Commercial Office Real Estate

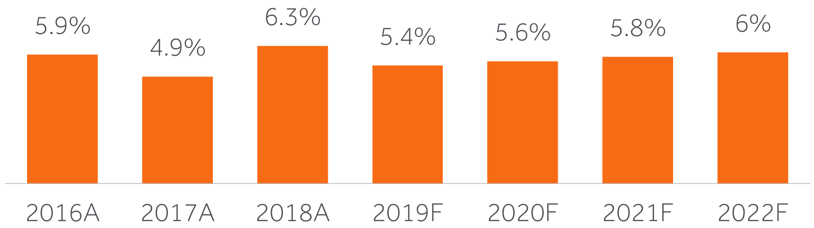
Market Overview

November 2019

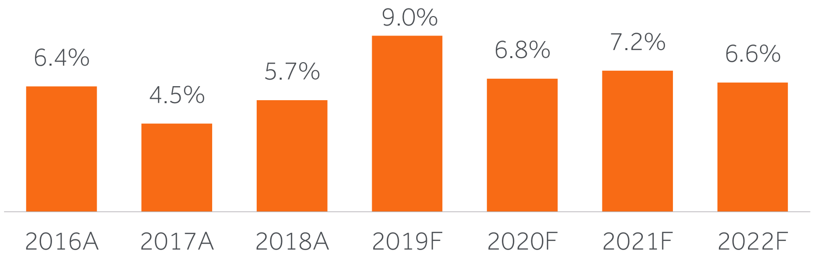
Kenya Macroeconomic Overview

Headwinds continue to hamper growth, medium-long term outlook strong

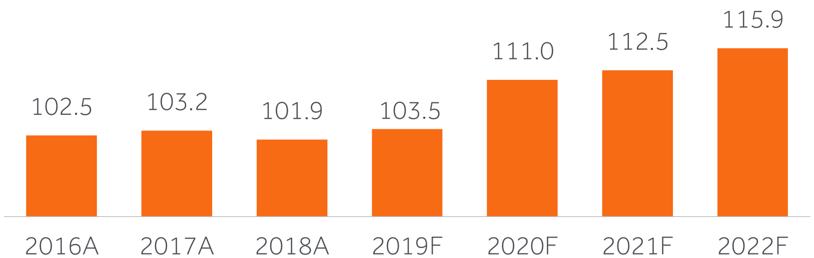
Real GDP Growth (%)



End-Period Consumer Price Inflation (%)



Exchange Rates (EIU) – KES:US$ (end-period)

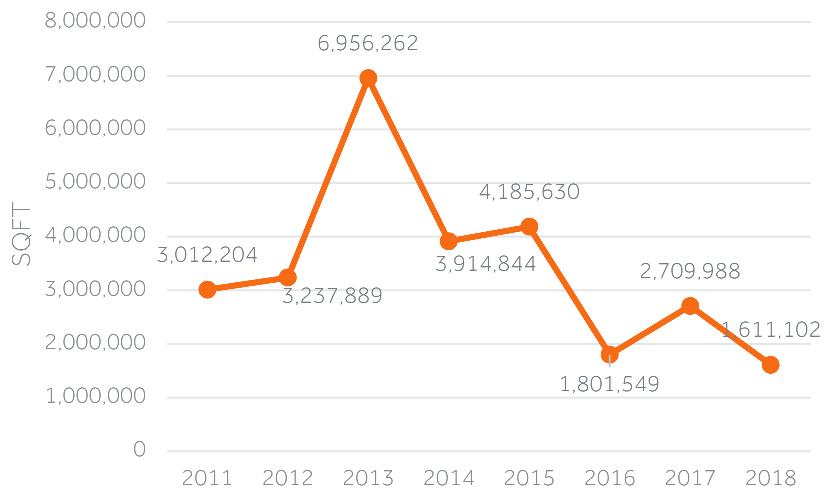


- Economic growth is expected to ease to around 5.4% in 2019, 60bps lower year-over-year
- Slowdown is broad-based with most subsectors experiencing slower growth
  - Agriculture—the largest contributor to GDP—has suffered due to delayed rains, which has lowered production and has had a negative spillover effect on other economic sectors
- There has been a more recent uptick in economic activity driven by the government's directive to settle all public bills and an increase in private investment mostly through PPPs
- The controversial lending-rate cap of 400bp above the benchmark rate has suppressed allocation of private credit and the operating environment
- Inflation continues to rise as a result of delayed rainfall and higher food costs
  - Annual inflation for the year is forecast at 9.0% compared to a multi-year low of 4.5% recorded in 2018
- The shilling has been largely stable over the year, maintaining a range of KES100-KES104 to the US Dollar. FX stability has allowed Kenya's imports and foreign debt repayments to remain more manageable
- Kenya's longer-term outlook remains fairly strong on the back of continued infrastructure investment by the government and growth in the private sector
  - Government continues to focus on implementation of "Big 4" agenda to deliver food security, affordable housing, manufacturing growth, and better healthcare
- Renewed investor confidence due to local currency stability and a favorable investment climate has seen Kenya move up 5 places in the latest edition of World Bank's Ease of Doing Business survey (56/190)

Commercial Office Space Building Approvals

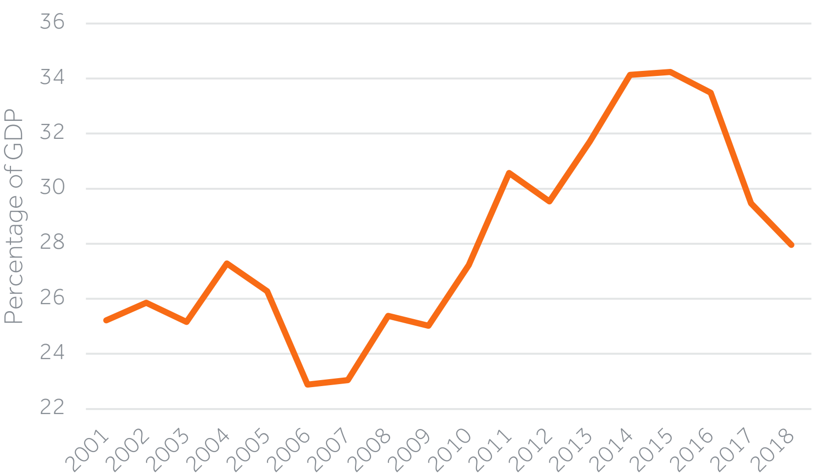
Continued Decline in Commercial Building Activity in Nairobi

NCC Commercial Building Approvals



Source: Nairobi City County Approvals

Domestic Credit Extended to the Private Sector

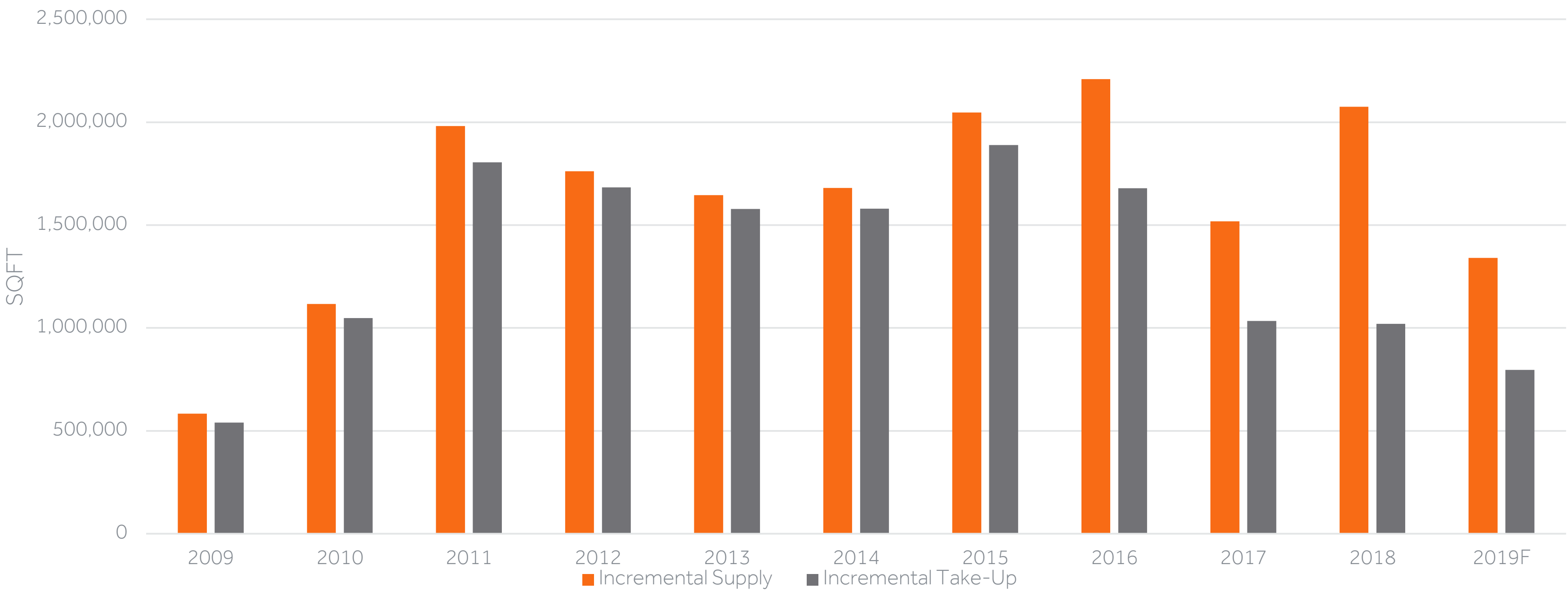


Source: Kenya National Bureau of Statistics

- The commercial real estate sector continues to face downward pressure as indicated by the decline in new building approvals
- Constrained access to credit due to the interest rate caps has made it difficult for developers to finance the construction and completion of new commercial developments in the city
- This has been compounded by delays in the processing of construction permits also contributed to this slump. Online system downtime, suspension of planning committees and inadequate staffing has led to a backlog of developments seeking approval
- Supply pipeline of commercial office buildings is expected to continue decline in the medium term as the market begins to stabilize in line with market conditions

Incremental Supply and Absorption

Incremental supply and absorption continue to decline

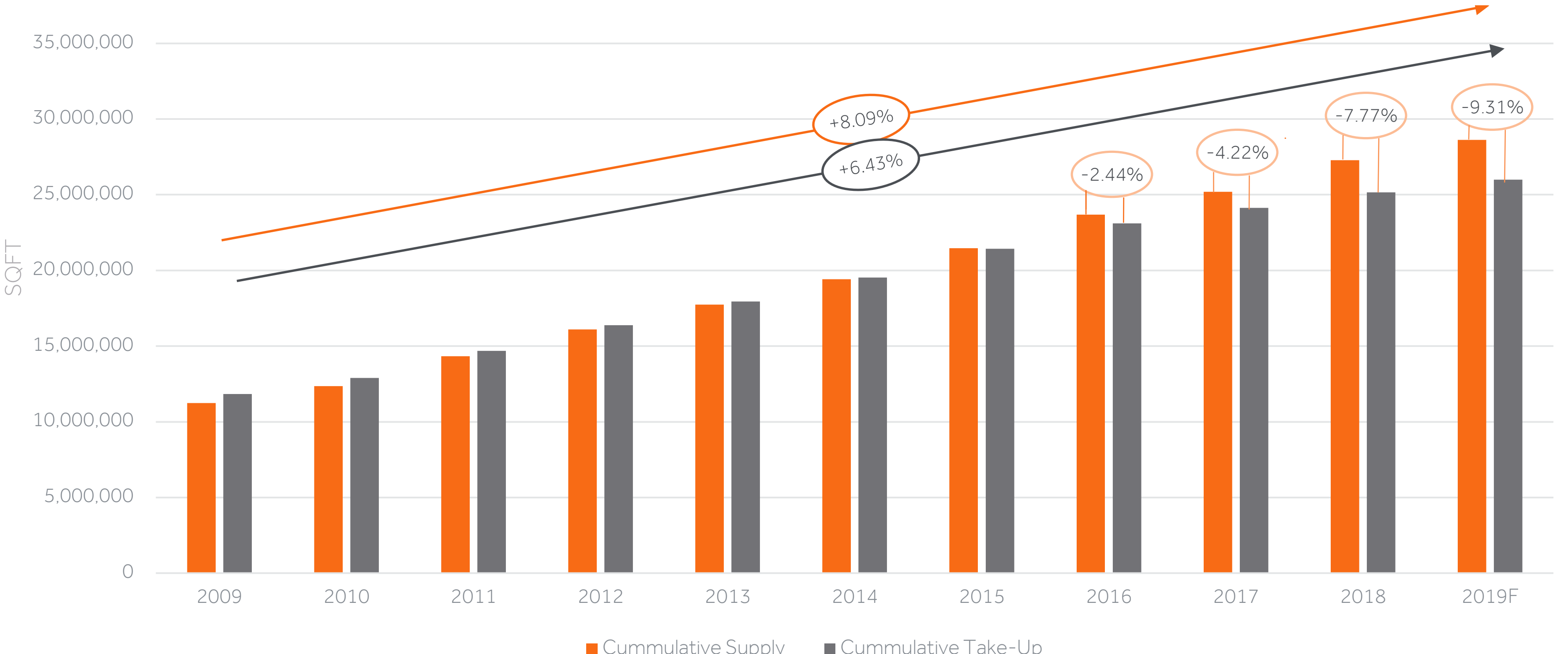


Source: Nairobi City County Approvals, Actis Research

- Between 2009 and 2015, incremental supply grew by 23.26% CAGR and incremental take up by 23.21% CAGR. During this period, the demand-supply gap remained relatively narrow leading to increased speculation from developers
- Based on our sample set, the market began to decline around 2016 and to date, incremental take up/absorption is yet to recover
- Due to the demand-supply lag, we continue to see relatively high delivery of new office space into the market. However, developers have began to scale back the development of new commercial real estate as evidenced by the decline in approvals citing market oversupply, constrained access to credit and political uncertainty among other market related issues

Cumulative Supply and Absorption

Oversupply of commercial office space in Nairobi

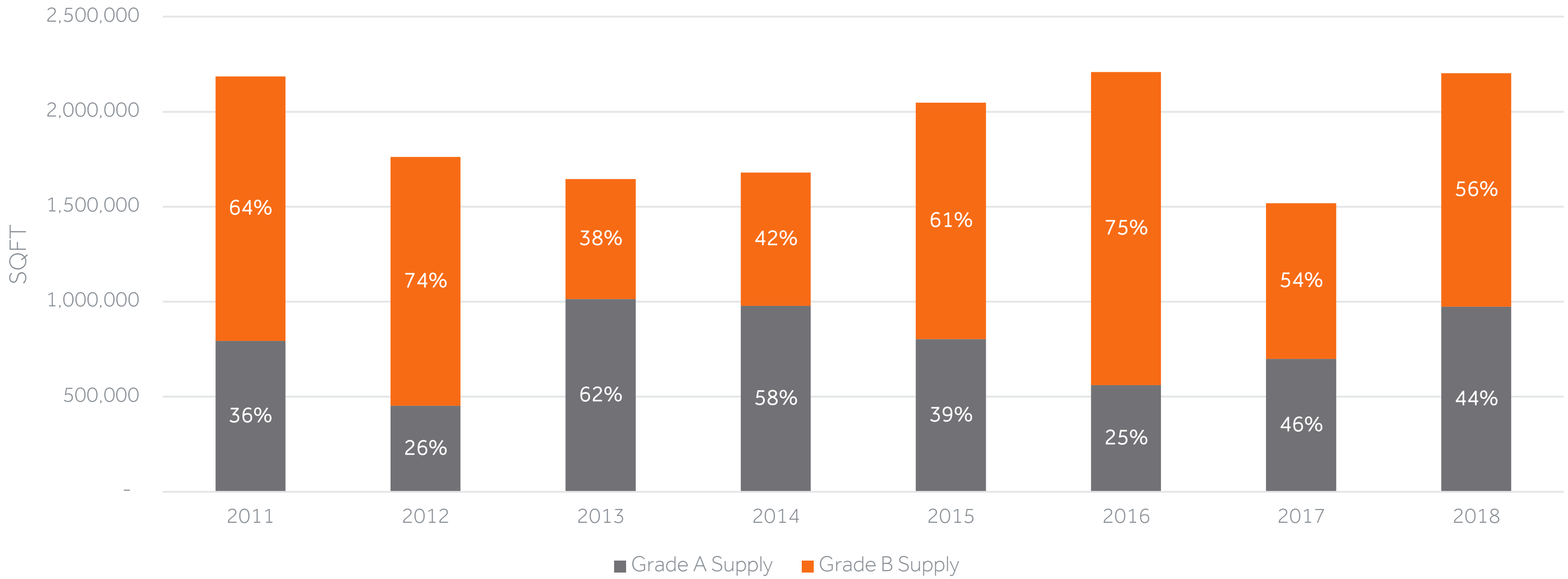


Source: Nairobi City County Approvals, Actis Research

- Cumulative supply has grown by 8.09% CAGR over the past due to improved investment sentiment and prospects in the private sector
- Increased speculation by developers driving incremental supply has led to oversupply of commercial office space beginning around. The demand supply gap has continued to grow year on year post 2016 and is estimated at 12.63% in 2019
- An adverse effect of this oversupply is the downward pressure it has had on rentals as landlords lower rental rates to retain and attract tenants
- Of all the stock currently available in the market, c.41% was delivered pre-2011 and is characterized by inefficient design principles, dated amenities and lower parking ratios. As these older developments become less desirable, we expect to see a rise in demand by tenants for centrally located, congestion free and modernized office spaces

Delivery by Grade

Grade A delivery continues to lag Grade B

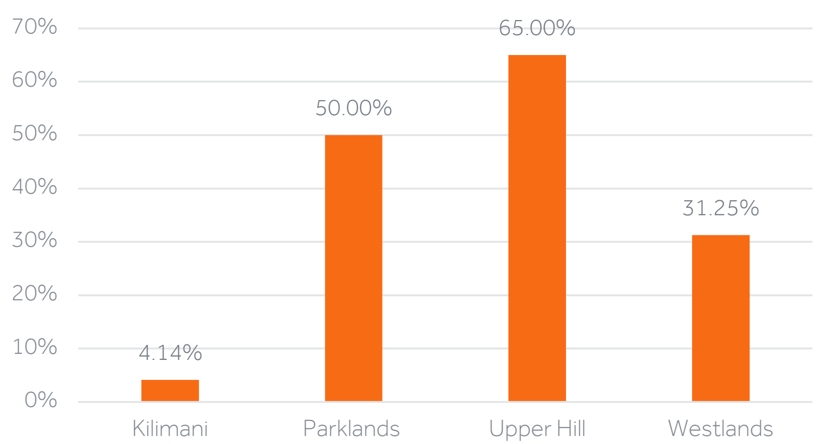


Source: Nairobi County Council Approvals, Actis Research

- There has been an increase in demand for prime-located Grade A space from local corporates and MNC's and as a result, delivery of higher quality units introduced in to the market has risen considerably
- Grade B delivery however continues to surpass Grade A as speculative Grade B developments are delivered in prime nodes such as Riverside, Kilimani and Westlands attracting near Grade A level rentals and high occupancies
- As more tenants demand efficient demand principles, high parking ratios and complimentary amenities, Grade A delivery to the market has risen incrementally over the years. We expect this to continue into the short to medium term, as current leases expire and older developments start to become obsolete and less desirable to prospective tenants

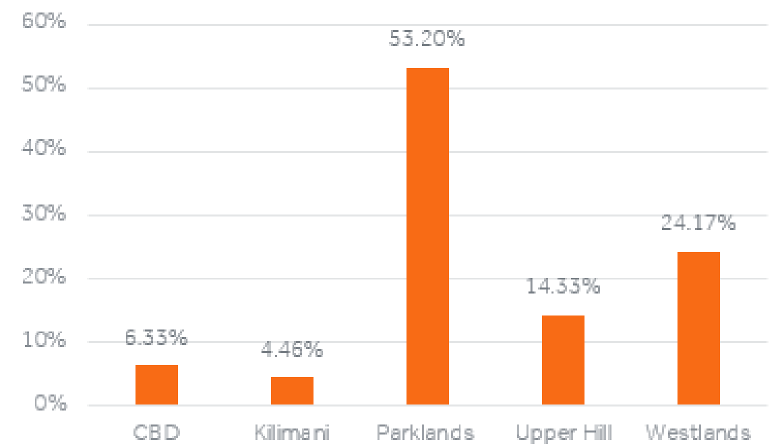
Vacancy Rates

Average Grade A Vacancy Rates



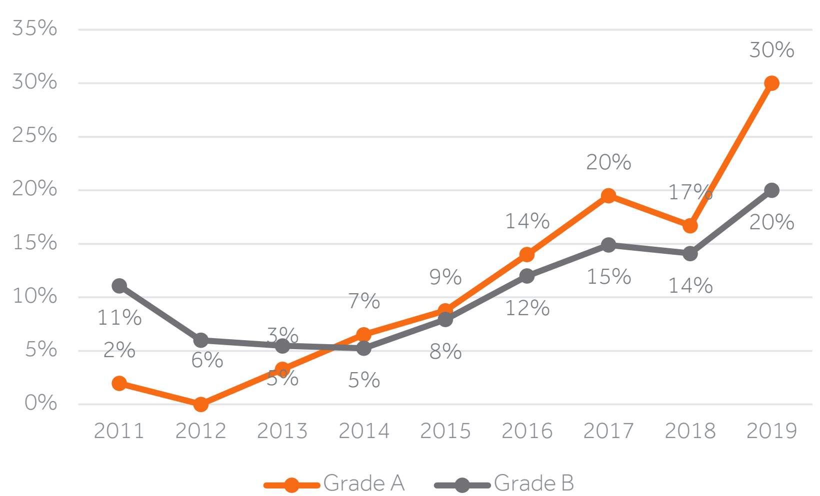
Source: Pam Golding Commercial

Average Grade B Vacancy Rates



Source: Pam Golding Commercial

Average Vacancy Rates 2011 - 2019



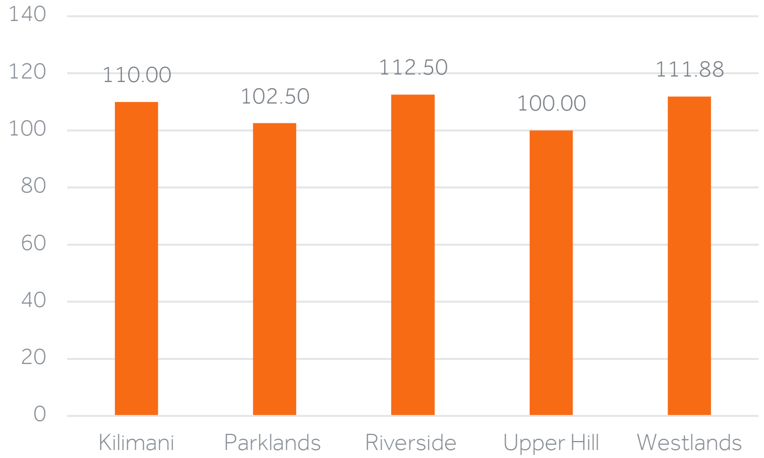
Source: Pam Golding, Actis Research

- Most office supply in the last 2-3 years has been delivered in Upper Hill and Westlands which has led to high vacancy rates in these nodes as absorption continues to slow
- Some notable Grade A developments delivered recently such as Britam Towers (Upper Hill), One Park Avenue (Parklands), Sanlam towers (Westlands) and The Address (Westlands) are experiencing high vacancy rates of between 50%-70%
- Despite improved economic performance and political stability, growth in office demand continues to remain flat as private sector growth remains muted
- We however expect recovery of vacancy rates in the medium term as economic prospects and business conditions continue to improve

Rental Rates

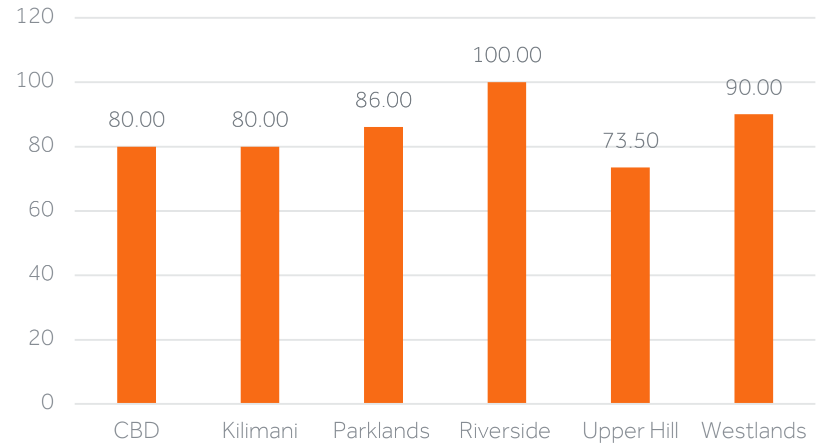
Decline in rates across Nairobi

Grade A Rental Rates



Source: Pam Golding Commercial

Grade B Rental Rates



Source: Pam Golding Commercial

Change in Rental Rates

	2016	2019	Change
Westlands	160	112	(30%)
Upper Hill	118	100	(15%)
Grade A Average	123	110	(11%)
Market Average	100	98	(2%)

- The impact of the current oversupply has seen a decline in rentals across the city as the market becomes increasingly tenant driven
- Grade A rentals have declined 11% compared to 2016 with the market average rentals declining 2% over the same period
- Developers continue to lower rentals and offer concessions to attract tenants and shore up occupancy rates. This has seen an increase in rent free periods offered to prospective tenants, with Grade A developments averaging rent free periods of 3 months
- Westlands and Riverside continue to attract premium rentals in comparison to other nodes despite this decline in rentals owing to locational advantages and favorable parking ratios
- Bi-furcation of rentals between Grade A and Grade B is clear as the market comes to terms with the distinction of Grade A and Grade B office space

Nodal Performance

Subdued performance across Nairobi

Node	Average Occupancy Change
Upper Hill	13.45%
CBD	-2.00%
Riverside	-4.60%
Kilimani	-5.15%
Westlands	-5.45%
Parklands	-19.29%
Nairobi Average	-4.56%

Source: Pam Golding Commercial, Actis Research

Node	Average Closing Rent
Riverside	112.5
Westlands	112
Kilimani	110
Parklands	102.5
Upper Hill	100
Grade A Average	110

Source: Pam Golding Commercial, Actis Research

Node	Average Closing Sales Price
Westlands	12,500
Upper Hill	11,000
Parklands	10,500
Grade A Average	11,333

Source: Pam Golding Commercial, Actis Research

Location, quality of office space and amenities continue to be the key drivers in commercial office real estate performance. Despite deteriorating market conditions across the market over the review period, we continue to see nodes located in proximity to the CBD and emerging business centers perform better.

Westlands:

- Westlands experienced a slight decline in average occupancy over the review period due to the introduction of new commercial office space (i.e. Sanlam Towers and The Address).
- This increased supply has served to lower rentals to KES 112 per sqft from KES 160 per sqft in 2016.
- Sales prices in Westlands continue to outperform other nodes with reported average closing prices of KES 12,500 per sqft.

Upper Hill:

- Upper Hill registered an improved performance, with occupancies rising in the review period. The improvement is marked by the increased uptake of current office supply in the node against a decline in incremental office space delivery

Parklands:

- The node recorded the sharpest decline in occupancy in the review period owing to the increase in new office complexes such as One Park Place and sustained vacancies in existing complexes.

Nairobi Commercial Real Estate

Overview of Grade A terms and offers

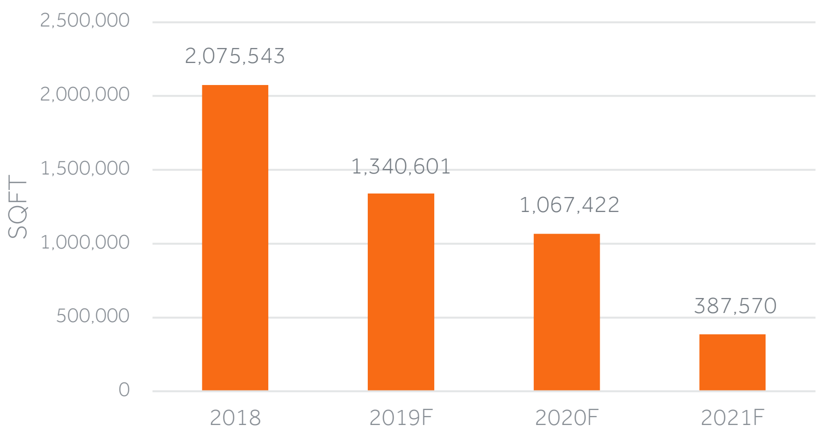
>90% of Grade A Developments offer tenants local currency denominated rentals	KES	Average Grade A Escalation	7.5%
Average Grade A Service Charge (KES/Sqft)	23	Average Sales Price (KES/Sqft)	12,000
Average Rent Free Period Offered	3 months	Average Lease Term Offered	5 years
Average Parking Ratios	2.7	Average Grade A Parking Fee (KES/Bay/Month)	10,500

Source: Pam Golding Commercial

Market Outlook

Improving market conditions with recovery expected in the medium term

Incremental Supply Forecast



Source: Actis Research, Nairobi City County Approvals

Growth (%)	2019E	2020F	2021F	2022F	2023F	2024F
Gross Domestic Product	5.4	5.6	5.8	6.0	6.1	6.6
Private Consumption	6.0	6.5	6.2	6.3	6.4	5.6
Government Consumption	7.0	4.0	3.3	3.6	4.0	4.5
Gross Fixed Investment	6.5	5.0	5.6	5.9	6.5	5.9

Source: Economist Intelligence Unit

Supply

- We forecast a continued decrease in supply of new commercial office space over the next two to three years with most of this new office stock deriving from buildings currently under construction (such as the Global Trade Centre).
- As a result of the continued supply delivery we expect the current state of oversupply to prevail in the short term, with normalization of the market being attained in the medium term

Demand

- The government continues to make headway in improving business conditions in the country. The directive to settle all pending public bills and traction in the review of the interest rate caps have renewed optimism and growth prospects of the market
- However, the realization and impact of these improvements will likely lag and thus we expect relatively stable growth in the demand for commercial Grade A office space from local corporates and MNCs

Rental Rates

- Rental prices are expected to remain fairly unchanged over the short term due to downward pressure arising from oversupply in the market. We expect upward growth in rentals in the medium to longer term with most of these denominated in local currency.

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