RESEARCH

Knight Frank

KENYA

MARKET UPDATE - 2ND HALF 2018

ALP North at Tatu City, Kiambu County

HIGHLIGHTS

- Kenya's GDP records faster growth in 2018
- Cement production and consumption drop as value of approved building plans falls
- Court suspends Housing Levy Fund
- International retailers continue to expand
- Prime office rents stagnate
- Office space absorption continues to gain momentum
- Prime residential prices decline
- Number of mortgage accounts rises
- Kenya remains favourable destination for MICE tourism
- KQ launches direct flights to the US
- ALP opens modern Grade-A warehousing park
- International educational institutions increase local footprint

The Economy

The Kenyan economy expanded by 6% in the third quarter of 2018, compared to 4.7% over the same period in 2017. During the review period several sectors recorded improved growth rates. These included accommodation and food services, construction, financial services and insurance, public administration, manufacturing, and mining and quarrying. The real estate sector recorded the slowest quarterly growth since 2014. This was mainly attributed to tighter lending restriction s by commercial banks and high capital costs of properties currently in the market.

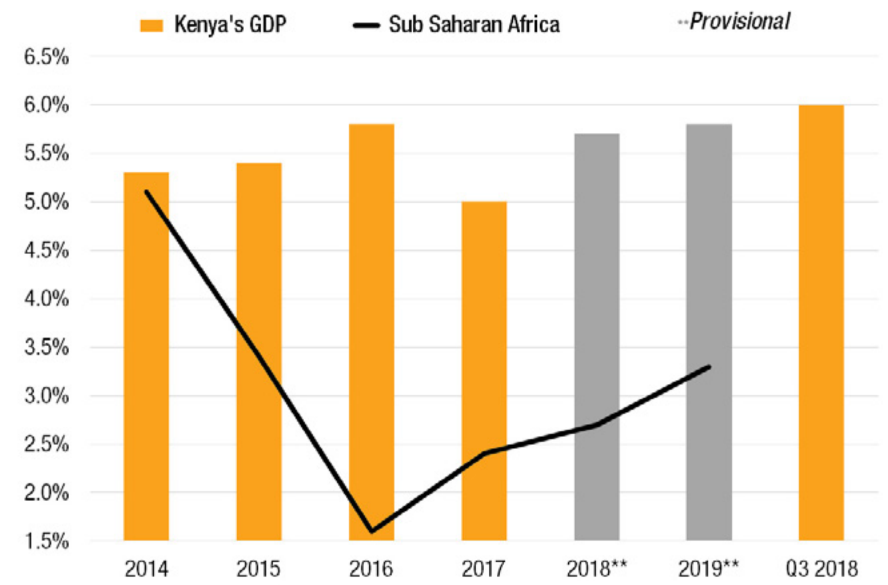
According to the World Bank, the Kenyan economy was expected to rebound in 2018 after a slowdown in 2017. The annual GDP growth was projected to expand by 5.7% in 2018 compared to 4.9% in 2017. This was mainly attributed to favourable weather conditions which improved the agricultural sector, stable political climate, growth in private consumption and investment, and overall renewed confidence in the business environment. The annual GDP is further forecast to grow by 5.8% in 2019. The World Bank also noted that the Sub-Saharan African annual GDP rate would rise by 2.7% in 2018 compared to 2.3% in 2017. Despite the region's three largest economies Angola, Nigeria and South Africa experiencing slow growth, the rest of the region's fast-growing, non-resource rich countries had improved economic activity. Sub-Saharan Africa's GDP is predicted to grow by 3.3% in 2019.

Cement production decreased to 4.71 million metric tonnes (MT) in the 10 months to October 2018, an 8.7% drop from 5.16 million metric tonnes over the same period in 2017. Similarly, cement consumption decreased to 4.58 million metric tonnes in the 10 months, a 6% drop from 4.87 million metric tonnes over the same period in 2017. The value of building plans approved in Nairobi County decreased to Ksh 169.26 billion in the 10 months to October 2018 a 17.6% drop from Ksh 205.54 billion in a comparable period in 2017.

The decrease in cement production, cement consumption and the value of building plans approved is attributable to the current oversupply and lack of transactions, indicating caution amongst developers in undertaking new projects. Additionally, the interest rate cap has hindered many developments as commercial banks became increasingly cautious in lending to the private sector.

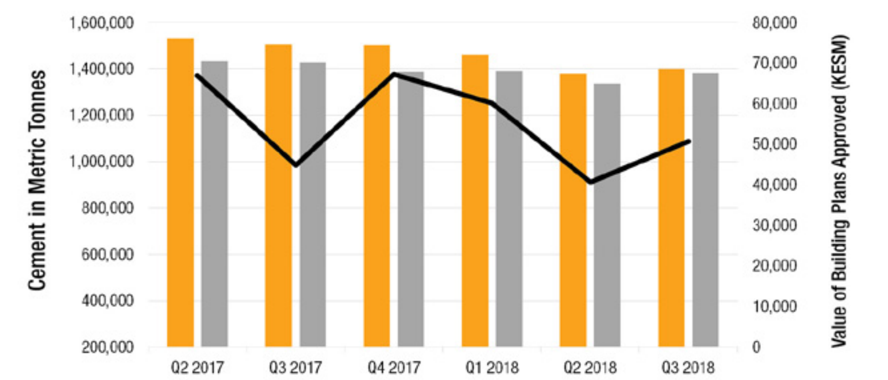
The Kenya Shilling remained stable against most major currencies such as the Sterling Pound, US Dollar, Euro and Chinese Yuan over the second half of 2018. This was mainly due to inflows from the horticulture and tourism sectors, as well as diaspora remittances.

FIGURE 1:
GDP Rates



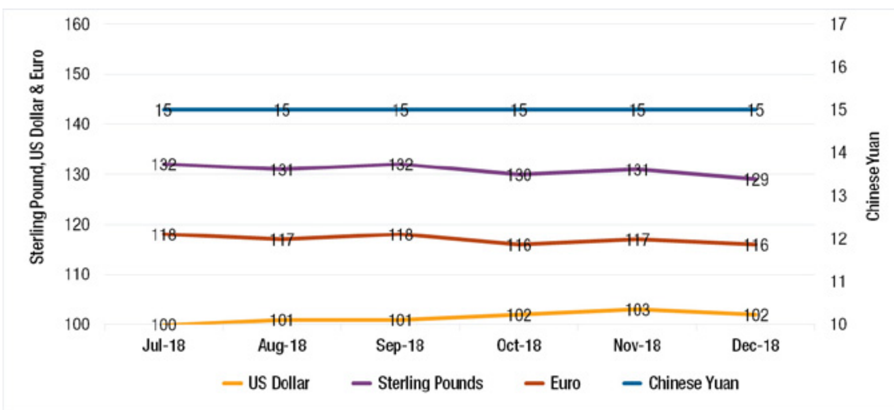
Source: Kenya National Bureau of Statistics (KNBS) & World Bank

FIGURE 2:
Value of Building Plans Vs Cement Consumption



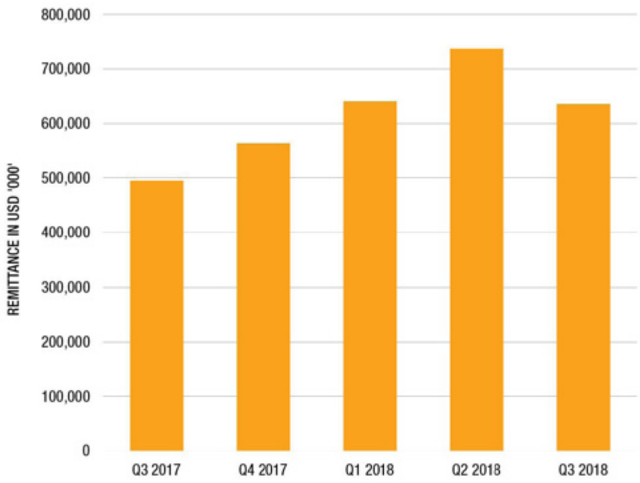
Source: KNBS

FIGURE 3:
Foreign Currency Exchange Rates



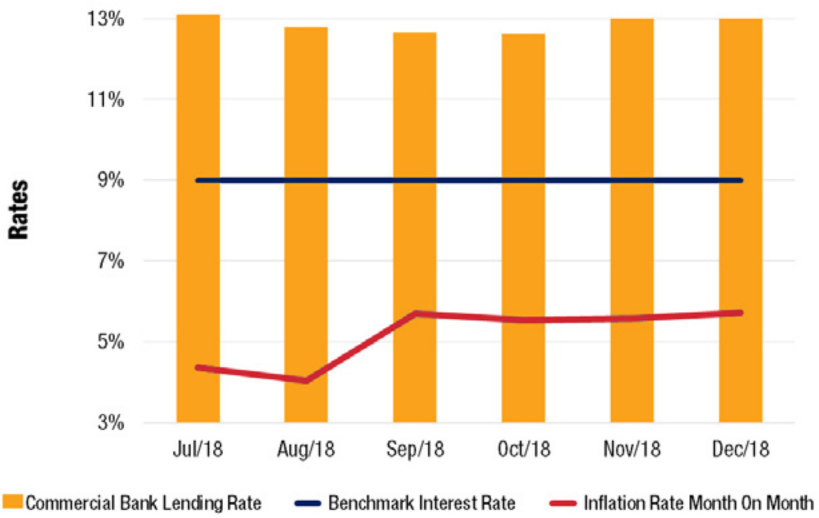
Source: Central Bank of Kenya

FIGURE 4:
Quarterly Diaspora Remittances



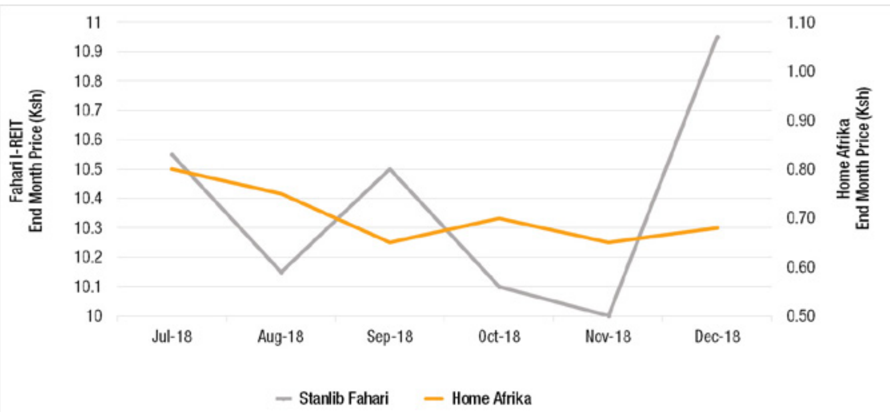
Source: KNBS

FIGURE 5:
Benchmark Economic Rates



Source: Central Bank of Kenya

FIGURE 6:
Real Estate-Related Listings



Source: Nairobi Securities Exchange

Despite the inflation rate remaining within the government's target range, it steadily rose over the review period with September and December recording the highest monthly inflation rates in 2018 at 5.7% and 5.71% respectively.

The President in September signed into law the Finance Bill 2018 which imposed a 8% Value Added Tax (VAT) on petroleum products which may have contributed to the increase in inflation. In respect of interest rates, the Monetary Policy Committee (MPC) lowered the Central Bank Rate (CBR) to 9% from 9.5% in July to boost economic output, which saw commercial banks' lending rates remain at 13% over the second half of 2018 in line with the Banking Act.

Diaspora remittances increased by circa 38% to US$ 2.2 million in the 10 months to October 2018 compared to US$ 1.6 million in a similar period in 2018, with the main source being North America.

Listed Real Estate Companies

Listed real estate equities (Home Afrika and Stanlib Fahari I-REIT) continued to perform poorly on the Nairobi Securities Exchange in the second half of 2018. Stanlib Fahari I-REIT closed at Ksh 10.95 in December, which was 45% lower than its initial listing price of Ksh 20. Home Afrika's share price closed at Ksh 0.68 in December, which was 94% lower than the initial listing price of Ksh 12. The property developer announced in September plans to exit two of its ventures in Kisumu and Mombasa counties due to inadequate capital. It is currently in the process of seeking buyers to purchase the land in the Kisumu Lakeview project and is in negotiations with Lango investors to exit the Kwale Lango project. Home Afrika said it will use the funds generated from the project disposals to complete Migaa, a residential development located in Kiambu County.

Infrastructure & Policy

Construction of Phase 2 of the 26.8-kilometre Dongo Kundu bypass in Mombasa, which was set to begin in August, has been delayed. Phase 2 will entail the construction of a 8.9-km road between Mwache junction and Mteza. Phase 3, which has not commenced, entails the construction of a 6.9-km road between Mteza and Kibudani, linking the highway to the Likoni-Lunga Lunga Road. Once completed, the bypass is expected to connect the North Coast to the South Coast.

In the second half of 2018, the government began to focus on bridging the current housing deficit through construction of 500,000 affordable houses by 2022 and other tax incentives.

In July, the President approved the amendment to the Income Tax Act allowing home buyers a 15% relief on gross salaries if they purchase properties under the affordable housing scheme. However, the tax relief will not exceed Ksh 108,000 per annum. The amendment also exempted first-time home buyers from the Stamp Duty. The Housing Levy Fund, which was part of the Finance Bill 2018, was signed into law in September. The law states that every employee will contribute 1.5% of their monthly gross salary, while employers will contribute a maximum of Ksh 5,000 for each employee. The funds raised will go towards the construction of affordable housing. The Housing Levy Fund is, however, yet to be fully implemented as it was suspended by the Employment and Labour Relations Court in December.

In October, the Government approved guidelines for the implementation of affordable housing scheme. The guidelines stipulate that the State Department for Housing and Urban Development (SDHUD) will steer the Affordable Housing Programme (AHP) and manage delivery throughout the project lifecycle.

The guidelines also address the project's financing, cost, design, quality and affordability as well as forming a 'level playing field' for both the public and private sector investors. The government has defined four levels of housing types under the AHP. These include:

- The Social category, which targets employees who earn a salary of up to Ksh 14,999. They are eligible for the social housing plan.
- The Low Cost category, which targets employees earning Ksh 15,000 - 49,999. They are eligible for affordable housing.
- The Mortgage category, which targets those earning Ksh 50,000 - 99,999. They are eligible for the mortgage plan.
- Middle and High-Income earners category, which targets employees who earn more than Ksh 100,000 per month. This category is exempt from purchasing houses under the AHP and will receive their contribution plus interest to their pension scheme after 15 years of contribution or upon retirement.

The AHP is expected to develop four sizes of houses ranging from studio apartments at Ksh 600,000, to 3-bedroom apartments at Ksh 2 million.

In the review period, the National Environment Management Authority (NEMA) announced it would demolish 4,000 buildings constructed on riparian reserves. Some of the notable residential and commercial properties that were demolished over the review period included, Ukay Centre and the car park opposite Westgate Shopping Mall and part of the Oshwal Centre, all in Westlands; South End Mall on Langata Road; Grand Manor Hotel in Gigiri; Shell service station and a Java House outlet in Kileleshwa; and Airgate Centre (Taj Mall) on Airport North Road. The government in December suspended the demolition of properties across the country.

Retail

Prime retail rents remained unchanged in the second half of 2018 at US$5.1/sqft/month while the service charge across retail malls in Kenya ranged from Kshs 44 to Ksh 59 per square foot per month. The stagnation was mainly attributed to the retail market adjusting to continued oversupply in certain locations, making it a tenant's market.

Escalations on Kenya Shilling leases ranged at 5-10% annually.

Occupancy levels for established malls remained high at over 90%. Newly completed retail centres continue to experience low occupancy levels of 45-75%. This is mainly attributed to the current oversupply and recent openings of various retail centres trading over the review period. Various landlords therefore resorted to providing concessions on rentals and other incentives to attract tenants and to increase occupancy levels. Footfall in shopping malls over the review period rose mainly owing to the revival of anchor tenants in the retail centres replacing Nakumatt.

Zhong Wu (Fujian) Cross Border E-commerce Co Ltd, a subsidiary of China Wu Yi Limited, opened a Ksh 5 billion specialised home furnishings and building materials supermarket in Athi River, Machakos County, known as Coloho Mall. This is East Africa's first and largest building materials warehouse with a built-up area of 300,000 square feet.

New retail developments that opened within the second half of 2018 are listed on Table 1. Some of the major retail developments in the pipeline are listed on Table 2.

International retail brands continued expanding and entering the Kenyan market in the second half of the year. Westgate Shopping Mall opened its doors to South African supermarket chain Shoprite as the new anchor tenant,

TABLE 1:
Completed Retail Developments

RETAIL DEVELOPMENT	LOCATION	APPROX. SIZE (SQFT)
Westgate Mall Phase II	Westlands, Nairobi	150,000
The Well	Karen, Nairobi	80,000
Diamond Plaza II	Parklands, Nairobi	90,000
Kiambu Mall	Kiambu	150,000
Signature Mall	Mlolongo	221,000
Rupa Mall	Eldoret	150,000
Airport Centre Mall	Changamwe, Mombasa	172,222
The Waterfront	Karen, Nairobi	210,000
Coloho Mall	Athi River, Machakos County	300,000

Source: Knight Frank Kenya

TABLE 2:
Retail Developments in the pipeline

RETAIL DEVELOPMENT	LOCATION	APPROX. SIZE (SQFT)
Sarit Centre Phase III	Westlands, Nairobi	323,000
Comesa Mall	Eastleigh, Nairobi	280,000
ENA Hub	Nakuru	116,000

Source: Knight Frank Kenya

Spanish fashion brand Mango, German fashion brand Hugo Boss, Japanese lifestyle brand Miniso and South African restaurant chain The Grilll Shack. French sports retailer Decathlon also opened at The Hub Karen over the review period.

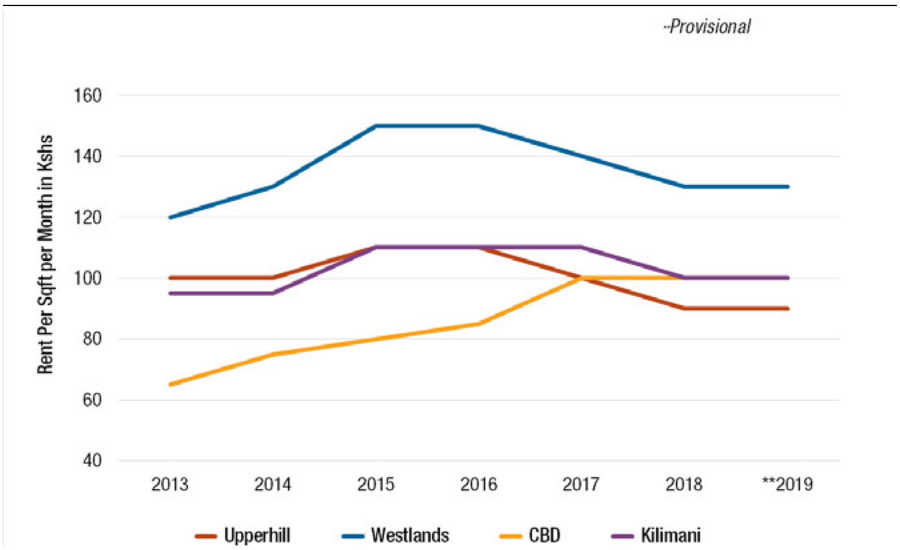
It is anticipated that more international brands will expand their presence into the Kenyan market in 2019. Looking ahead, a reduction in the supply of retail malls is projected to boost absorption of space in the existing malls. However, prime rents are expected to stagnate despite the forecasted economic growth due to the current oversupply.

Office

Prime asking rents in Nairobi stagnated over the second half of 2018 at US$1.3/sqft/month. This was a result of continued oversupply in specific locations of the market.

Absorption of Grade A office space increased by 63% in the review period compared to the first half of 2018. The increase was mainly due to completion of Grade A space in strategic locations and companies that looked to finalise on deals before the end of their financial years, even as the economy continued to recover from the previous year's election.

FIGURE 7:
Average Prime Office Rental Rate per Month



Source: Knight Frank Kenya

TABLE 3:
Commercial Developments in the pipeline

COMMERCIAL DEVELOPMENT	LOCATION	APPROX. SIZE (SQFT)
Merchant Square	Riverside	165,000
1 Park Avenue	Parklands	133,000
Laxcon Plaza	Parklands	100,000
Church Commissioners for Kenya (CCK)	Kilimani	120,000
Capital Square	Parklands	90,000
Le' Mac	Westlands	85,000
Global Trade Centre (GTC)	Westlands	678,000
Sandalwood	Riverside	250,000
Pinnacle (office section)	Upperhill	70,000
The Address	Westlands	243,000
19 Kabasarian Avenue	Lavington	76,600

Source: Knight Frank Kenya

One of the major takers of space was the serviced office sector from both local and international firms.

Serviced offices vis-à-vis traditional offices have recently gained traction, with demand driven by small and medium-sized enterprises (SMEs) for various reasons, which include: lower operating costs, risk reduction, lease agreement and office space flexibility, and providing SMEs the opportunity to be situated in prime locations.

Completions in Nairobi over the review period included One Africa Place (138,004sqft), The Promenade (215,999sqft) and Victoria Towers in Two Rivers (85,002sqft).

East and Central Africa's tallest building, Britam Tower in Upperhill, opened in July. The building has a lettable area of 349,999sqft. Avic International Real Estate Kenya Limited launched the Global Trade Centre (GTC) in September. The Ksh 40 billion mixed-use development formerly known as AVIC Towers comprises of an office tower, luxury five-star hotel, residential apartment complex and a retail mall. This is the first mixed-use development being constructed in the prime location and is expected to be completed in 2020.

Major commercial office developments in Nairobi that are in the pipeline are indicated on Table 3.

Prime rents in the commercial office market are expected to continue stagnating over the first half of 2019 due to the current oversupply and upcoming developments.

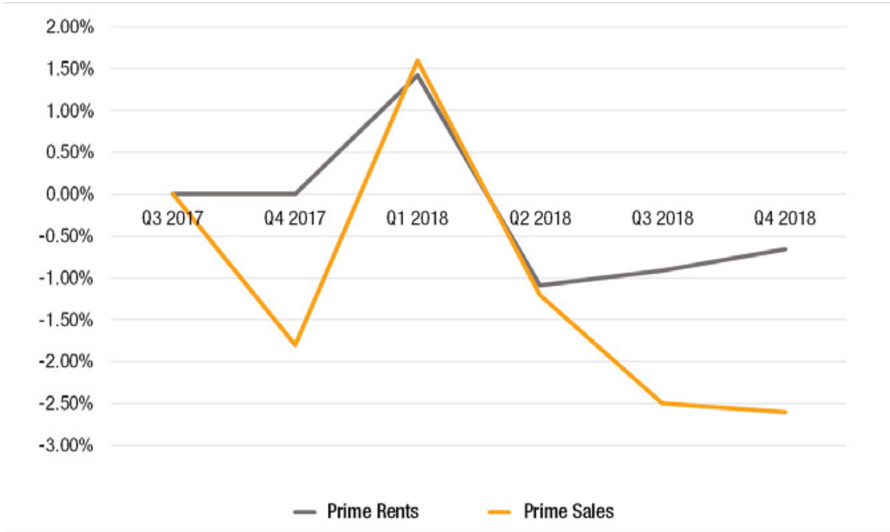
Residential

Prime residential prices decreased by 4.5% in 2018, compared to 0.9% in 2017. This was mainly attributed to an oversupply in the market, tighter liquidity due to the new banking legislation which capped interest rates and a general market price correction, all of which turned the high-end residential market into a buyers' market. A trend also noted in 2018 saw buyers opting to purchase distressed properties rather than new properties, as the former's prices were favourable.

Prime residential rents decreased at a slower rate of 1.34% in 2018 compared to 2.75% in 2017. Despite the residential rental market still experiencing an oversupply, the high-end segment of the market still has significant demand, particularly from expatriates and middle- to high-income earners owing to the locations and quality of houses.

Various public institutions and private firms made major residential announcements over the second half of 2018. Centum Investments announced it would commence the second phase of the Two Rivers development in

FIGURE 8:
Prime Residential Rents and Prices



Source: Knight Frank Kenya

Nairobi, which entails the construction of 196 residential units over a gross built up area of 495,140sqft. Lancet Housing Co-operative Society Limited broke ground on its Ksh 1.2 billion Lancet Village mixed-use development which sits on 10 acres in Machakos County. The mixed-use development consists of 188 residential units, a commercial area and an educational institution. Lancet said it will retain 50% of the residential units.

The Mombasa County Government announced plans to invest Ksh 200 billion towards an affordable housing scheme, which it expects to achieve by demolishing and reconstructing old government housing estates such as Mzizima, Changamwe and Likoni Customs.

The Kenyan Government and the United Nations Office for Project Services (UNOPS) in September signed an affordable housing agreement to deliver 100,000 affordable housing units in line with the Affordable Housing Programme. Financing of the project is from both the Kenya government and UNOPS.

In the private sector, Tatu City set aside 300 acres towards the construction of 10,000 houses, which will be part of the government's affordable housing scheme and will be priced at Ksh 1.5-5 million. Construction is set to commence in May 2019. Tatu City also signed agreements with several residential developers to construct residential units within the allocated residential sections of the mixed-use development. Unity Homes will construct 1,200 affordable homes, which will sit over 23 acres and cost Ksh 4.5 billion to construct. Karibu Homes will also build 1,000 homes in the mixed-use development at a cost of Ksh 4 billion.

Home ownership remains a challenge in the market even as the number of mortgage loans increased from 24,059 in 2016 to 26,187 in 2017. The 8.8% increase was mainly attributed to the favourable interest rates available.

FIGURE 9:
Trends in international visitor arrivals & tourism earnings

Source: KNBS and Kenya Tourism Board

Hotel & Tourism

Leading global hospitality brands continued to venture into the Kenyan market via expansion or by taking over operational hotels, as the country remained a popular destination for luxury travellers. Five-star luxury hotel, Sankara Hotel in Westlands, joined the American luxury hospitality group Marriott International through a franchise agreement. The hotel will begin trading in 2019 as a Marriott brand, but the Sankara Hotel Group will be retained as the manager. Marriott International currently operates two hotels – Four Points by Sheraton Nairobi Airport and Four Points by Sheraton Nairobi Hurlingham – which it took over from Best Western Hotels & Resorts brand. The hospitality group currently has two upcoming hotels in the pipeline: JW Marriott, which is expected to open in 2020 and will be located at GTC's mixed-use development in Westlands, and Protea Hotel by Marriott Nairobi, which will be located near the Jomo Kenyatta International Airport (JKIA) and is expected to open in 2021.

Other 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. The increased supply of hotel rooms especially in and around Nairobi, is expected to have a downward pressure on occupancy and room rates.

Kenya's Meetings, Incentives, Conferences and Events (MICE) sector has rapidly grown over the past few years, allowing the country to continue raising its profile as a top destination for business tourists. The Kenyan government hosted the Sustainable Blue Economy Conference in November, the first of the global conference, hosting over 18,000 participants including heads of States and government and heads of international organisations. It addressed the sustainable use of oceans, lakes, seas and rivers for sustainable economic development, improved livelihoods and job creation. The growth of MICE tourism has had a ripple effect on the residential market as some business tourists opted to stay in serviced apartments close to the conference venues.

Tourist arrivals surged by 38.1% to 2.03 million in 2018 from 1.47 million in 2017. This is the highest number of tourist arrivals recorded in the country over the last five years. The main factors that attributed to this increase included political stability, withdrawal of travel advisories and improved security regionally.

As is the norm over the festive season, hotels at the Coast recorded a significant increase in bookings as the number of domestic guests pushed up occupancy to more than 65% over the festive season.

In October, Kenya Airways (KQ) made its inaugural 15-hour direct flight from Nairobi to New York, becoming the second national carrier from Eastern Africa after Ethiopian Airways to fly to the US. KQ announced in December it would reduce New York daily flights from January to five per week over off-peak periods, which are characterised by lower demand such as during the winter season.

The launch of the direct flights to the US is expected to have several benefits to the Kenyan economy, including boosting trade ties between the two countries, promoting the inflow of foreign investments, creating employment and increasing tourism, which is one of Kenya's major foreign exchange earners.

Qatar Airways in December launched direct flights to Mombasa, Kenya's second largest city, joining other international carriers such as Ethiopian Airlines, Turkish Airlines and RwandAir on the destination. Whilst this increases the number and variety of airlines that fly directly to Kenya's main coastal tourist destination, it will also be a competitive threat to local carriers which currently dominate the coastal route.

Industrial Market

Demand for high quality warehousing space continued to rise in the second half of 2018. In September, Africa Logistics Properties (ALP) launched ALP North, its 527,432sqft Grade A warehousing park, which was 75% pre-let. Since unveiling ALP North, it has signed a long-term lease for 32,291sqft with Kensta, East Africa's largest regional print and packaging company. ALP West, ALP's second project, completed road infrastructure on its 49-acre site at the Tilisi Logistic Park where it plans to construct a 1,076,391sqft logistics and distribution warehousing complex.

Infrastructure construction for Phase 1 of the Park was completed during the review period with Phase 2 expected to commence within the first half of 2019.

Improvon Group and private equity fund Actis, through a partnership, announced the launch of a 53,820-sq ft warehousing development estimated to cost Ksh 11 billion. Nairobi Gate Industrial Park will sit on 103 acres and is located off the Eastern bypass. Phase 1 is expected to be completed within the first half of 2019.

Institutional Market

Crawford International School owned by ADvTECH, Africa's largest private education provider, opened in Kiambu's Tatu City in September. The educational institution has a capacity of 1,700 students.

Sabis International School in Runda opened in September through a partnership with Centum Investments Company, Dubai firm Investbridge Capital and South African firm, Sabis Education Network. The educational institution will cost approximately Ksh 2 billion to develop and sits on 20 acres. The investors are expected to set aside an additional Ksh 1 billion for expansion, which will go towards the construction of three accommodation blocks, two classroom blocks and a 400-metre athletics track.

In the same period, Acorn Holdings Africa continued to roll out its purpose-built student residences. It currently has two developments under construction in Parklands and Madaraka that combined will provide over 1,300 student beds, with another 2,000 in the pipeline, spread over various locations in Nairobi.

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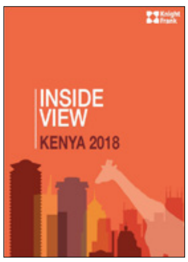

Inside View Kenya 2018

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