted rentals so as to retain existing tenants and attract new ones. Commercial office buildings completed in Nairobi over the review period included 19 Kabasarian Avenue (76,600 sq ft) in Lavington, The Arch Place in Kilimani (120,000 sq ft), The Address (243,000 sq ft) and Laxcon Plaza (100,000 sq ft), both in Westlands. Major commercial office developments in the pipeline are illustrated on Table 1.

The serviced office sector has recorded rapid growth over the last few years owing to new shared workspace entrants as well as increased demand from SMEs, maturing start-ups and multinational firms. The increased interest is due to the flexibility that comes with serviced offices in comparison to traditional offices. Serviced offices allow organisations to have flexible lease agreements and office space, lower operating costs and the opportunity of being located in a prime address. Several serviced office providers have opened new facilities over the review period. Local co-working provider Workable opened a 12,000 sq ft shared office space in January at Sanlam Towers. In February, Nairobi Garage opened its third co-working space at The Watermark Business Park, Karen, where it took up 14,000 sq ft. Its other locations are The Mirage Towers in Westlands and Pine Tree in Kilimani. The niche market is expected to continue recording growth over the next few years.

The Fintech sector also posted growth during the review period, with American technology multinational Microsoft announcing plans in May to open a development centre in Kenya. This will be Microsoft's seventh technology centre globally and the first technology hub in the East Africa region. Once the Africa development centre opens, it is expected to help the IT sector and Kenyan economy through job creation. It is expected that such projects will boost demand for new A-Grade office space in specific locations. For example, One Africa Place in Westlands (138,000 sq ft) has received significant interest from both local and international companies since its completion early this year.

Over the last two years, international firms have taken up over half of the Grade A office space available in the market.

Residential

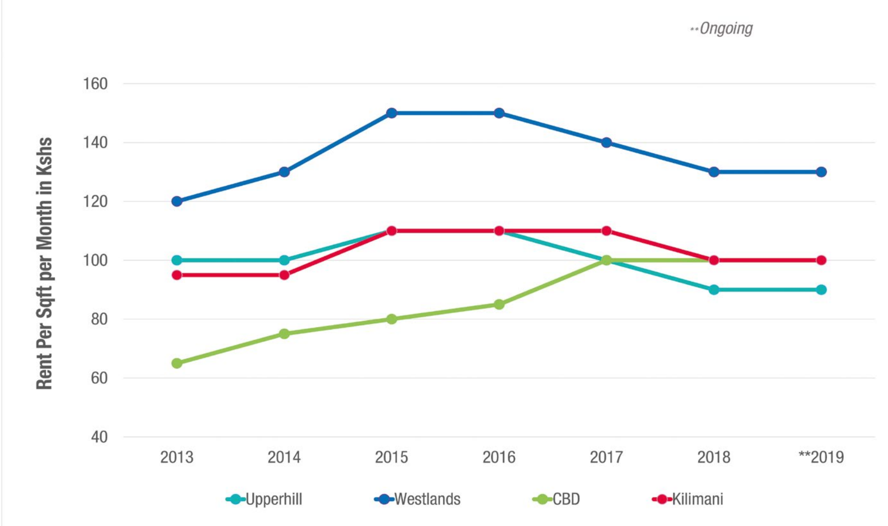
Prime residential sale prices in Nairobi decreased by 1.8% over the first half of 2019 compared to an incease of 0.4% in the first half of 2018, pushing the annual decline to 6.7% in the year to June. Prime residential rents also declined over the review period by 1.68% compared to 0.33% over a similar period in 2018, taking the annual decline to 3.3% in the year to June. The decline in both prime residential sale and rental prices is mainly attributed to the continued oversupply of residential developments in certain locations such as Karen and the ongoing credit crunch which has resulted in reduced money circulation. These factors have transformed the market in favour of buyers and tenants, even as some multinationals continue to downsize while fewer expatriates are relocating to Kenya, impacting negatively on the niche market.

TABLE 1:
Select office developments in the pipeline

DEVELOPMENT NAME	LOCATION	APPROX. SIZE (SQFT)
Merchant Square	Riverside	165,000
1 Park Avenue	Parklands	133,000
Capital Square	Parklands	90,000
Le' Mac	Westlands	85,000
Global Trade Centre	Westlands	678,000
Sandalwood	Riverside	250,000
Curzon Properties	Westlands	146,715
Pink Pearl Limited	Westlands	126,109

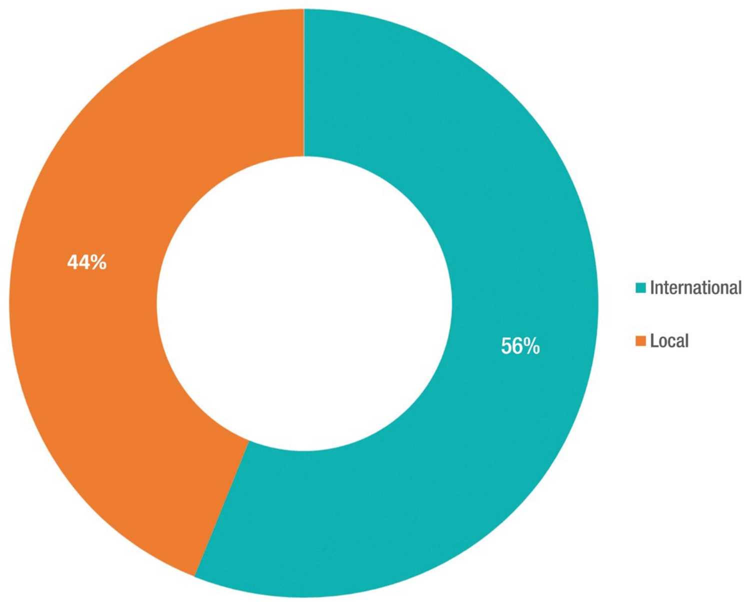
Source: Knight Frank Kenya

FIGURE 8:
Average Prime Office Rental Rates per Month



Source: Knight Frank Kenya

FIGURE 9:
Tenant Profile of Grade A office take-up 2017-2019



Source: Knight Frank Kenya

Over the review period, the government made progress towards the Affordable Housing Project. In January, an online portal christened 'Boma Yangu' was launched, allowing Kenyans to register and apply for affordable homes. The portal, which had over 200,000 registered applicants by June, allows applicants to choose where they would like to live, which is expected to assist the government in collecting data on the preferred locations to construct the affordable houses.

Phase 1 of the government's AHP flagship project is expected to be completed by September. Park Road, which is being built by China State Construction Engineering, is expected to have 288 of its 1,370 units completed by September.

In March, Chinese property developer Erdemann Property Limited broke ground for its affordable housing project named River Bank Estate. The Ksh 7 billion development will consist of 3,000 housing units which will be constructed in phases. It is expected to be completed in 2021. Once completed, River Bank Estate will join other residential developments such as the upcoming 88 Nairobi Condominium, GTC residential development and Le' Mac Towers as one of the tallest residential towers in East Africa. Local developer Unity Homes broke ground at Tatu City in May for its Unity West project. Unity Homes expects to build 1,200 2-bedroom units on seven acres at an estimated cost of Ksh 4.5 billion. This project is expected to be completed by 2021. Elsewhere, AFRA Holdings, through its subsidiary Singapura Developers Private Limited, has entered into a partnership with Habitat Housing Co-operative Society to construct an affordable housing development in Lukenya, Machakos County. The Ksh 50 billion development is expected to build 8,888 units which will sit on 100 acres. The project will be done in seven phases, with Phase 1 expected to break ground in July. The project is anticipated to be complete within the next three to five years.

Private equity firm Actis and Indian developer Shapoorji Pallonji Group, through a joint venture known as Mi Vida Homes, announced plans to build 600 apartments at Garden City. The Ksh 12 billion joint venture project is targeting middle-income earners.

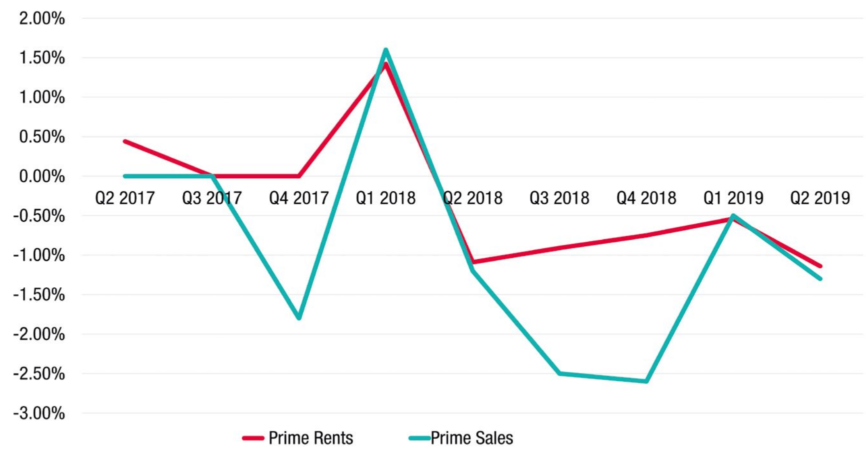
Hotel & Tourism

In January, 14 Riverside, a mixed-use development consisting of a Thai luxury hospitality chain Dusit D2 Nairobi and several Grade A office blocks, suffered a tragic terror attack. Historically, such invasions have impacted negatively on the economy, specifically the tourism industry which is Kenya's second largest source of income after agriculture. Travel advisories issued in the past resulted in declines of international visitor arrivals and hotel occupancy levels. Despite this recent attack, countries such as the UK and USA issued warnings but did not place travel advisories against Kenya. Dusit D2 Hotel announced in May it would re-open in the second half of 2019. The terrorist attack was expected to exert a downward pressure on 2019 total hotel occupancy which had increased by 52% in 2018 compared to a 48% growth in 2017.

The tourism industry recorded growth in international visitor arrivals in January with 66,859 compared to 61,137 in January 2018.

To enhance national security, the Treasury announced in the 2018/2019 Budget Statement an allocation of Ksh 8.9 billion towards enhancing security operations, Ksh 29.8 billion to police and military modernisation and Ksh 3.0 billion to securitise Kenya's borders.

FIGURE 10:
Quarterly Prime Residential Rents and Prices



Source: Knight Frank Kenya

Kenya won in major categories during the 2019 World Travel Awards Africa and Indian Ocean Gala Ceremony hosted in Mauritius in June, including being named 'Africa's Leading Destination'. The national airline Kenya Airways was named 'Africa's Leading Airline', while the Kenya Tourism Board was named 'Africa's Leading Tourist Board' for the seventh time. Diani beach was named 'Africa's Leading Beach Destination' for the sixth time, while the Kenya International Convention Centre (KICC) was named 'Africa's Leading Meetings & Conferences Centre'. The country's capital, Nairobi, was named 'Africa's Leading Business Travel Destination'.

The awards indicate that Kenya remains a top destination in Africa for Meetings, Incentives, Conferences and Exhibitions (MICE) tourism as well as coastal and wildlife tourism. Kenya will host the 2020 World Travel Awards Africa and Indian Ocean Gala ceremony at the KICC, a major feat which is expected to significantly boost the tourism sector.

Major hotel developments in the pipeline include the Radisson Blu Hotel and Apartments in Arboretum by Carlson Rezidor; The Alba Hotel in Lavington Nairobi and Azure Best Western at Signature Mall, both part of Best Western's Collection; and JW Marriott at GTC and Protea Hotel by Marriott Nairobi, which will be located near the JKIA.

Pullman Hotel, which is part of French hospitality chain Accor, was expected to open in 2018 but this was in April pushed to the second half of 2019 and blamed on delayed construction works. Other hotels under the same hospitality chain in Nairobi include Ibis hotel, Mövenpick Hotels and Resorts and the Fairmont Norfolk. The Fairmont Mara Safari Club in Narok County and Fairmount Mount Kenya Safari Club in Nanyuki also form part of the hospitality chain.

Industrial Market

In May, Africa Logistics Properties (ALP) was advanced a US$ 26.5 million loan by Stanbic Bank Kenya to assist in the expansion of its modern warehousing. Mapei East Africa, the Kenyan subsidiary of Italian multinational group Mapei S.p.A, signed a long-term lease to take up 21,529 sq ft of warehousing space at ALP North. Mapei is a manufacturer of adhesives and chemical products for the building industry.

Kenya Wines Agency Limited (KWAL) in May announced it will open a modern manufacturing facility in Tatu City. Construction of the Ksh 3 billion plant is expected to commence in 2020.

Construction of infrastructure at Tilisi's 85-acre Logistic Park Phase 1 was completed in February. ALP currently owns 49 acres in the Tilisi Logistic Park and construction of its second warehouse project, ALP West, is due to commence. Sales of Tilisi's Phase 2 began in February, with the 120-acre mixed-use site comprising residential, commercial, educational, medical and educational uses. Local developer Chigwell Holdings Limited purchased 47 acres in the development and is expected to build residential units targeting middle-income earners.

Construction of Nairobi Gate Industrial Park is on-going.

Institutional Market

Private equity firm Fanisi Capital sold Hillcrest International Schools to Dubai-based GEMS Education for Ksh 2.6 billion, exiting the investment. The transaction will expand the Dubai-based firm's portfolio which currently includes GEMS Cambridge International School in Langata. It will close the GEMS Cambridge School and relocate students to the Hillcrest International Schools in 2020.

Crawford International Schools, which is part of South Africa's ADvTECH, opened in January. The school has a capacity to accommodate 1,700 students and is located in the mixed-use development Tatu City.

Acorn Holdings Africa opened its third student accommodation, the 336-room Qwetu Residences, in Parklands in March. It now has four developments under construction in Hurlingham, Madaraka and near the United States International University (USIU). All of its student residences are expected to open in 2020 except Qwetu Madaraka which is expected to open in the second half of 2019. Once opened, Qwetu Student Living, is expected to provide over 2,300 student beds to the market.

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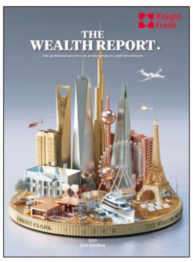

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