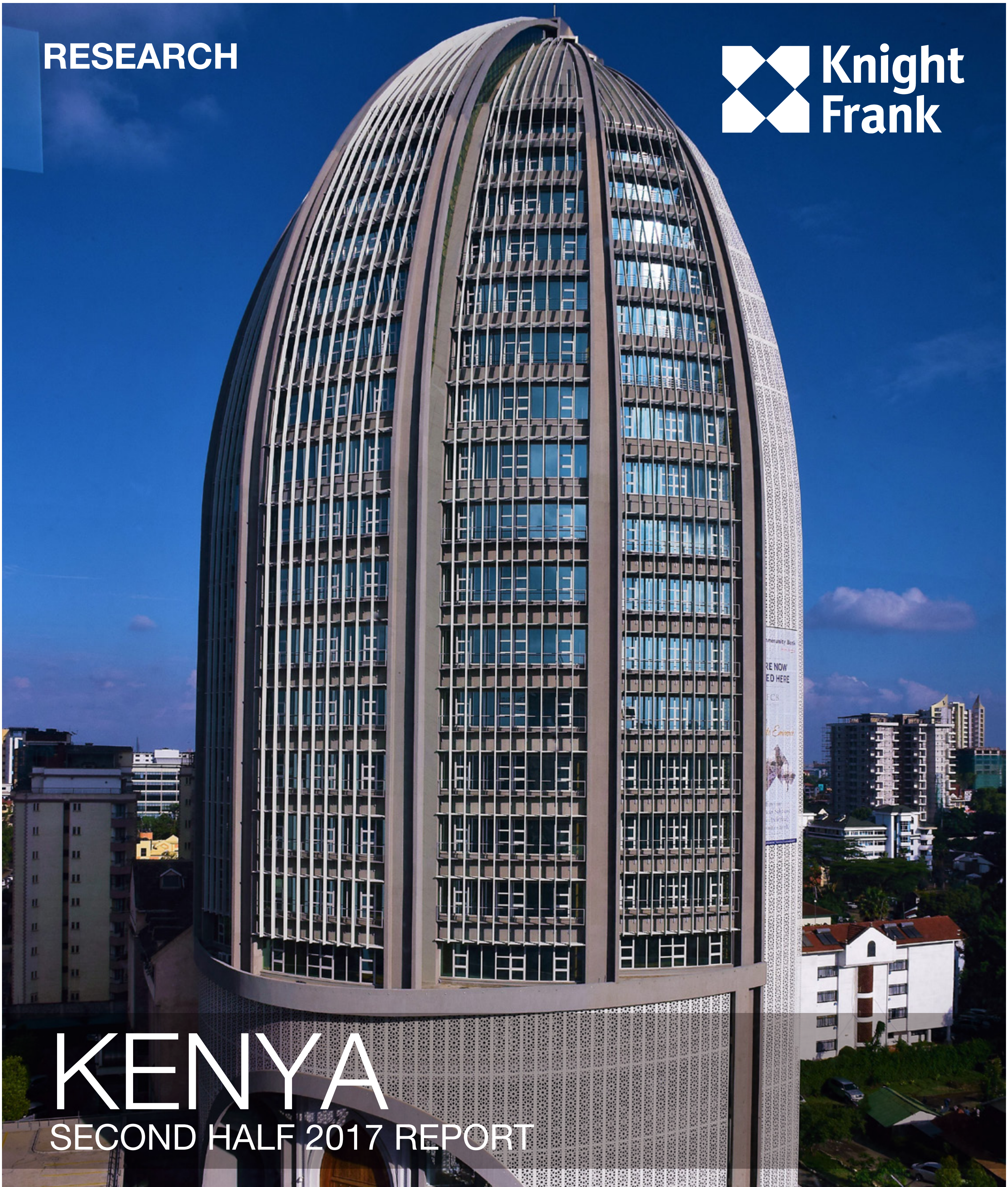
RESEARCH



KENYA

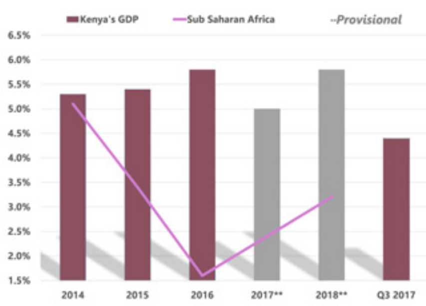
SECOND HALF 2017 REPORT

FCB Mihrab, Kilimani, Nairobi

HIGHLIGHTS

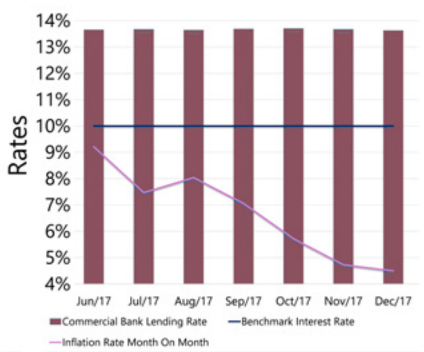
- Kenyan economy slows down
- Kenya shilling weakens against major currencies
- Fahari I-REIT gets regulatory exemption on net assets
- Prolonged electioneering impacts on real estate
- Decline in absorption of office space
- Prime commercial rents continue to stagnate
- Prime residential prices decline marginally
- Local and international hospitality chains open for business
- Local supermarket chain Nakumatt closes several branches
- National carrier Kenya Airways granted permit for direct flights to the US
- Retail chains make major moves in the shopping centre market
- Industrial property sector's growth continues apace

FIGURE 1:
GDP Rates



Source: KNBS & World Bank

FIGURE 4:
Benchmark Economic Rates



Source: Central Bank of Kenya

The Economy

The Kenyan economy slowed down in the third quarter of 2017, growing at 4.4% compared to 5.7% over the same period in 2016, according to the Kenya Bureau of Statistics data. This is the slowest quarterly GDP rate for the Kenyan economy over the last five years. The main factor attributed to this decline was the uncertain political climate following the general elections in August, in which the presidential election was nullified by the Supreme Court and a re-run held in October. Other factors included adverse weather conditions that in turn led to higher food prices, higher inflation rates and the continued cap of interest rates on commercial bank loans.

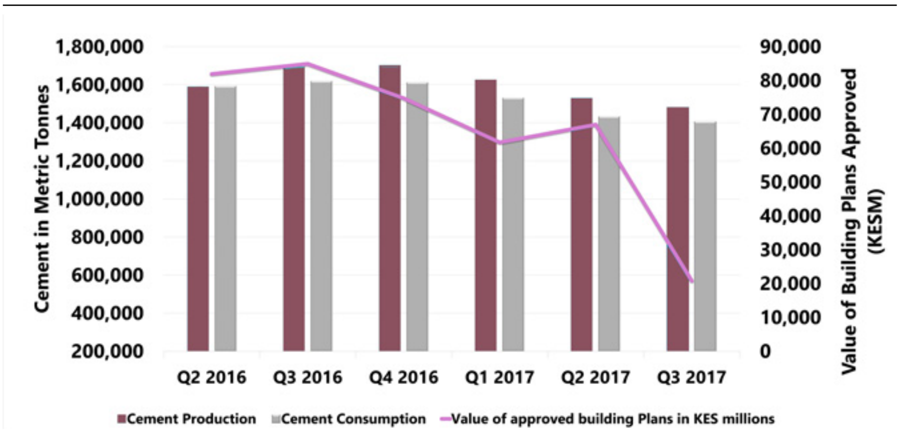
Most sectors, which traditionally have been strong, recorded slowed growth during the review period, including manufacturing, accommodation and food services, agriculture, and mining. A few sectors recorded improved growth rates such as professional and support services and public administration.

The World Bank has predicted that Sub-Saharan Africa's GDP will grow by 3.2% in 2018 compared to 2.4% in 2017. This growth is expected to be driven by stable commodity prices and increased domestic demand, inflation rates and easing of monetary policies.

Similar to the first half of 2017, the construction industry – which is historically a strong contributor to Kenya's GDP growth – experienced a slowdown, expanding by 4.9% compared to 7.8% in the same quarter in 2016. The prolonged electioneering period led investors to scale down on construction activities.

Cement production decreased by 12.5% to 1.4 million Metric Tonnes (MT) in the third quarter, compared to 1.6 million MT over the same period in 2016. Cement consumption also decreased by 13.1% over the same period to 1.4 million MT compared to 1.6 million MT in the third quarter of 2016.

FIGURE 2:
Value of Building Plans Vs Cement Consumption



Source: KNBS

The Kenya Shilling continued to weaken against most major currencies such as the US Dollar, Euro, Sterling Pound and Chinese Yuan. This was mainly due to the extended electioneering period from August to November.

The Monetary Policy Committee (MPC) maintained the Central Bank Rate at 10% throughout the second half of 2017. Month-on-month overall inflation gradually reduced over the second half due to lower food prices. Over the fourth quarter of 2017, inflation remained within the government's target range of 5%. It dropped to 4.5% in December from 4.73% in November. Commercial banks' interest rates remained capped at 14% over the second half of 2017 in line with the Banking Act passed by parliament.

Listed Real Estate Companies

The second half of 2017 saw listed real estate stocks (Home Afrika and Fahari I-REIT) perform poorly on the Nairobi Securities Exchange (NSE), continuing a trend witnessed since their debut at the bourse. Home Afrika's share price closed at Kshs1.35 a piece in December, which was 89% lower than the initial listing price of Kshs12.

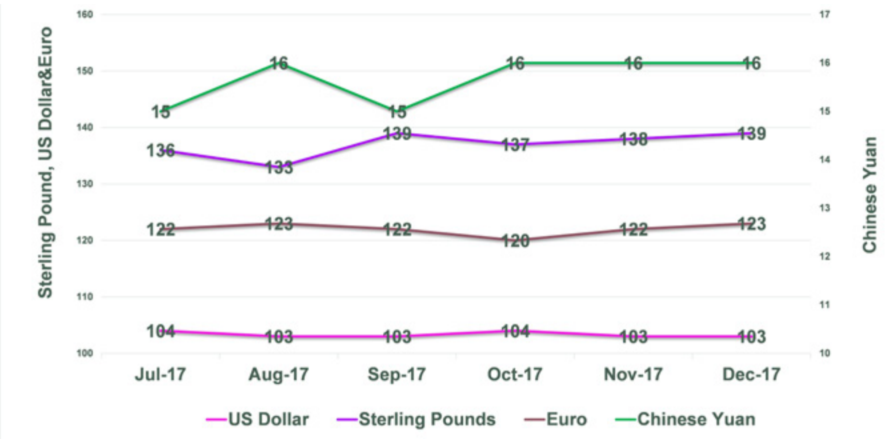
The Stanlib Fahari I-REIT remained relatively stable during the second half of 2017 and closed at Kshs11 in December, which was 45% lower than the initial listing price of Kshs20.

Two years after listing, the Fahari I-Reit was granted a regulatory exemption by the Capital Markets Authority (CMA), allowing it more time to acquire real estate worth at least Kshs245 million. According to the CMA regulations, the firm was required to hold at least 75% of its net assets in income-generating real estate by the end of September 2017. However, the firm had only invested 68% of its portfolio in income-generating properties. The firm said it was unable to hit the investment target due to the expensive nature of targeted properties and was allowed up to March 31, 2018 to meet the requirement.

Infrastructure & Policy

The dualling of Mombasa-Mariakani highway in Mombasa County commenced in July. The project is expected to cost Kshs6.1 billion and was awarded by the Kenya National Highways Authority (KeNHA) to Third China Engineering Company. It is expected to be built in two phases. The first section will entail the construction of the 11.3-kilometre Mombasa-Kwa Jomvu section, whilst the second section which will include dualling of the major highway from Kwa Jomvu to Mariakani.

FIGURE 3:
Foreign Currency Exchange Rates



Source: CBK

KeNHA has signed a financing deal with US-based firm Bechtel International Inc. for the construction of Kenya's first high-speed expressway between Mombasa and Nairobi. Funding for the project is expected to be provided by Export Credit Agencies (ECA) based in the US. The four-lane, 473-kilometre expressway will take six years to complete at a cost of Kshs230 billion. It will be built in 10 sections over the six years, with the first section being Nairobi to Namanga Road junction. Construction of this section is expected to begin in October 2019. On completion, the expressway is expected to cut travel time between the two cities from six hours to four hours and improve East Africa's trade, as it links the Mombasa port to important neighbouring landlocked markets e.g. Uganda, Rwanda, and Democratic Republic of Congo (DRC). The project is also expected to include the development of three Special Economic Zones (SEZs) along the highway.

Construction of the 2,000-km Lamu Port-South Sudan-Ethiopia-Transport Corridor (LAPSSET) infrastructure project, approved by the government during the second half of 2016, will commence in June 2018. The first section will include construction of the 530-km Lamu-Garissa-Isiolo Highway. KeNHA entered a deal with a consortium to fund the project. Kshs62 billion (US$620 million) has been injected in the project as an initial capital investment. The four-year infrastructure project will be operated and maintained by Lamu Road Consortium (LRC) for 25 years after completion.

The Land (Extension and Renewal of Leases) Rules 2017 published in December has ended the automatic renewal of leases. The new rules are expected to free up land parcels which are held by individuals and corporations for speculative purposes. Lease renewals will not be effective anymore on idle land parcels which do not generate economic value.

The Kenya Urban Roads Authority (KURA) has launched a three-year project to pave 22 kilometres of roads off the major highway in Nakuru. The project is being carried out by Chinese firm Weihai International Economic and Technical Cooperative. KURA has paid Kshs181.5 million to the contractor to commence the project, which is expected to be finalised by 2020. The roads once completed will link several residential, industrial and trading centres in the area.

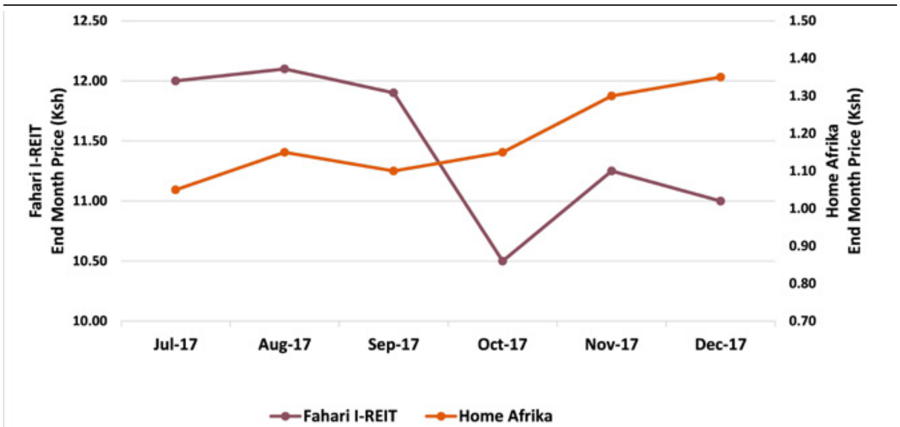
Retail

Prime retail rents and service charge remained unchanged in the second half of 2017 at US$55 per square metre per month and Kshs485 per square metre per month respectively. The stagnation is still attributed to continued oversupply in certain locations, a slowdown in the economy, coupled with the underperformance of some retailers.

Local supermarket chain Nakumatt closed several of its branches in various malls over the second half of 2017 due to liquidity problems. These included The Junction, Westgate Mall, NextGen Mall and Thika Road Mall in Nairobi; Nanyuki Mall in Nanyuki; Mega Plaza Shopping Mall in Kisumu; and Mwitu Centre in Meru. The supermarket chain also shut its Haile Selassie and Ronald Ngala branches in Nairobi's Central Business District.

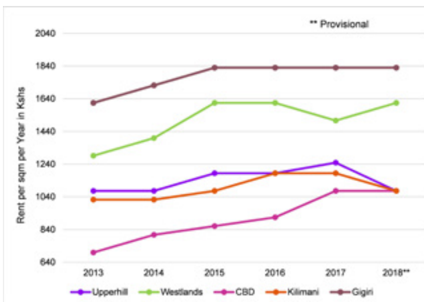
The void left by Nakumatt is being capitalised on by various local and international supermarket chains. For instance, French retailer Carrefour opened its third branch in Thika Road Mall (TRM). South Africa's Shoprite is currently in negotiations with various property owners as it prepares to enter the Kenyan market. Local supermarket chain Naivas has expanded across various locations in South C, while Tuskys supermarket is upgrading its space in New Muthaiga Mall, Thigiri Ridge, to cater for the mid-market to high-end demographic in the area.

FIGURE 5:
Real Estate-Related Listings



Source: Nairobi Securities Exchange

FIGURE 6:
Average Prime Rents per Year per SqM



Source: Knight Frank Kenya

Major international brands entering the market include Foschini, Markham, Mugg & Bean – from South Africa; Jennifer and Celio – from France; and Miniso from Japan.

Occupancy within the second half of 2017 decreased due to the prevailing economic conditions that resulted in anchor tenants underperforming or leaving retail centres. Footfall also decreased due to poorly stocked, or the absence of, anchor tenants. Despite the situation over the period, there is a positive outlook for 2018 with the economy expected to perform better due to the political climate improving and various macroeconomic factors.

New retail developments that opened within the second half of 2017 included Ciata City Mall on Kiambu Road (6,000sqm), Village Market Phase III (21,367sqm) and Southfield Mall in Embakasi (13,935sqm).

Retail developments in the pipeline for 2018 include: Westgate Mall Phase II (additional 14,000sqm), Diamond Plaza II (8,361sqm retail space), Waterfront Mall in Karen (19,509sqm), Jubilee Mall on Langata Road, Crystal Rivers in Athi River (18,766sqm), KWH Hub in Nakuru (10,766sqm), Rupa Mall in Eldoret (13,935sqm) and Limuru Mall in Kiambu County (approximately 14,000sqm) where Tuskys is expected to be the anchor tenant. Kiambu Mall's developer, where Choppies is expected to be the anchor tenant, pushed the opening date to the first half of 2018 from August 2017 due to construction delays. Signature Mall in Mlolongo (20,570sqm), Machakos County where Choppies is expected to be the anchor tenant is also expected to open within the first half of 2018. Azure Best Western by Best Western Hotels and Resorts will occupy two upper floors in the development and is expected to open by May 2018.

In Mombasa County, Airport Centre Mall (16,000sqm), a two-level building in Changamwe, is expected to be completed in the first half of 2018 at a cost of Kshs700 million.

Office

The second half of 2017 experienced a 53% decline in the absorption of Grade A office space compared to the first half of 2017. This decline in absorption was mainly due to the prevailing macroeconomic factors and the prolonged electioneering period. This specifically had an impact on the international corporations looking to enter or expand in the country.

Prime asking rents stagnated in the second half of 2017 at US$1.4/sqft/m. This stagnation was as a result of several factors, including: slow economic growth, the political situation, multinationals continuing to downsize, and oversupply within certain commercial nodes such as Upperhill. Consequently, asking rents are expected to largely remain flat in 2018 with a few exceptions.

Notable completions in the second half of 2017 included FCB Mihrab (16,900sqm) Delta Corner Annexe (7,200sqm), 90 James Gichuru (6,225sqm) and Sadani House (2,973sqm). Major developments in the pipeline for 2018 include One Africa Place (12,821sqm), Sanlam Office Tower (14,864sqm), The Promenade (20,067sqm), Merchant Square (15,329sqm), 1 Park Avenue (12,356sqm), Galleria Office Park (7,432sqm) and Laxcon Plaza (9,290sqm). The Nairobi commercial market will have added circa 100,000sqm in supply in 2018.

Aviation Industry Corporation of China (AVIC), through its subsidiary China National Aero-Technology International Engineering Corporation (Catic), is constructing a Kshs2.9 billion complex in Nairobi. The development will house institutions such as KeNHA, Kenya Urban Roads Authority (Kura), Kenya Rural Roads Authority (KeRRA), Engineers Registration Board of Kenya, National Construction Authority (NCA) and National Transport and Safety Authority (NTSA). The complex will comprise four office blocks covering 35,000sqm, a 500-seater auditorium and a service building.

Garden City Business Park, the third section of the Garden City Development, broke ground in December. Phase 1 of the business park, which is circa 10,000sqm and being developed by Actis, is expected to be completed by 2019. 60% of office space has been pre-let to East Africa Breweries Limited (EABL).

Residential

Prime residential prices decreased by 1.8% over the second half of 2017 compared to a 0.9% decline in the first half. Prime residential rents remained unchanged over the second half of 2017. The protracted electioneering period slowed down transactions during this period as most people adopted a wait-and-see approach.

The annual change in prime residential prices improved, however, to -0.9% in 2017 compared to -2.1% in 2016. Prime residential rents also decreased at a slower rate of -2.75% compared to -5.96% in 2016. This was mainly due to transactions occurring in slightly higher volumes during the first half of 2017 as most individuals rushed to finalise before the general elections in August.

The outlook for 2018 is cautiously positive for prime residential prices and rents due to the expected improvement in the political climate and the economy in general.

Thirty-five savings and credit co-operative societies (Saccos) unveiled a scheme called Africa Tenancy Purchase Initiative in July, allowing their members to get housing loans with interest-free mortgages. The affordable rent-and-purchase mechanism will have members paying an upfront deposit at 10% of the cost of a unit and the remainder in interest-free 'rent' instalments for up to 20 years.

This scheme will eventually allow tenants to become homeowners in the long run as well as provide low-income earners the chance to access cheaper mortgages. Initially, 5,000 members will benefit from this scheme over the next two years, with the number projected to rise in the future.

The International Finance Corporation (IFC) will provide partial credit guarantee for the housing projects, while Co-operative Bank and Shelter Afrique will provide short-term financing to develop the units. The Saccos have also received backing from the UN-Habitat and the State department for Housing and Urban Development. The upcoming projects include: Kshs2 billion Sunset Boulevard phase 2 and Kshs22 billion Habitat Heights – both in Athi River; Kshs800 million Wendani Heights in Komarock; Kshs6 billion Karen Heights; and Kshs6 billion Art Stone in Juja.

Demand for student housing has grown over the last few years, further increasing the deficit in the market for affordable accommodation for students in tertiary institutions. Various institutions have partnered with international companies through the Public Private Partnerships (PPPs) model to help bridge the student housing gap. Acorn and UK-based private equity fund Helios have formed a new company, Acorn Newco Limited, each owning 50% and signed a Kshs7.4 billion deal to construct 3,800 hostels in Nairobi. IFC is providing Kshs4 billion that will go into funding the project. The first set of hostels will be built near various tertiary institutions such as Strathmore School, USIU-Africa and Daystar University. During the first half of 2017, Kenyatta University and New York-based private firm Africa Integras signed a deal to construct a 10,000 capacity student hostel on a 20-acre land parcel in Kahawa, Nairobi. The project is expected to cost Kshs5.1 billion and is based on a build-operate-transfer model.

The Nairobi County Assembly passed a motion in December to introduce new zoning of estates in the city to cater to the high demand for housing and business centres. The motion, if implemented, will allow the construction of commercial centres and high-rise apartments within various upmarket neighbourhoods in Zone 4, Zone 5 and Zone 15 of Nairobi to cater to the increasing city population. The affected estates include Spring Valley, Riverside Drive, Kileleshwa, Kilimani, Thompson and Woodley, Kyuna, Loresho, Lavington and Dagoretti. The motion specified that the current Metropolitan Growth Strategy Nairobi uses was formulated in 1973 and expired in 2000.

Hotel & Tourism

The Sarova Hotel Group is undertaking a refurbishment of some of its hotel properties in the country. Sarova Whitesands Beach Resort & Spa in Mombasa is undergoing the final phase of its room upgrade which is expected to cost Kshs400 million and will be completed within the first half of 2018. The hotel group's upgrade has already seen 200 rooms fully redone at a cost of Kshs1 billion and the final phase will include remodelling 138 rooms. Sarova Panafric Hotel in Nairobi is also expected to begin refurbishment over the next few months. In August the hotel group opened a five-star hotel in Nakuru called Sarova Woodlands. The hotel development, which costed Kshs1 billion to construct, consists of 147 rooms and will be the second five-star hotel within the region after Lake Elementaita Serena Camp.

Various local and international hospitality chains opened in the country within the second half of 2017. The Tamarind Group opened the Tamarind Tree Hotel in Nairobi, which is a four-star, 160-guest room hotel, located off Langata Road, inside the Carnivore Grounds. Four Points by Sheraton Nairobi Airport Hotel near the Jomo Kenyatta International Airport (JKIA) opened in October. The 144-room hotel became the second hotel to open within the area after Lazizi Premiere opened its doors in the first half of 2017. Hemingways Hotel in Watamu, Mombasa, which is part of the Hemingways collection, re-opened in December after undergoing an 18-month redevelopment that costed circa Kshs1.2 billion. The refurbished hotel is now a 39-room boutique hotel along with Hemingways Residences.

Hilton Worldwide is taking over Nairobi's Amber Hotel on Ngong Road under a franchising agreement with the current owner. The facility is being renovated and will be renamed as Double Tree by Hilton to be aligned with Hilton's international standards. Hilton Garden Inn near JKIA is expected to open in 2018.

FIGURE 7:
Prime Residential Rent and Sale Prices

Source: Knight Frank Kenya

Other major developments in the pipeline for 2018 include City Lodge Hotel owned by City Lodge Group at the Two Rivers development, and Mövenpick Hotel & Residences by Mövenpick Hotels & Resorts in Westlands, Nairobi.

In 2017, 720 hotel keys were added in Nairobi compared to an average of 490 room keys over the previous three years. This figure is anticipated to rise to 1,400 room keys in 2018 and expected to result in an oversupply.

National carrier Kenya Airways was granted a permit to operate direct flights to America by the United States government in September. This approval allows Kenya Airways to fly both passengers and cargo. KQ expects to start the direct flights to the United States in October 2018. Once finalised, direct flights are expected to boost trade and tourism between the two countries.

Jambojet, a subsidiary of Kenya Airways, has applied for permission to start flights on six regional routes in East Africa, specifically Uganda, Tanzania, Rwanda, Burundi, Ethiopia and DRC. During the first half of 2017, the budget airline received regulatory approval to fly to 16 routes in the aforementioned countries. Jambojet hoped to begin flying to Tanzania and Uganda by February 2018. Once actualised, the no-frills airline operating across Sub-Saharan Africa is expected to impact positively on tourism.

Industrial Market & Redevelopment Land

Kenya Breweries Limited broke ground in July for the refurbishment of its Kisumu plant, which had halted production in 2002. The refurbishment is expected to cost Kshs15 billion and will be completed in 2019.

Kenya's first privately-owned Special Economic Zone (SEZ) was launched in July in Eldoret, Uasin Gishu County. It is being led by a joint venture between Kenya's Africa Economic Zones Limited (AEZ) and China's Guangdong New South Group. The SEZ will sit on over 1,768 acres and contain an industrial park on 700 acres, a science and technology park on 70 acres and an Olympia City on 1,000 acres for commercial, residential and recreational development. The project is expected to cost US$2 billion (Kshs207 billion) and will be implemented in four phases over the next 10 years, with phase 1 being the construction of the 700-acre industrial park.

Local and international educational institutions have shown a recent interest for redevelopment land. This is to cater to the demand for quality education from middle- to high-income households and expatriates. In this regard, Brookhouse School opened its second campus in Runda, while South African private education firm Advtech has purchased land in Tatu City, Kiambu County, to build an educational institution named Crawford International School. The school joins other international institutions that have set up in the area such as Nova Pioneer and Sabis International School for which Centum purchased 20 acres during the first half of 2017 for the facility, including accommodation for staff and students.

Demand for prime logistics and warehousing space continued to grow in the second half of 2017, with more organisations taking interest in this niche market. More developers are investing in vacant land across Nairobi and its environs to put up high quality warehouses to cater to the rising demand. South African logistics and warehouse property specialist Improvon Group entered into a joint venture with Actis to tap into the growing demand for long-term logistical and warehousing needs within Sub-Saharan Africa. In September, Improvon concluded an agreement to develop the 104-acre Northlands Commercial Park. The AAA Grade warehousing, logistics and distribution park is situated on the Eastern Bypass and set to break ground during the first half of 2018. The Commercial Park will provide lettable space of 2,000sqm-50,000sqm and additional land sale options to tenants.

The Communications Authority of Kenya found that Kenyans spent Kshs10 billion in 2016 on e-commerce platforms compared to Kshs2.4 billion in 2014. This change in consumers' shopping habits in favour of online shopping or home deliveries as opposed to conventional shopping has led to online retailers acquiring warehouse space for stock storage.

High-end logistic warehouses currently underway include Tatu Industrial and Logistics Park on the Northern Bypass, Infinity Industrial Park as well as the Northlands Commercial Park, both located on the Eastern Bypass, and Tilisi Industrial Park on the Nairobi-Nakuru highway.

Africa Logistics Properties (ALP) has signed a 10-year lease with Freight Forwarders Solutions Limited (FFS) which is the logistics section of Freight Forwarders Kenya (FFK). This is the largest industrial lease to be signed in Kenya, which will see FFS take up 14,000sqm at ALP's 50,000-sqm logistics and distribution complex in Tatu Industrial Park currently under construction. It is expected to be operational by October 2018 and will be Kenya's first international standard logistics and distribution hub. ALP in November also agreed lease terms with an e-commerce distributor for 4,400sqm at ALP North.

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