RESEARCH

KENYA MARKET UPDATE

1ST HALF 2015

Garden City Mall

HIGHLIGHTS

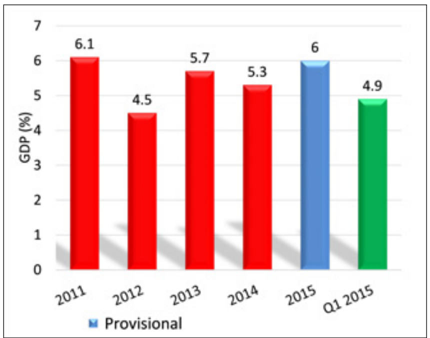
- Kenya shilling hits 3-year low
- Government increases infrastructure budget allocation
- Southern by-pass opened
- Number of mortgage accounts increases
- Office absorption levels dip
- Rental prices plateau
- Residential sale prices creep up
- Garden City opens for business
- International hotel brands focus on Kenya
- Decentralisation of industries gains momentum

The Economy

The country's economic performance improved to 4.9% during the 1st quarter of 2015 compared to a growth of 4.7% in the same quarter of 2014. This is against an annual expected growth rate of 6%, mainly supported by expansion of various sectors, including construction.

The construction and real estate sectors together contributed circa 13% to this growth. Construction grew by 11.3% in the 1st quarter of 2015 compared to a growth of 7.6% in a similar period in 2014. The real estate sector witnessed a contracted growth of 2% over the same period in 2015 compared to 6% in 2014.

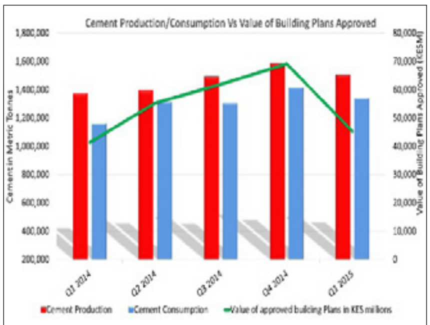
Figure 1: Quarterly GDP Rates



Source: KNBS

Consumption of cement increased by 9.8% in the 1st half of 2015 to 2,719,839 MT, from 2,476,591 MT recorded in a similar period in 2014. Similarly, the value of approved building plans in Nairobi increased by circa 4.8% to around KShs81.3 billion in the first five months of 2015, from KShs77.6 billion over the same period in 2014.

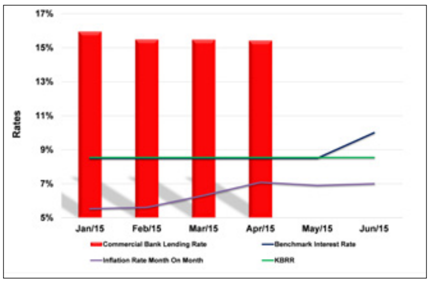
Figure 2: Value of Building Plans VS Cement Consumption



Source: KNBS

The Monetary Policy Committee (MPC) in June 2015 increased the base rate by 150 basis points to 10% and by a further 150 basis points to 11.5% in July 2015. The increments were meant to tame the persistent volatility in the global foreign exchange markets coupled with the projected recovery in international oil prices that have implications on inflationary expectations. Consequently, the Kenya Banks Reference Rate was increased by 133 basis points, from 8.54% to 9.87%, the highest since its inception in July 2014. Commercial bank lending rates were observed to fall marginally in the 1st quarter of 2015, but are expected to rise with the revision of the KBRR. Overall month-on-month inflation increased to 7% in June 2015 from 5.53% in January 2015. This was mainly attributed to increase in fuel prices and the pass-through effects from the weakening Kenya shilling against the US dollar.

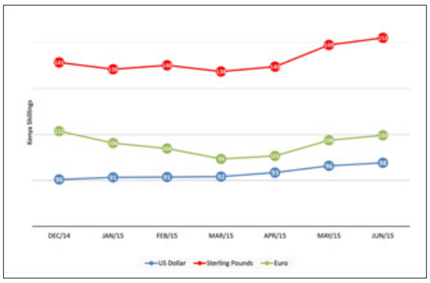
Figure 3: Benchmark Economic Rates



Source: Central Bank of Kenya

The Kenyan shilling hit three-year lows in the 1st half of 2015, weakening by about 7% against the US dollar mainly due to the strengthening of the latter against most currencies. This has been compounded by domestic factors such as a widening current account deficit.

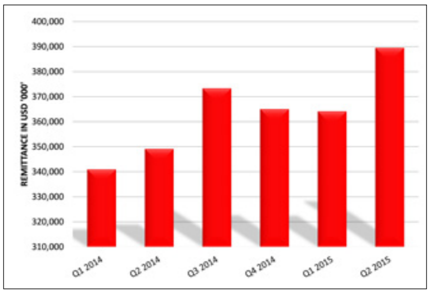
Figure 4: Foreign Currency Exchange Rates



Source: Central Bank of Kenya

Diaspora remittances increased to circa US$745 million in the 1st half of 2015 compared to US$690 million for a similar period in 2014.

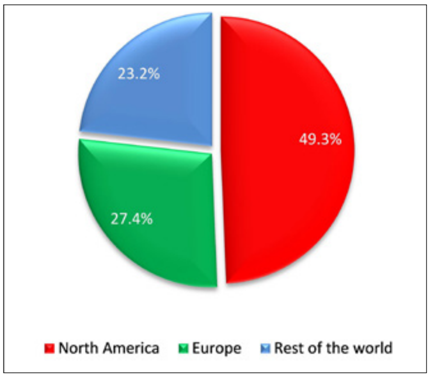
Figure 5: Total Diaspora Remittances



Source: Central Bank of Kenya

The share of diaspora remittances to Kenya from North America increased from US$57.3 million in May 2015 to US$67.1 million in June 2015. This constituted a 44.4% and 49.3% of the total cash inflows in the respective months.

Figure 6: Remittance Inflow Share by Source - June 2015



Source: Central Bank of Kenya

Infrastructure

The Government of Kenya continued its investment in infrastructure through expansion of the road network, specifically through the allocation of KShs132.2 billion in the 2015/2016 fiscal year. This represented a 14% increase from the previous fiscal year. Earlier in the year, the Treasury signed a grant agreement of US$20 million with Trade Mark East Africa for the expansion of Port Reitz and Moi International Airport access roads in Mombasa, completion of which is expected in the 2nd quarter of 2016. The Kenya Urban Roads

Authority commissioned a feasibility study for the second Nyali Bridge that is to be financed through a public private partnership agreement. The new bridge will provide an alternative link between Mombasa Island and the North Coast and facilitate a steady flow of imports and exports while easing traffic from the port of Mombasa. In Nairobi, as part of Nairobi's master plan, the Ministry of Land, Housing and Urban Development invited bids for consultancy services for the preparation of a strategy for the redevelopment of the Nairobi Central station and its surrounds into a world-class, sustainable urban railway city. The site comprises of circa 200 acres.

With regard to road infrastructure, the Southern by-pass was opened in a move aimed to ease traffic congestion in the city. It connects road A109 (Mombasa-Nairobi) and A104 (Nairobi-Nakuru). The project involves construction of a 28.6-kilometre dual carriageway with 12km slip roads and an extra 8.5km service roads. The road has been constructed at a total cost of US$186 million. In Kisumu County, a consortium led by Maritime & Transport Business Solutions (MTBS) of Netherlands has been appointed to advice on the planned construction of a modern KSh22.5 billion port in Kisumu. In Meru County, plans were announced for the construction of a 120-km by-pass. These projects not only have the effect of improving accessibility, but also increasing the property values in the areas they serve.

Retail

- Rental levels stagnate
- Garden City opens for business
- International retailers still keen on Kenya

Figure 7: Nairobi Supply of Retail Space

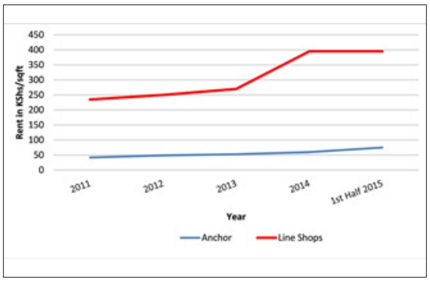
Source: Knight Frank

Garden City opened its doors for business in Q2 of 2015, with Game as the anchor tenant and an overall space uptake of 90%, although a number of shops are yet to open. This is a positive indication not only for the retail sector but also for Phase 2, which will comprise a lettable area of 15,000 square metres. The existing mall comprises approximately 33,000 sqm of retail space and contributes circa 30% of the formal retail space that was expected in the market in 2015.

Prime retail rents remained unchanged in the 1st half of 2015 at US$48/sqm/month. Retail projects that broke ground in the 1st half of 2015 include the 40,000 sqm Karen Waterfront, 20,000 sqm Crystal Rivers in Athi River and Cedar Mall in Nanyuki. The other major completion was Ananas Mall in Thika.

Nakumatt, the largest supermarket chain in Kenya, announced plans to open 40,000 sqft at Comesa Mall that is along General Waruinge Street in Nairobi and will lease a 1/3 of the development. Completion of the mall is expected in December 2016.

Figure 8: Average Prime Rental Rate per Month per Ft²



Source: Knight Frank

Other completions expected in the 2nd half include The Hub in Karen and Diamond Plaza II in Parklands, which will incorporate a revolving restaurant, both of which have a lettable area of 30,000 sqm. Two Rivers, set to be the largest formal retail development East and Central Africa, pushed its opening date to the 1st quarter of 2016 from the 2nd half of 2015.

Knight Frank continues to receive substantial interest from international traders, with most of the international investors citing sourcing of local partners as their main hurdle.

Office

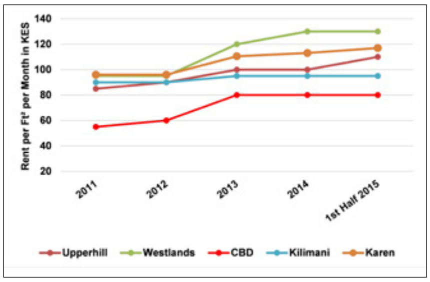
- Absorption levels dip
- Asking rentals plateau
- Supply of office space steady
- Commercial mortgage rates remain high

The 1st half of 2015 experienced a 45% decline in absorption of Grade A office space compared to a similar period in 2014.

This decline is attributed to the drop in supply of prime Grade A offices coupled with the fact that many multinationals are downsizing their operations in Kenya. In addition, Government agencies, which were major takers of the space, are devolving their functions to counties.

The prime commercial office rents in Nairobi remained stable in the first half of 2015 at US$21/sqm/month. This is similar to that of other capitals such as Dar es Salaam, but considerably lower than other African financial hubs such as Lagos, Cairo and Johannesburg.

Figure 9: Average Prime Rental Rate per month per Ft²

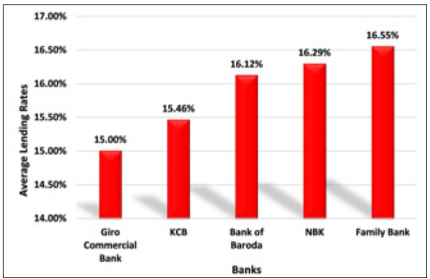


Source: Knight Frank

The most notable office completions in Nairobi include The Riverfront at Riverside Drive and Adlife Plaza along Ring Road, Kilimani. Other developments in the pipeline include AVIC Towers in Westlands, which will comprise a 43-level office tower, a 35-floor hotel tower and four apartment towers of 24 levels each. The development is costed at circa KShs9.6 billion. In Upperhill, Corporate Business Park along Elgon Road was completed, while Jabavu Village Limited broke ground on a mixed-use, 45-storey building that will comprise two towers located at the junction of Upper Hill Road and Haile Selassie Avenue, with a built up area of over 100,000 sqm.

With regard to commercial mortgages, the Central Bank – in its role of promoting price stability – published the average risk premiums on loan products based on its recently introduced KBRR. Giro Bank emerged as the most favourable bank with an average risk premium of 6.46% for commercial mortgages, translating into an average lending rate of about 15%. The graph below indicates the five other favourable banks, according to the report.

Figure 10: Average commercial Lending Rate - March 2015



Source: CBK

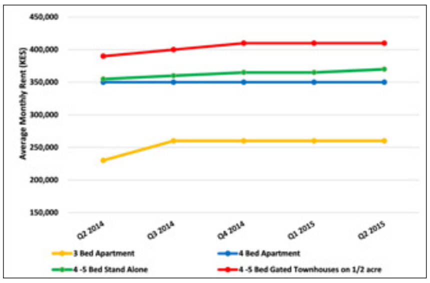
Residential

- Stabilised rental levels
- Marginal price increases
- Increase in number of mortgages

The 1st half of 2015 has been relatively stable although somewhat sluggish for the high-income and upper-middle residential rental market. The price stabilisation through Q1 and Q2 meant that rents remained more or less the same.

Accommodation uptake has been slow and there was no marked record of rental price change from Q4 2014. Nairobi has enjoyed rental increments over the past years with annual escalations in the region of 10%, which built up rents in prime properties beyond affordable levels. The result is low occupancy levels and longer letting periods.

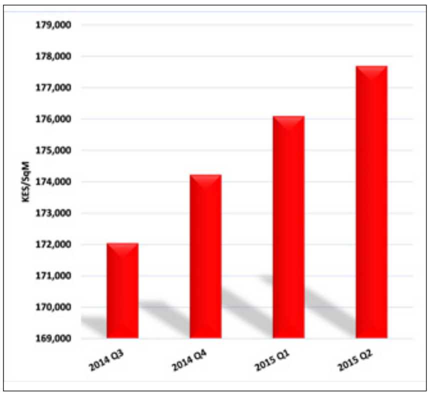
Figure 11: Prime Residential Rental Market



Source: Knight Frank

In the same vein, the high-end residential sale market witnessed a 2.1% annual growth increase in the 2nd quarter of 2015 compared to a 4% increase for a similar period last year, with an increase of circa 0.9% in the 2nd quarter.

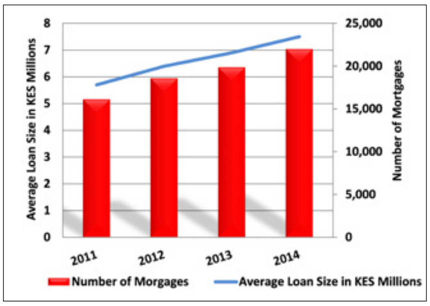
Figure 12: Prime Residential Sale Rates



Source: Knight Frank

In the middle-income residential market, the number of mortgages increased in 2014 by circa 10.7% from 2013 because of the relatively favourable interest rates. Similarly, the average mortgage size increased by 9% to KShs7.5 million in 2014, from KShs6.9 million in 2013.

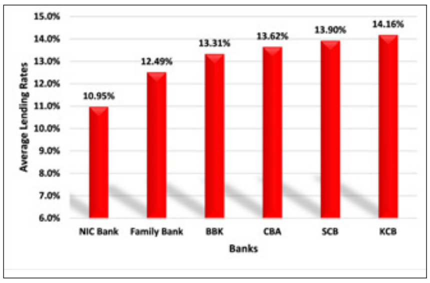
Figure 13: Average Mortgage Size Vs Number of Mortgages



Source: CBK

With regard to lending rates on residential mortgage loans, NIC Bank emerged as the most favourable lender with an average risk premium of 2.41%, translating into an average lending rate of approximately 10.95%. The graph below indicates the five other favourable banks, according to the CBK report.

Figure 14: Average Residential Lending Rates



Source: CBK

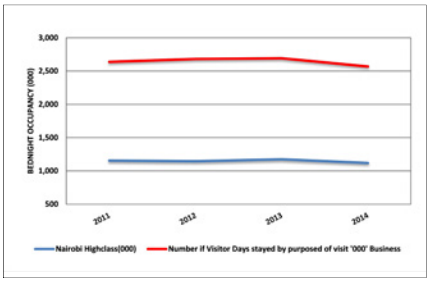
The 1st half of 2015 also witnessed announcements of several huge investments by educational institutions, with the most notable being Kenyatta University announcing plans to build a Kshs4 billion hostel on 20 acres to house 9,530 students, and the Oshwal Community, which announced plans to build a KShs3 billion facility in Thika. This is as Mombasa International University broke ground on a KShs10 billion campus at the Coast.

Hotel & Tourism

- Business tourists remain bullish
- International hotel chains focus on Kenya

Most sectors of the economy recorded positive growths of varying magnitude in the 1st quarter of 2015, except the hotels and restaurant sector whose growth contracted. This was mainly attributed to low hotel occupancy rates arising from insecurity concerns by international visitors. These concerns have seen a decline in tourist arrivals of circa 30% in Q1 2015 compared to Q1 2014. Despite this, Nairobi's hotel occupancy levels have remained relatively resilient. These hotels mainly cater for the business tourist. The relatively stable occupancy level has led to a sharp increase in the number of hotels in the pipeline that includes Hilton Garden Inn, Golden Tulip, Tamarind Tree Hotel and Sun Africa. JW Marriott also plans to establish a hotel in Westlands. These will raise the number of hotel rooms in Nairobi by 20% by the end of 2016, further cementing Nairobi as a regional hub for East Africa.

Figure 15: Bed Night Occupancy Nairobi High Class Hotels & Visitor Arrivals



Source: KNBS

In addition, a new terminal was opened at the Jomo Kenyatta International Airport, which has a capacity to handle 2.5 million passengers every year. The additional terminal brings JKIA's capacity to 7.5 million passengers annually, compared to the estimated 6.5 million passengers who go through the airport currently. At the Coast, a 26-room boutique hotel was opened at the English Point Marina to complement the 107 apartments and the soon-to-be-completed Marina.

Industrial Market and Redevelopment Land

- Decentralisation of industries gains momentum
- Proctor & Allan opens plant in Kiambu County
- Strong demand for prime redevelopment land

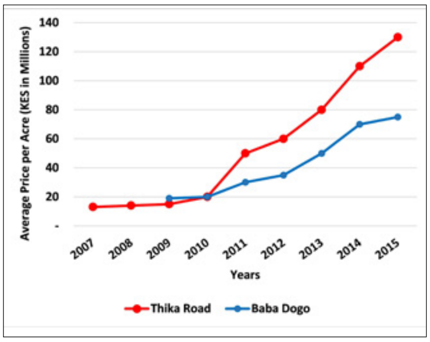
Manufacturing plants continued the trend of decentralising from traditional industrial areas in line with the Government's strategy and Vision 2030. Wrigley announced plans to build a KShs5.8 billion plant in Machakos County that will be operational by April 2017 and will see its annual output double. Knight Frank sourced for the site on which the plant is to be built.

In addition, Proctor & Allan East Africa opened its KShs1.8 billion plant in Limuru in a move aimed at boosting its production capacity.

Several industrial parks are also in the pipeline such as Tatu in Kiambu County and the newly launched Tilisi in Limuru. These parks are set to take advantage of the current exemption from VAT of taxable goods and services for use in the construction of the infrastructure works as was announced in the 2015/16 budget.

In Nairobi, land prices along Thika Road and Baba Dogo Road areas have increased significantly, with the former rising ten-fold since 2007. This is mainly attributed to the completion of the Thika Superhighway and land scarcity principally along Thika Road, between the Central Business District and the Moi International Sports Centre in Kasarani. This is also because of the change of user from industrial to other competing land uses such as residential and commercial offices.

Figure 16: Average Land Value per Acre per Location



Source: Knight Frank

Knight Frank continued recording significant interest in prime redevelopment land in its books, with the most notable transaction being a 21-acre site in Ruaraka, Nairobi.

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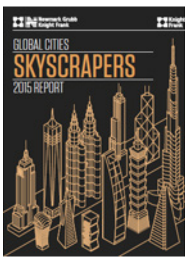

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