RESEARCH

KENYA
MARKET UPDATE - 2ND HALF 2016

Britam Tower - Upperhill

HIGHLIGHTS

- Kenyan economy records marginal growth
- Kenya shilling stabilises against major currencies
- Finance Act 2016 and Banking Amendment Act 2015 assented
- REITs face challenges
- Prime retail rents under pressure
- Absorption of Grade A office space rises
- Office asking rents stagnate
- Prime residential rents dip
- Prime residential sale prices plateau
- Hospitality sector diversifying through MICE

"The significant increase in absorption of grade A office space was due to major relocations by local organisations and multinationals opting to increase or consolidate their offices to single locations."

CHARLES MACHARIA
Senior Research Analyst

The Economy

The economy is estimated to have expanded by 5.9% in 2016 compared to 5.4% in 2015. The second half of 2016 saw Kenya's economy recording growth in some sectors. Notably, sectors that have contributed to the economic growth include real estate, agriculture, forestry and fishing, transportation and storage, and wholesale and trade. According to the Kenya National Bureau of Statistics, the GDP in the third quarter of 2016 expanded by 5.7% compared to 6% over the same period in 2015. This was due to macroeconomic factors such as higher inflation rates owing to the increase in prices of food and beverages.

Despite weaknesses in global economic performance, Kenya's growth has remained consistently solid, helped by investments and private consumption. The continuous growth over the last eight years, according to the World Bank, has been generated by a vibrant services sector, enhanced construction, currency stability, low inflation, low fuel prices and a growing middle class. This growth is projected to surpass the average regional growth for Sub-Saharan Africa, making Kenya a major hotspot.

However, Kenya remains vulnerable to external and internal shocks such as adverse weather conditions, which will have a huge impact on agricultural growth, and the general election in 2017 that will create uncertainty amongst investors.

Traditionally strong sectors that posted decreased growth include the construction industry. The real estate sector contributed Ksh138.97 billion to the GDP in the period under review compared to Ksh126.36 billion of over the same period in 2015. From an international perspective, oil prices declined by 9.3% in the third quarter compared to the same period in 2015.

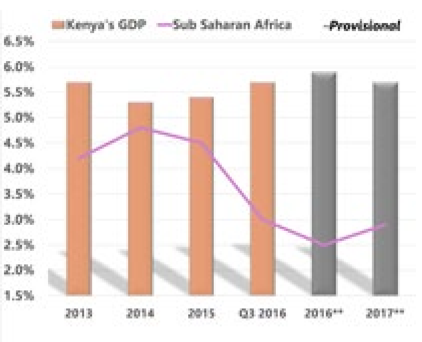
While the construction sector experienced growth within the second half of 2016, the third quarter recorded a slower growth of 9.3% compared to 15.6% over the same quarter in 2015, owing to a reduction in civil works for the Mombasa-Nairobi Standard Gauge Railway (SGR) that is currently in its final phase. Despite this decline, the construction sector performed better in the fourth quarter. Cement consumption increased to 1.6 million MT (Metric Tonnes) in the fourth quarter of 2016 compared to 1.5 million MT in the fourth quarter of 2015. Cement production also increased over the same period to 1.7 million MT, from 1.5 million MT in the fourth quarter of 2015. Property developers maintained a positive outlook similar to the first half of 2016, with the value of building plans in Nairobi increasing by 3% to Ksh159.70 billion in the second half of 2016, from Ksh154.59 billion in the first half.

The Kenya Shilling followed a similar trend in the second half of 2016 as the first half, remaining stable against the US Dollar, Euro and Chinese Yuan. The Sterling Pound, similar to the first half in 2016, continued to depreciate significantly against the Kenya Shilling. In December 2016, the shilling was at Ksh125 to the pound, the lowest point in the year. One of the main factors that caused this significant depreciation of the pound was the United Kingdom's referendum result to exit from the European Union (Brexit) in June 2016.

The Banking Amendment Act 2015 was passed in August 2016. The law capped commercial interest rates at 400 basis points above the prevailing Central Bank Rate (CBR), which currently stands at 10%.

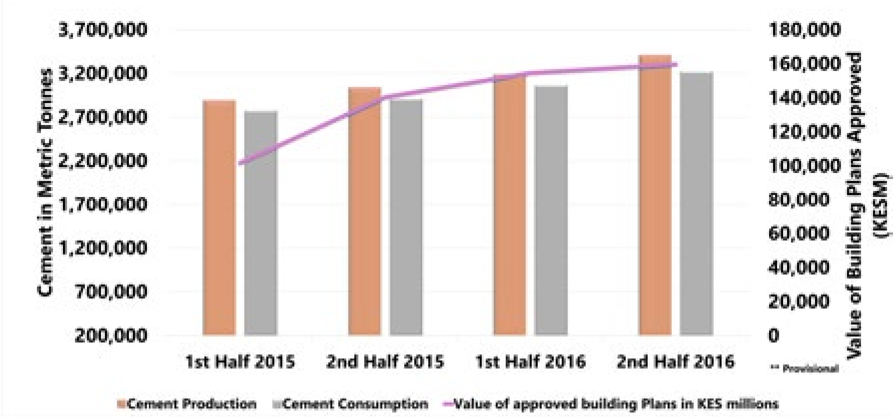
This amendment of the Banking Act resulted in a substantial decline in the average commercial banks' interest rates from September to December at 13.84%, compared to 16.75% over the same period in 2015 and this was expected to see an increase in the number of mortgage loans.

FIGURE 1:
GDP Rates



Source: KNBS & World Bank

FIGURE 2:
Value of Building Plans Vs Cement Production & Consumption



Source: KNBS

Financial Market

The second half of 2016 saw listed real estate stocks (Home Afrika and Fahari I-REIT) perform poorly on the Nairobi Securities Exchange, continuing a trend similar to the first half. Fahari I-REIT remained volatile until September to December where the share price stabilised. Fahari I-REIT closed the year at Ksh11.50 which was 43% lower than the initial listing price of Ksh20. Similarly, Home Afrika's price in December was Ksh1.20 per share, 90% lower than its initial listing price of Ksh12 in Q2 of 2013.

Fusion Capital extended the offer period of its debut Development REIT to the public from July to August, with the sale having begun in the first half. This indicated that the D-REIT was still trying to raise the targeted Ksh2.3 billion for the construction of Greenwood City, a mixed-use development in Meru County. The offer was restricted to professional investors only. Despite the extension, its bid to raise the full amount was unsuccessful and it failed to meet the listing threshold.

REITs are still a new concept in the Kenyan market and the product requires concerted efforts such as industry initiatives or backing by State agencies to succeed.

Infrastructure

The Standard Gauge Railway is still considered the country's most expensive infrastructure project, costing more than US$3.27 billion. The first phase of the project is anticipated to be completed in June 2017. Construction of the second phase started in October and completion of the entire project is expected to contribute to the establishment of new urban centres.

The second phase is a 490-km line that links Nairobi and Malaba on the Kenya-Uganda border and is being constructed by the China Communications Construction Company Ltd (CCCC). This phase is expected to cost US$1.5 billion.

The current works for the first phase of the single-track standard gauge railway between Mombasa and Nairobi is 98% complete. The SGR project has experienced various hurdles, including reduction in the proportion of supplies by Chinese contractors from 40% to 25%, as well as compensation for land along the route.

The LAPSSET Corridor Programme, which brings together Kenya, Ethiopia and South Sudan, was recognised during the World Economic Forum (WEF) in Kigali by the Sustainable Development Investment Partnership (SDIP) in May 2016. The government approved an additional Ksh1 billion for the project and will complete the LAPSSET headquarters and first berth before opening the whole project to private investors.

The Land Value Index Laws (Amendment) Bill was enacted by The National Assembly in December. This is an Act of Parliament to amend the Land Act, the Land Registration Act and the Prevention, Protection and Assistance to Internally Displaced Persons and Affected Communities Act; to provide for the assessment of a land value index in respect of compulsory acquisition of land. The Bill introduces the Land Value Index that will standardise and harmonise the value of land across the country. The Bill seeks to make Land Rates, Rent, Stamp Duty and compensation predictable, rational and not prone to subjective valuations.

The Finance Act 2016 was assented into law on September 13, 2016. The incentives to the real estate sector included: a reduction of the corporate tax rate from 30% to 15% when a company builds a minimum of 400 residential units annually, effective from January 1, 2017. The qualifying mortgage interest deduction has been increased to Ksh300,000 annually or Ksh25,000 per month from the previous Ksh150,000 per annum. In addition, rental income below Ksh144,000 per annum was exempted from residential income tax.

Retail

Rents for prime centrally located retail space in the capital typically ranged between US$40 and US$50 per sqm/month but now reached upwards of US$55 per sqm/month in the second half of 2016. The increase is a reflection of the quality of premises currently being built, together with the rise in tenant demand for the top locations. While the new highs are an adjustment for some, the rents are still lower than other major capitals in Africa e.g. Cairo at US$70/sqm/month and Johannesburg at US$60/sqm/month.

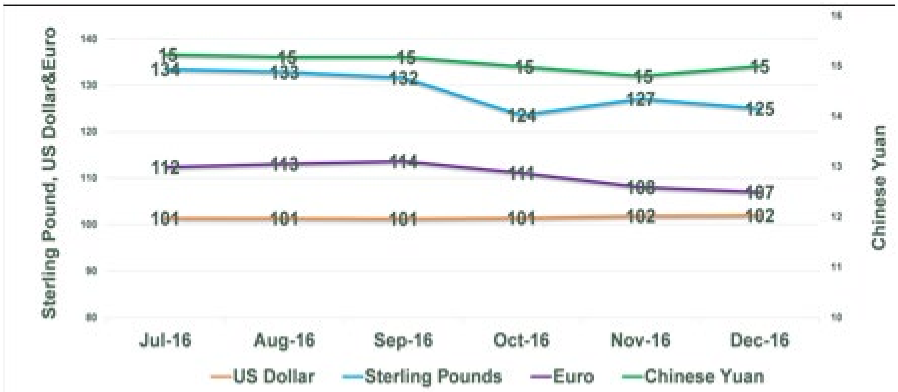
The construction pipeline in the large formal retail sector remains high, with over four million square feet that could potentially be delivered over the next three years in the capital alone. This has resulted in more landlord concessions such as longer rent free periods, reduced escalations and increased fit-out contributions. The service charge across retail centres in Kenya averaged Ksh485/sqm/month, depending on management practices.

New retail developments that opened in 2016 increased competition for retailers and caused a reduction in foot and vehicular traffic for older retail malls in some instances. This trend is expected to continue into the first half of 2017. However, occupancy levels remained high for older malls in popular locations.

Major retail entrants into the Kenyan market in the second half of 2016 included Cedar Mall and NextGen Mall. Cedar Mall is an 18,000-sqm retail mall located in Nanyuki,

FIGURE 3:

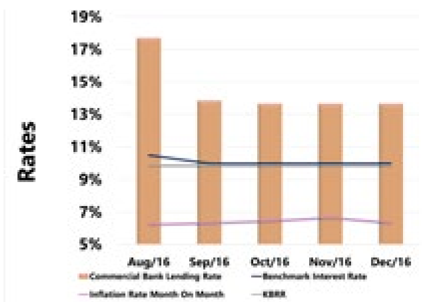
Foreign Currency Exchange Rates



Source: KNBS

FIGURE 4:

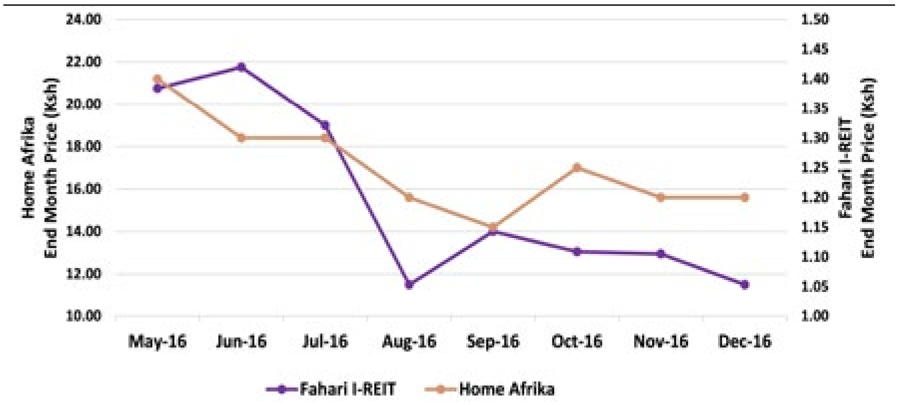
Benchmark Economic Rates



Source: Central Bank of Kenya

FIGURE 5:

Real Estate-Related Listings



Source: Knight Frank Kenya

with Phase 1 occupying 12,000 sqm, and opened in December. NextGen Mall, located along Mombasa Road, is circa 15,000 sqm in size. Kisumu City had two new retail malls that opened in 2016, namely Tuff Foam and West End. Lake Basin Mall that is estimated to have a built up area of circa 55,000 sqm will be Kisumu's largest mall upon opening. This will increase the number of formal retail developments in Kisumu to seven.

Rosslyn Riviera Mall (12,000 sqm) in Rosslyn and Two Rivers Mall (64,000 sqm) in Ruaka, which is Kenya's and East Africa's largest shopping centre development, pushed their opening dates to February 2017. Two Rivers Mall is eventually expected to be compliant with international green building standards, which will render it the second mall in Kenya to comply with the global standard after Garden City, which was the first Kenyan mall to be awarded the Leadership in Energy and Environmental Design (LEED) Gold pre-certification.

Major international brands that entered the Kenyan market in the second half of 2016 included Florence and Fred (F&F) and Burger King, while those venturing into the market in 2017 include LC Waikiki, Swarovski, Magic Planet, Smart Gyms and Vox Cinemas.

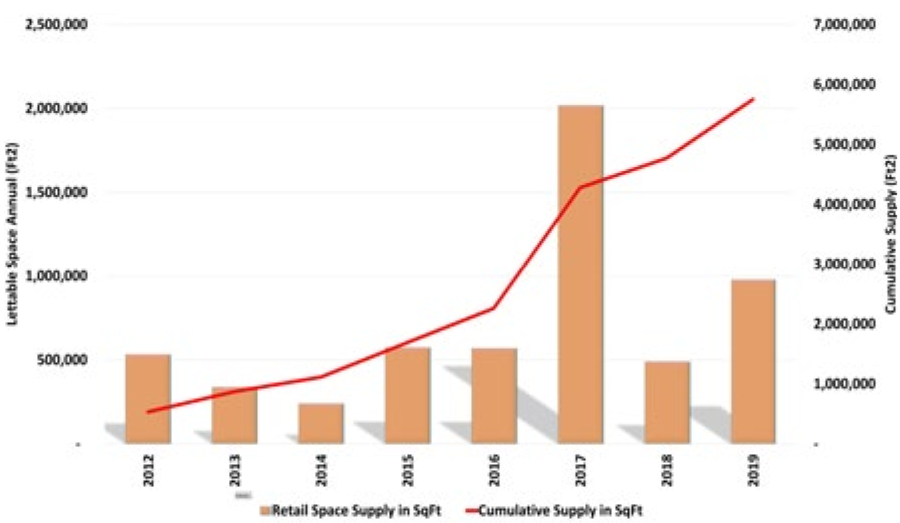
Office

The second half of 2016 experienced a 50% increase in the absorption of Grade A office space compared to the first half, and a 92% rise compared to a similar period in 2015.

The significant increase in absorption of office space was due to major relocations by local organisations and multinationals opting to increase or consolidate their offices to single locations, coupled with tenants requiring larger spaces to accommodate expansion. Examples of these included KenolKobil, Ecobank and GIZ Kenya Limited. This trend is likely to continue albeit at a slower pace.

FIGURE 6:

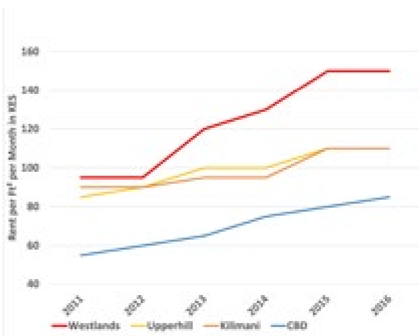
Nairobi's Formal Supply of Retail Space



Source: Nairobi Securities Exchange

FIGURE 7:

Average Prime Office Rental Rate per Month



Source: Knight Frank Kenya

Asking rents were flat in the review period due to the supply of office space in the market exceeding the demand by potential tenants. Asking office rents remained within the range of US$12-14sqm/month.

Prime headline rents and prime asking rents remained stable and similar to the first half of 2016 at US$21/sqm/month and US$/14/sqm/month respectively. The large variance is as a result of escalations applicable to headline rents that exists in most leases. The second half recorded fewer completions in comparison to the first half of 2016. These included UAP Old Mutual Tower in Upper Hill with a lettable area of 29,000 sqm and 96 Riverside on Riverside Drive with a lettable area of 6,500 sqm. The major developments in the pipeline expected for 2017 include Diamond Plaza Phase II, Trade and Development Bank's (TDB) 19-floor office block situated in Kilimani, Britam Towers, Two Rivers offices and Keystone Park in Westlands.

The most notable commercial building that was offered for sale in the market was Ecobank Towers, circa 8,700 sqm, located in the Central Business District. The vendor was seeking in excess of Ksh1.5 billion. FCB Mihrab, a mixed-use commercial development on Lenana Road, Kilimani, has office space for sale and is expected to be ready for occupation within the first half of 2017.

Residential

Prime residential prices decreased by 3.3% over the second half of 2016 and recorded an overall annual decline of 2.1%. Transactions occurred in low volumes and this is expected to continue into 2017, which being an election year is likely to evoke hesitation from property buyers.

Prime residential rents decreased by 5.96% in 2016 due to an oversupply in the market.

The capping of interest rates being at four percentage points above the Central Bank Rate, which is currently at 10%, on loans will however provide potential buyers and developers an opportunity to borrow at friendlier rates albeit with stricter terms from the banks.

Major housing developments announced over the period included Housing Finance's various projects in satellite towns. HF Group has a joint venture with Clayworks Limited for the construction of 1,520 units at Clayworks, off Thika Road. The three-phase development sits on 24.5 acres and is expected to be completed in 2019 at an estimated cost of Ksh5 billion. The lender is also currently working on the second phase of Precious Heights Estate in Riruta, and parcelling work on a 183-acre plot in Ruiru. Cytonn Investments has unveiled a Ksh2.5 billion project dubbed The Alma, being developed in Ruaka, with expected completion in 2019. Satellite towns such as Ruaka, Ngong and Ongata Rongai are catering to the high housing demand.

Hotel & Tourism

In the second half of 2016, Kenya continued to be a top destination for conferences, raising its profile in the meetings, incentives, conferences and events (MICE) sector. Nairobi was named by the World Travel Awards as the leading African meetings and conferences destination, while the International Congress and Convention Association (ICCA) voted Kenya as the second most popular meeting destination within Sub-Saharan Africa just after South Africa. This has had a significant benefit to the tourism sector.

Over five major conferences were hosted in Nairobi during the review period, including the 14th United Nations Conference on Trade and Development (Unctad), held in Kenya for the second time. The sixth Tokyo International Conference on African Development (Ticad VI) in Nairobi was the first time Ticad was held outside Japan. Others were the fourth East Africa Oil and Gas Summit & Exhibition (EAOGS), Agritec Africa and the Global Partnership for Economic Development Co-operation (HLM2). These conferences resulted in an increase in the number of tourist arrivals by 20% compared to the first half of 2016.

The number of international hospitality chains investing in Kenya, specifically Nairobi, also rose in the review period. Major hotel brands that are in the pipeline in 2017 include Pullman by Accor Group, Mövenpick Hotel & Residences by Mövenpick Hotel and Resorts, Four Points by Sheraton expected to open in April 2017, Park Inn by Radisson, Carlson Rezidor Hotel Group opening in February, and City Lodge being constructed by City Lodge Hotel Group next to Two Rivers Mall. Indian hotel chain Sarovar is expected to open a four-star airport hotel near Jomo Kenyatta International Airport, titled Lazizi Premiere Hotel, within the first half of 2017.

Hilton Worldwide will also be opening a 175-room airport hotel on Mombasa Road, near JKIA, in March, christened Hilton Garden Inn, which is estimated to have cost Ksh2.3 billion. The Hilton Garden Inn will price its services at a lower rate than the existing Hilton Hotel located in the Central Business District (CBD). Hilton also announced plans to construct a 43-storey, 255-room hotel in 2020 that will be located in Upper Hill within Pinnacle, a building that is set to become Africa's tallest, standing at 330 metres high.

Hotels at the Coast recorded a significant increase in bookings as numbers of domestic guests pushed up occupancy to more than 70% over the festive season. Occupancy for most beach hotels, cottages, villas, budget hotels, apartments and other accommodation facilities reached 90% during the Christmas weekend through to the New Year.

Industrial Market & Redevelopment Land

Modern logistics property is currently scarce across much of the Sub-Saharan Africa region amid a growing need for high quality modern developments, which has led to the increase in warehouse construction. The International Finance Corporation, a subsidiary of the World Bank, was seeking to buy a Ksh1 billion stake in a commercial property company, Africa Logistics Properties (ALP), which was raising Ksh7 billion to develop three warehouses in Embakasi, Tilisi Logistics Park and Tatu City Industrial Park. ALP has acquired 71 acres of industrial zone sites to set up Grade A warehouses for international companies. In the first phase of this project, ALP is raising $65-70 million to develop the three sites around Nairobi. IFC has proposed contributing an equity investment of US$10 million into ALP. A multi-billion-shilling industrial park named Sino-African Incubation Park, set to be constructed in Kenya's Export Processing Zone (EPZ) in Athi River, was also launched in the second half of 2016. The 200,000-sqm industrial park is funded by Chinese investors – CIFAL International and China International Investment – to the tune of US$200 million. It will sit on 60 acres of land. The project will be undertaken in four phases over the next three years, with the initial phase expecting an investment of US$5 million. The business incubation park is expected to support African companies in technology, manufacturing and production, and provide value-added services to help in global exportation of their products. The Export Processing Zones Authority (EPZA) currently has 130 companies operating in the 66 EPZs across Kenya.

One of the most notable transaction in the second half involved Gateway Delta Property Holdings, which was in negotiations to acquire the Imperial Health Sciences logistics warehouse along Mombasa Road for US$16.88 million on a sale-and-lease-back arrangement with IHS for 10 years. Gateway Delta Property Holdings will also acquire an adjacent vacant land parcel that would have a value of US$2.9 million once developed. Prime industrial yields range between 8-9%.

The World Bank's Logistic Performance Index (LPI) ranked Kenya as the best logistics performer in East Africa. The LPI ranked Kenya 42nd globally with a score of 3.33 compared to neighbouring countries Uganda and Tanzania which were ranked 58th and 61st respectively. Kenya was ranked second in Africa just after South Africa, which was 20th globally with a 3.78 score. The higher ranking signifies Kenya has greatly improved trade flow and reduced the cost of business for importers and exporters. Effective logistics allows firms access to domestic and international markets through reliable supply chain markets. Improved transport facilities by Kenya is also expected to boost the country's external trade profile. Knight Frank continued recording interest in prime warehouse and logistics developments, with the most notable development being Alpha Business Park.

MANAGEMENT

Ben Woodhams
Managing Director
+254 733 619 031
ben.woodhams@ke.knightfrank.com

Maina Mwangi
Executive Director &
Head – Property Management
+254 733 805 205
maina.mwangi@ke.knightfrank.com

VALUATION & CONSULTANCY

Bernadette Gitari
General Manager - Knight Frank Valuers
+254 725 777 686
bernadette.gitari@ke.knightfrank.com

AGENCY

Anthony Havelock
Head – Agency
+254 727 099 364
anthony.havelock@ke.knightfrank.com

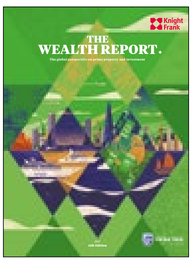
RESEARCH

Charles Macharia
Senior Research Analyst
+254 721 386 019
charles.macharia@ke.knightfrank.com

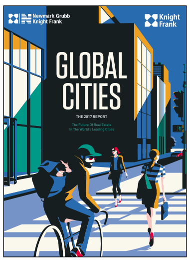
Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Africa Report 2017



The Wealth Report 2017



Global Cities 2017

International View 2016

Knight Frank Research Reports are available at **KnightFrank.com/Research**