THE ARCHITECTURAL ASSOCIATION OF KENYA

AAK | PROMOTING EXCELLENCE IN THE BUILT ENVIRONMENT

STATUS OF THE BUILT ENVIRONMENT REPORT

JULY-DECEMBER 2021

Table of Contents

Introduction

The real estate market in Kenya limped through to the finish line of 2021 with bruises sustained from economic fallouts due to the Covid-19 pandemic. However, the property industry appears to hold potential for the New Year. Opportunities created amid the pandemic have raised optimism that 2022 will be a good year for the real estate sector.

The residential, infrastructure and industrial segments of the real estate market are expected to drive the sector's growth and deliver good returns for developers, investors and landlords. This growth rides on the ***New Normal;*** a corollary of the Covid-19 pandemic. Moving on, what are the stakes for stakeholders in the real estate sector?

The Omicron virus will have a major say in that. In November 2021, the Omicron variant took hold and a new wave of COVID-19 infections emerged with countries across the globe imposing restrictions to curb the spread. Many jettisoned their travel plans and hesitated to undertake any major developments and this is expected to affect the performance of the various segments of the country's real estate sector.

Worryingly so, the commercial office sector is expected to experience poor performance as employers reversed their initial return-to-office plans in the wake of the new variant. One certainty: industry players must build flexibility and the capacity to adapt quickly to real estate market changes.

Opportunities created amid the pandemic have raised optimism that 2022 will be a good year for real estate

Residential, infrastructure and industrial segments of the real estate market are expected to drive the sector's growth

Commercial office sector is expected to experience poor performance in the wake of the new variant

Real Estate

Residential Properties

In 2021, residential real estate offered opportunities to developers as the gains in commercial office spaces dried up as a result of companies embracing the new normal or working virtually or remotely away from physical office buildings. Containment measures due to the corona virus pandemic shrank economic activities and companies' revenues leading to layoffs and pay cuts. These among other factors cause a slowdown in take-up rates in foci buildings and retail outlets. It needs to be pointed out however that opportunity still exists in commercial real estate. Businesses still need offices despite the work-from-home (WFH) initiative; manufacturers need factories and warehouses while e-commerce companies need logistics, such as sorting and dispatch centers.

Nevertheless, small-size residential family units such as one-bedroom and two-bedroom apartments were in high demand. The market for affordable small-size family housing units grew. Investors in this house type were among the few gainers in the sector. Returns were higher for smaller apartment units, especially 2-bedroom; this implies that demand is more for these house-types than the big-size apartments. It also means that smaller-unit apartments are the new investment destinations, and any investor intending to enter the market amid the COVID-19 pandemic should look in that direction. The residential real estate grew in the last half of the year as investment outlets dried up for investors and real estate was the only viable option left.

The residential real estate grew in the last half of the year

Smaller-unit apartments are the new investment destinations

Commercial Properties

Understandably, the demand for commercial office space is slowing with statistics in Half 2 of 2021 pointing to an oversupply of office spaces and declining performance of commercial entities due to the COVID-19 pandemic. The implication of this was that the conventional 2000 – 5000 square metres office space, sometimes on two to three floors, was no longer necessary, just as same size conference and event centers with all their fantastic designs and facilities may no longer be needed. The commercial sector was the worst hit in terms of demand. Many companies found themselves operating in unprecedented ways to continue conducting business. Although some companies; did not experience challenges of such magnitude and the transition was easy, they had to adapt, hence, a large proportion of employees worked from their homes. This sudden change in business practices also affected the industrial property sector.

Industrial Properties

The industrial market is the cream of the crop due to its few speculative developments, low vacancies and recovering rental growth. In the second quarter of 2021 nominal rentals for prime space of 500 m^2 on a national level grew by 1% year on year. This is better than the 0.5% growth achieved in 2020, but still well below the 5% rental growth of 2019.

The slow rental growth shows that the industrial market is also feeling the effect of the weak economy, although accompanied by less pain than the office and retail property markets. Nominal rentals for prime industrial space of 500 m^2 grew by 3% and 2% in Nairobi and Nakuru respectively, while growing by 1% in the port city of Mombasa. The demand for industrial property is slowly but gradually increasing in Nakuru, but rentals remain about 1% lower than in the last quarter of 2020.

Nominal rentals growth per 500m^2 industrial space

Nairobi- 3%

Nakuru- 2%

Mombasa-1%

Land and Property Market

Land and property prices in Nairobi and its environs are 'self-correcting' due to market forces with a new report revealing a drop of up to 27 per cent. A recent Macro Strategy Report published by EFG Hermes, a financial service company, which analyzed land prices in the high-end market segment, upper-middle and satellite towns in Nairobi found that the pricing of land was significantly lower in the third quarter of 2021 compared to the past four years. It notes that prices of residential and commercial property in Nairobi's satellite towns have dipped since quarter four of 2019. The report is almost in tandem with a June 2021 HassConsult which revealed that asking prices for property remain stagnant at a negligible 0.1 percent drop in the second quarter of 2021. According to Hass Consult, the property market was experiencing static sales price performance driven by the oversupplied apartment market in Kilimani and Kileleshwa, down 9.5 percent and 6.9 percent respectively in the last year. While most suburbs in and out of Nairobi reported somewhat mild movements, both up and down, Houses in Langata posted atypical property price movements of an increase of 4.1 percent in the quarter and 10.3 percent in the year in a market that is currently driven by affordability. Langata posts the cheapest price point for city houses at Kshs. 34.5m. According to the Macro Strategy report Kenya's land and property market is currently overvalued, noting that the Covid-19 pandemic has seen distressed properties sale for less than their initial valuation as developers sought to offload the financing burden as quickly as possible. The report by EFG Hermes further notes that the current land prices in the high-end segment are significantly lower than their peak levels over the past four years citing an example of Runda where land prices in H2 of 2021 were 27 per cent below their recent peaks in Q4 of 2017. The report also indicates that while current land prices in Parklands and Westlands have changed from their peak levels over the past four years, current land prices in Upper Hill - Nairobi's most expensive suburb are 13 per cent below their peaks in Q4 2017. On the other hand, Donholm stood out within the middle and low income segment for being the only suburb that has continued to see its land prices materially appreciate since Q4 2017.

The report says on the performance of suburb land prices in Nairobi, between Q4 2017 and Q1 of 2021 all have underperformed the Consumer Price Index (CPI) which is 20 per cent. According to the report, the said performance inherently spells doom for the property market in Nairobi's suburbs as we move into the future.

Kenya's land and property market is currently overvalued

Affordable Housing in Kenya

In 2017, President Uhuru Kenyatta's government embarked on an ambitious programme aimed at building 500,000 affordable housing units as part of the Big Four Agenda. Four years later, 2,235 affordable housing units have been occupied with several other units currently under construction. Of the 2,235 units, 1,370 units are at Park Road Ngara while Kisumu, Mavoko and Machakos have 250,463 and 152 of their affordable housing units currently occupied. On 27th September 2021, Centrum Real estate through a Public-Private Partnership launched a Kshs.850 million affordable housing project in Kasarani that will comprise a total of 284 units selling for between Kshs. 1.9 million and Kshs.5.4 Million.

The said project will add onto the four ongoing affordable housing projects that will result to a total of 21,642 units in Nairobi. According to a report by the Ministry of Transport, Infrastructure, Housing, Urban Development and Public Works, a total of 13,000 units will be built in Mukuru Housing Phase I and another 5,280 in Clay City while the Pangani Housing Project and the Bachelors Jeevanjee Estate all in Nairobi comprising of 1,562 and 1,800 units respectively. Nakuru's Bondeni Housing Project will contribute a total of 605 units to the project while Buxton Point Housing Project in Mombasa will have the tally of affordable housing units rise by 2,150. The realization of the Affordable Housing Agenda is also expected to receive a boost following the introduction of 3D printing as an alternative building technology in Kenya. 14-Trees, a Joint Venture between Holcim and CDC Group, extended its partnership with COBOD International to build the first 3D printed house in Nairobi, Kenya. This house is also the first to achieve the IFC-EDGE Design Certificate which exemplifies achievement in 45% energy savings, 23% water savings, and 71% less embodied energy in materials. The construction of the 3D printing project started in October 2021.14-Trees also announced that it will start printing 52 affordable housing units in Kilifi similar to a prototype currently being built in Nairobi in Q1 of 2022, in a project that will be one of the biggest 3D construction projects in the world.

This will demonstrate the economic potential of the Three-Dimensional Concrete Printing (3DCP) technology and document the speed advantages of 3DCP as a building method. The 52-unit project, also known as Mvule Gardens, will be made in the Indian Ocean coastal town of Kilifi, 50 km North of Mombasa, the second largest city in Kenya.

21,642 units

=

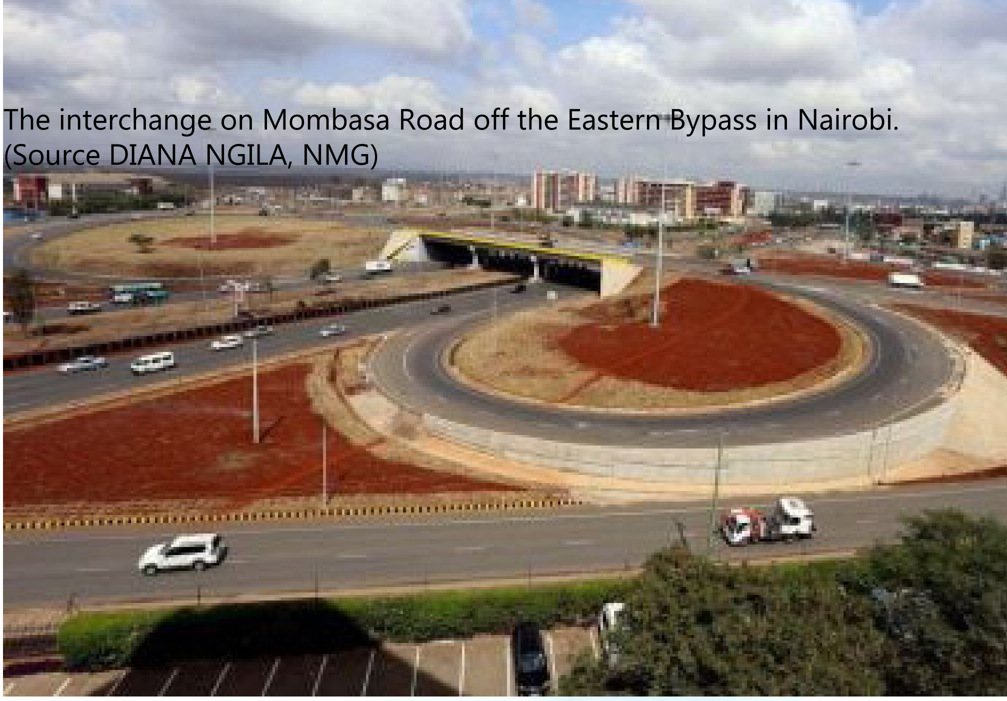
Current number of affordable housing units in Nairobi

Infrastructure

Expansion of the Eastern Bypass

In attempt to reduce traffic congestion in Nairobi City, the government recently embarked on the expansion and dualing of the Eastern Bypass. The 28km-road, which is under the Kenya Urban Roads Authority (KURA), starts at City Cabanas through Ruai towards Ruiru passing over Thika Road to Ruaka where it joins Northern Bypass. The project funded by the Kenyan government to the tune of Kshs. 12 Billion will involve upgrading the busy bypass to four lanes in some places and also six lanes in others to ease traffic in the capital and its environs. The multi-billion-shilling project is aimed at easing the growing traffic on the key road that links motorists from the Jomo Kenyatta International Airport (JKIA) and Mombasa-Nairobi highway to Thika Superhighway, bypassing the congested central business district.

The project will see the installation of other amenities like street lights and walk ways along the bypass that stretches Embakasi Barracks to Ruiru-Kiambu Road Junction. The dualling of the Eastern Bypass is part of the 11 infrastructure projects that the Kenyan government delegation showcased to global investors during the two-day Belt and Road Forum for International Co-operation in Beijing, China, in May 2017. Other such projects included the construction of the 16km Western bypass as well as the construction of seven interchanges including one at Rumenye and others at Ruaka, Kihara, Wangige, Lower Kabete.


The interchange on Mombasa Road off the Eastern Bypass in Nairobi. (Source DIANA NGILA, NMG)

The ongoing dualling of the Eastern Bypass near Tatu City, Ruiru (Source JEREMY GITONGA, KBC)

Investor and Developer Scene

Cost of Construction Drops Immensely Despite Increase in Price of Land

300%
Drop in construction costsover the last 4 years

Recently, the State Department of Housing and Urban Development revealed that data over the years shows that the cost of construction in the country within the last four years has dropped by nearly 300 percent. According to the Housing Department, the decline in cost of construction may be attributed to new technology, which has meant that construction is now more mechanized unlike in the past when it was manual. Further, the availability of cheaper construction materials such as gypsum has seen the building sector move away from wood which is more expensive.

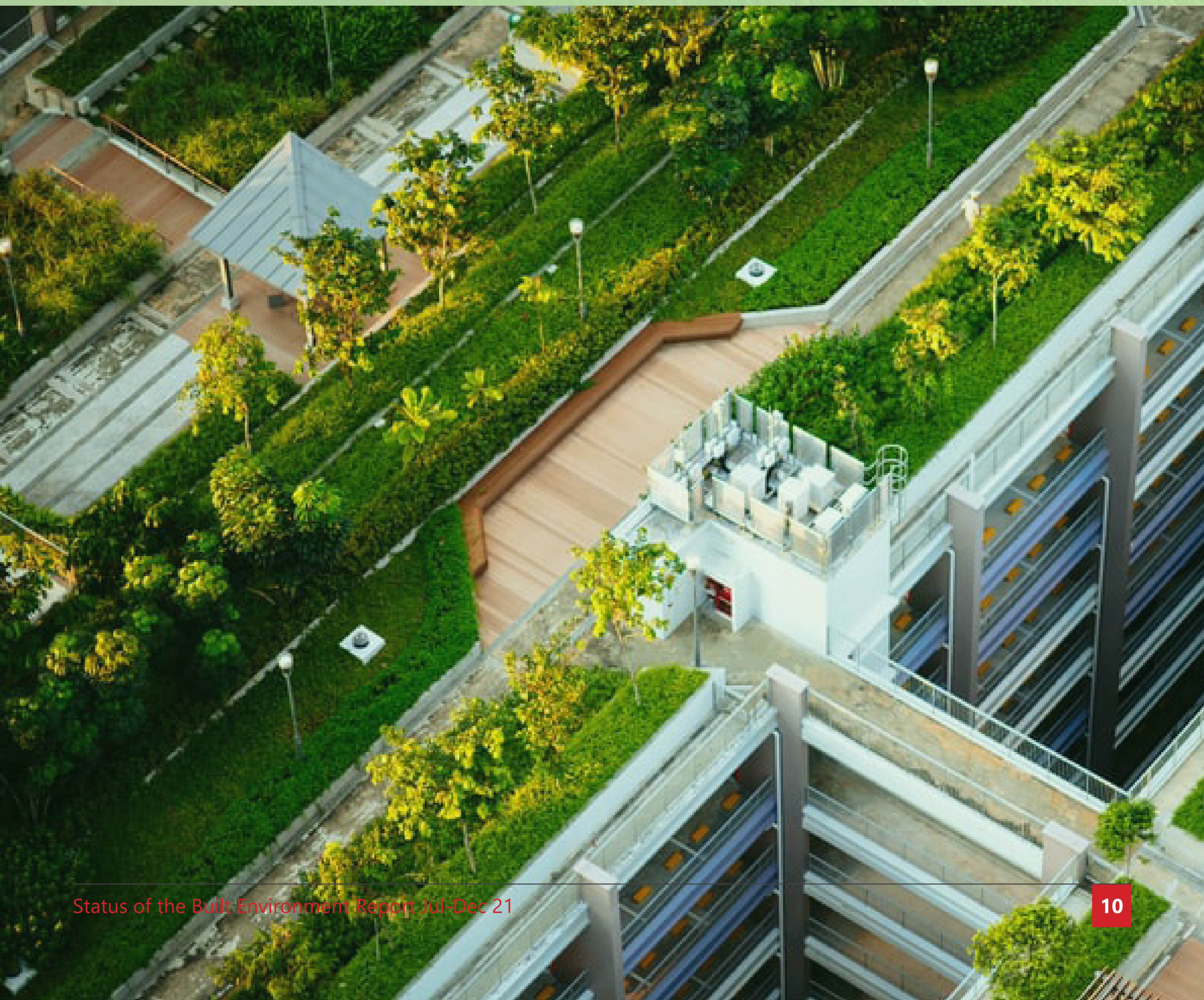
The said decline in the cost of construction notwithstanding, concern has been raised on the viability of investments in real estate given the rising prices of land. This according to the Kenya Mortgage Refinance Company is one of the major challenges facing the uptake of mortgage in Kenya which currently stands at only 25000 annually. In the report by the State Department of Housing and Urban Development the cost of constructing a one-meter square currently stands at approximately Kshs. 25,000 down from approximately Kshs. 65000 recorded in 2017.

The figures from the State Department of Housing and Urban Development nevertheless gives rise to fundamental questions as relates to the validity and reliability of the data relied upon. A back-of-the-hand calculation comparing 2020's building rates with the building costs in 2021, revealed that; overall, construction costs in Kenya have increased by up to 0.34 % in some areas such as Nairobi to as much as 3.89% in other areas such as Kakamega and Kisumu. Granted, there are several possible reasons why it costs more to build in 2021, increased pressure on the Kenya shilling has had the biggest impact so far.

In 2019, the Kenya shilling was trading at 101.4 per US dollar. Between 2020 and part of 2021, the shilling progressively plunged to a ten-plus-year low of 112.95 against the US dollar. In 2017, the exchange rate stood at Kshs.103.38. In addition, the rising prices in steel prices as we highlighted in the first half of 2021, further makes it debatable as to the possibility of a decline in cost of construction. Notably, in 2017, the price of steel bar per tonne stood at Kshs. 65000 as compared to the Kshs.80000 per tonne recorded in the first half of 2021.

Green Building and the Climate Agenda

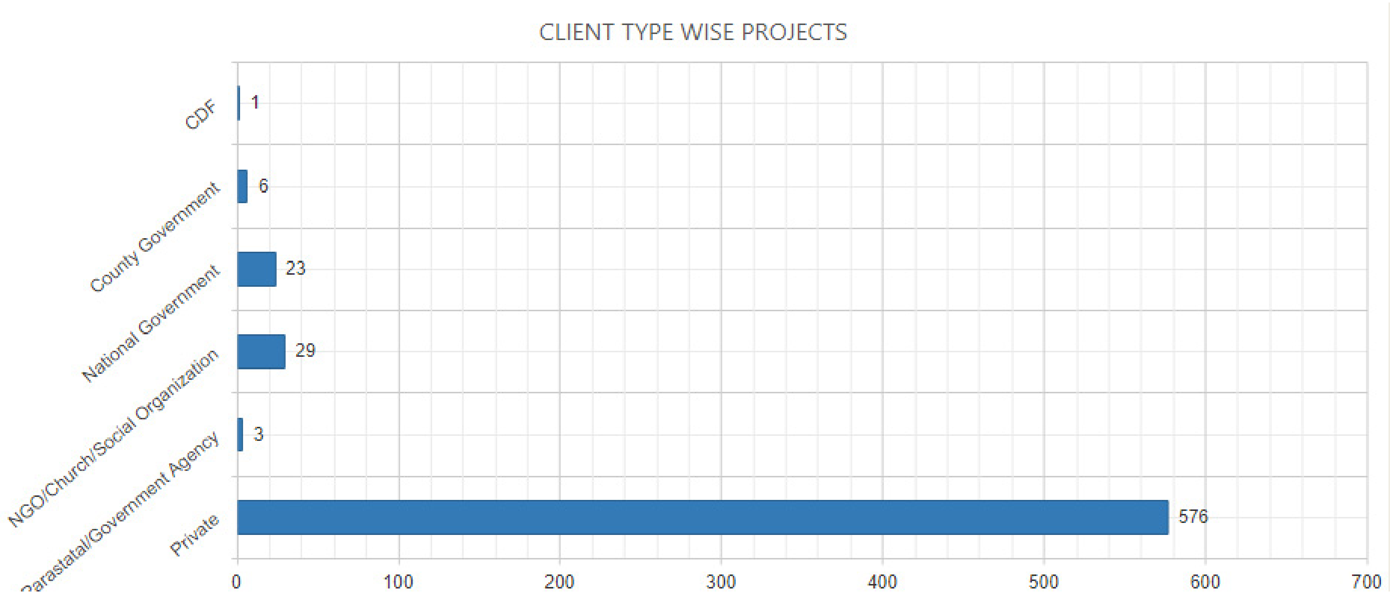
In August 2021 the UK Climate Investments (UKCI) and FSD Africa Investments (FSDAi) confirmed a Kshs. 5.2 billion funding commitment to the Kenyan green affordable housing venture. In a statement, the partners revealed that the initiative had received 100 percent of its targeted Sh9 billion investor backing for the first close, enabling the locally managed fund to become operational by August 2021. The initiative is targeted at the delivery of approximately 10,000 homes using modern green technologies. Accordingly, the housing units will provide affordable ownership and rental opportunities with 100 percent ownership at an average cost of Kshs. 4.5 million and rentals ranging from Kshs. 15,000 to Kshs. 50,000 per month. The investments from UKCI and FSDAi are expected to deepen and strengthen the UK Government's commitment to supporting a green post-Covid-19 recovery in Kenya. In recognition of the growing concerns as relates to climate change, the Architectural Association of Kenya (AAK) recently launched a green building certification tool that assesses construction projects to establish their environmental performance. Dubbed the Safari Green Building Index, the rating system is a guiding and performance oriented system where points are earned for meeting specified construction standards. The tool prescribes the categories, characteristics, and rating system used to award a green building certificate to buildings that incorporate environmentally sustainable materials, technologies and practices.

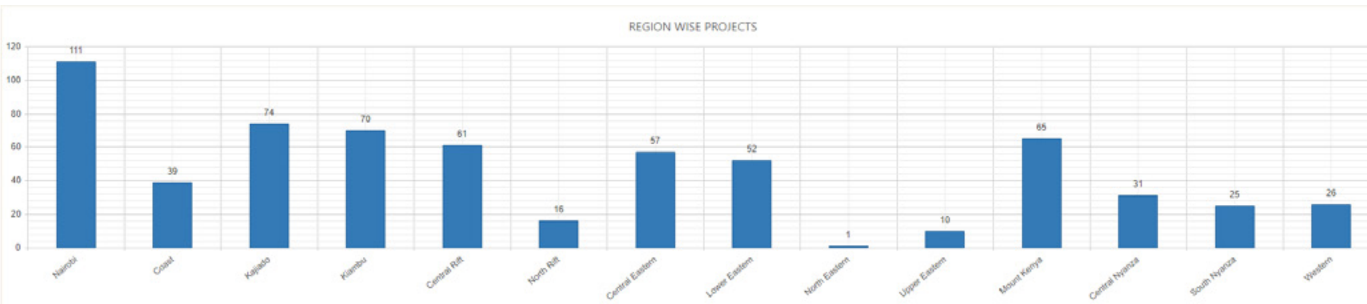


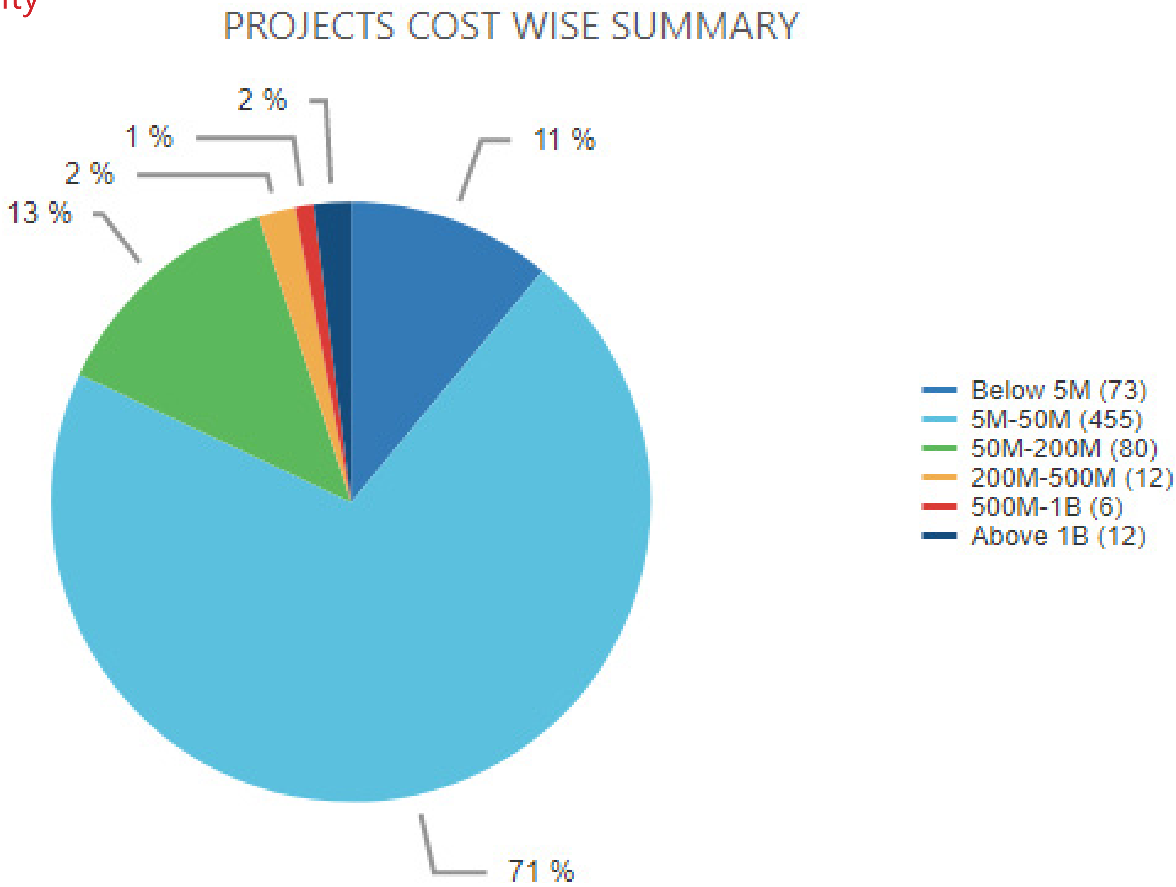
Development Control

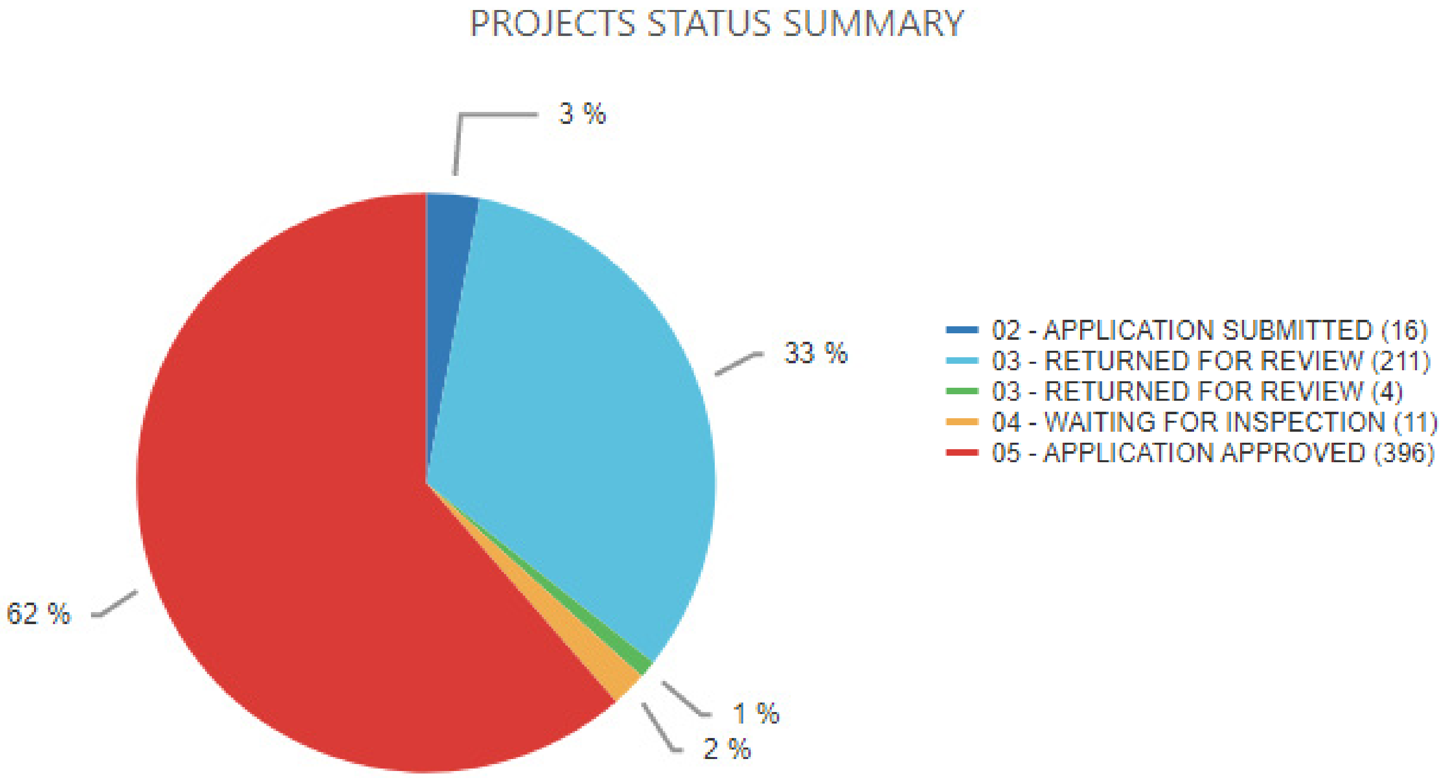
National Construction Authority

According to data from the National Construction Authority (NCA) private sector investments were the main drivers of the Kenyan construction industry for the period between July and December 2021. The projects most of which ranged from between Kshs. 5M and Kshs.50M were predominantly undertaken in Nairobi and Kiambu Counties.



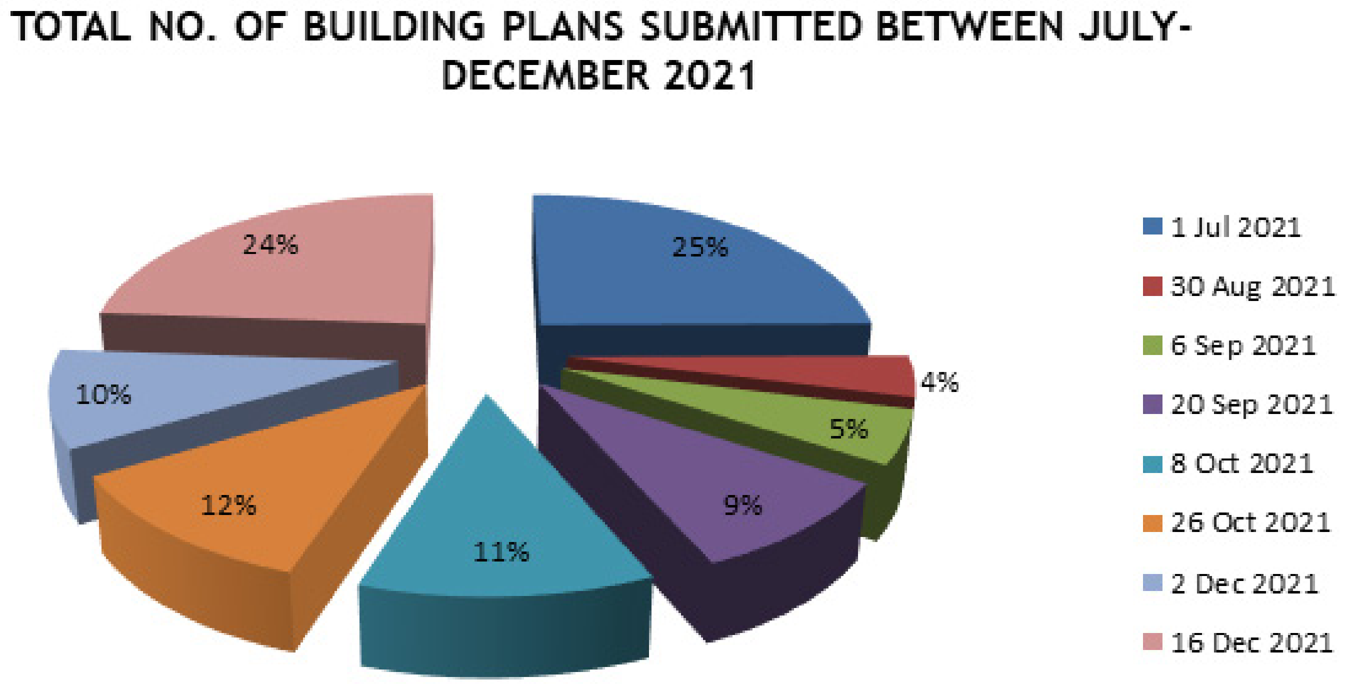



PROJECTS COST WISE SUMMARY
2 %
1 %
2 %
13 %
11 %
71 %
Below 5M (73)
5M-50M (455)
50M-200M (80)
200M-500M (12)
500M-1B (6)
Above 1B (12)


PROJECTS STATUS SUMMARY
3 %
33 %
62 %
1 %
2 %
02 - APPLICATION SUBMITTED (16)
03 - RETURNED FOR REVIEW (211)
03 - RETURNED FOR REVIEW (4)
04 - WAITING FOR INSPECTION (11)
05 - APPLICATION APPROVED (396)

NAIROBI METROPOLITAN SERVICES

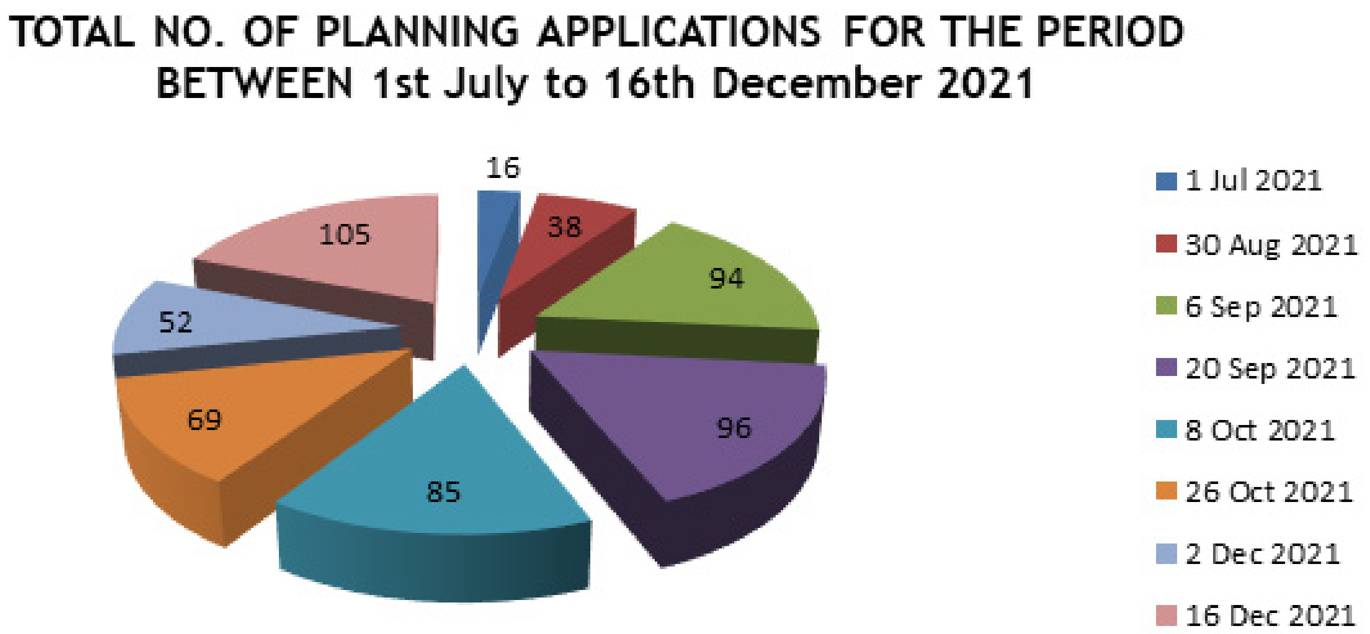
Buidling Plans



July and December had the highest number of Building Plans submitted for consideration with a total of 471 applications being submitted

The estimated cost of development for building applications submitted during the same period stood at Kshs. 118,162,455,630 with the NMS Development Control earning a totl of Kshs. 479,612,493 in permitting fees

Planning Applications



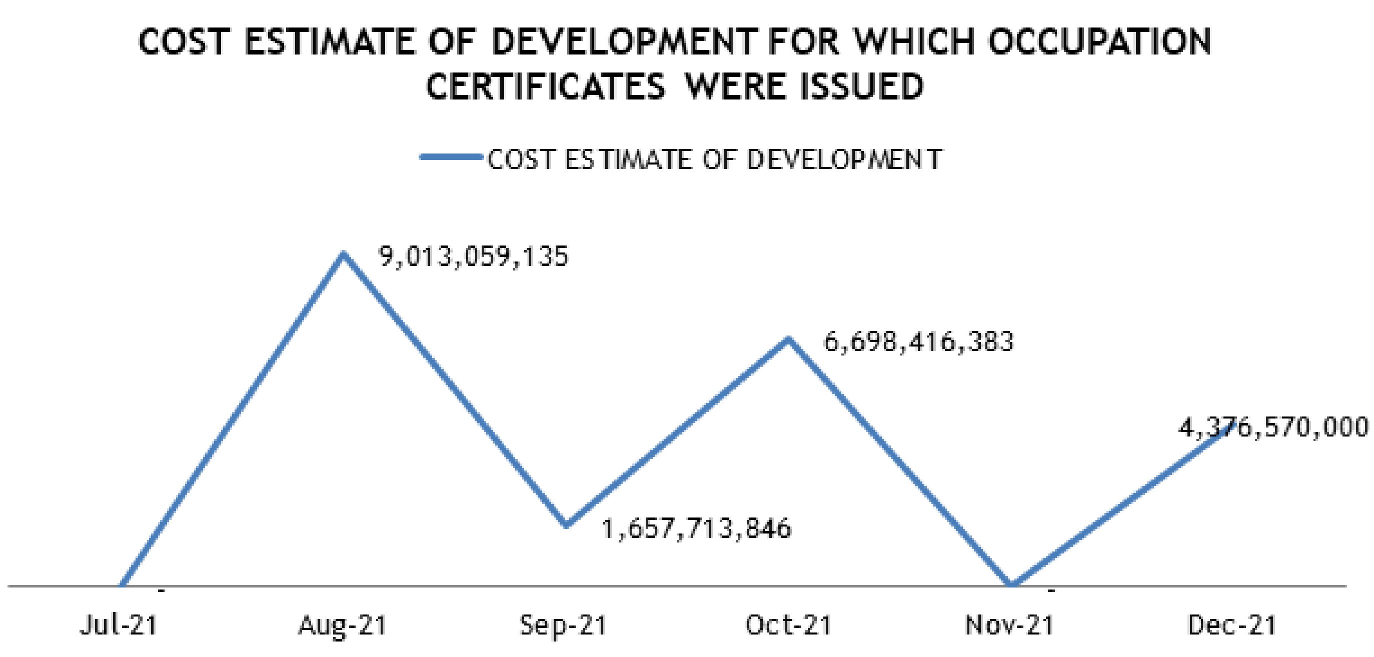
Development Control
Nairobi Metropolitan Services

Planning Applications

December 2021 recorded the highest number of planning applications submitted to the Nairobi County Development Control function. Accordingly, in the period between July-December 2021, the County received a total of Kshs. 49,571,000 in permitting fees for planning applications.

During the same period, 572 applications were made for purposes of renovation works earning the City a total of Kshs. 5,028,000 in permitting fees

Occupation Certificates



In August 2021, the NMS issued 36 certificates of occupation, making it the month with the highest estimated cost of development at Kshs. 9, 013,059,135

36 Highest No. of Occupation certificates issued in August at an estimated cost of Ksh. 9, 013, 059, 135

Moving Forward: 2021 Outlook

Residential

We foresee a major shift in the approach to the affordability question as far as residential housing is concerned and the number of housing units delivered by all development actors across Kenya. Harnessing non-government funds; say cooperatives and Diaspora remittances may be the way to go for low and middle income housing segments. Our observation over the past few years has shown that accommodation units are increasingly being produced yearly, some of which remain vacant for prolonged periods due to a lack of effective demand. The government agencies including the county governments and the Ministry of Land may be more impactful by easing the process of titling land, removing development constraints and improve on the ease of doing business.

Overall, we project that new housing opportunities will continue to be provided by existing landowners as they seek to cater to the mid-market demand for small apartments. This is expected to grow owing to the rapid increase in population in Kenya and increased globalization. Policies that facilitate affordable housing development are expected to be maintained within the government's agenda for housing even after the August 2022 elections. In addition, we expect that the government will help facilitate access to land and investment in infrastructure for the development of large scale private housing investment. This should translate to a growth in housing construction and rental markets. In light of the foregoing; our **OUTLOOK** for the residential sector remains **NEUTRAL.** Developers and potential investors must be deliberate on undertaking extensive research before embarking on any residential projects.

The affordable housing programme is expected to continue even after the elections

Retail Market

One immediate impact of COVID-19 lockdowns was a spike in online shopping, further driven by border closures and international export/import restrictions which put pressure on all aspects of the supply chain. This was noticeable in the expansion of demand for products that were almost exclusively in-store shopping. Many consumers have moved online for essential goods, forcing supermarkets to upgrade their delivery capabilities. Consumers will continue to prioritize delivery and convenience with an eye out for good deals, ease of ordering and free or cheap delivery.

With the uncertainty occasioned by the Omicron virus, the demand for physical shops and retail units might experience decreased demand. The situation may be compounded by the increased adoption of the dark kitchens concept that had started to gain traction locally during the initial phases of the COVID-19 lockdowns. The dark kitchen concept has seen restaurants convert their kitchens for back end order fulfillment designed for inner-city pickup or delivery for online shopping platforms. Understandably, the physical retail isn't dead but we are seeing a gradual reallocation of space. Investors are interested in mixed-use projects with the flexibility to respond to market changes. Local stores will continue to play a larger role in the delivery of goods and services. Core real estate faces a weakened economy and investors are looking to acquire real estate at below-market prices even as investments are expected to take a decline with the impending 2022 general elections in Kenya. Therefore, our 2022 OUTLOOK for the retail market remains NEGATIVE in the interim but NEUTRAL in the medium term if the COVID-19 situation will be arrested before maximum damage.

Many consumers have moved online for essential goods

Office/ Commercial

Granted, the COVID-19 pandemic triggered the sharpest economic slowdown in history. In response, companies both local and international have embarked on cost saving and austerity measures looking to save costs wherever possible in the short term. Underutilized real estate attracts immediate attention and with the increasing recognition of the possibilities in the virtual spaces we have observed increased contraction of expensive and premium office spaces. Innovation requires collaboration, and technology cannot replace live interaction. While there will be less demand for office space it is unlikely that it will precipitously fall. Most service based companies have now wholesomely embraced work from home policies with the primary objective of reducing employee commute times and improve productivity.

A hub & spoke model offers huge benefits in supporting flexible working, mitigates environmental impact and can be financially advantageous and with this in mind, commercial real estate with rents above $350psm have adopted more flexible lease terms underscored by concessions to attract clients. The same notwithstanding, head offices for most corporations with relatively structured occupancy have held on more conventional lease terms given their larger corporate portfolio. Moving into 2022, our **OUTLOOK** for the commercial office sector is **NEGATIVE** as the sector's performance continues to be constrained by oversupply of over 6.3 million SQFT of space and declining rental yields as at the first half of 2021.

Embracing Work from Home Policies

Industrial

The efficiency of logistics and transportation routes will depend on fulfillment centers and with the country committed towards *Building Back Better* post COVID-19. Providers of warehousing (Grade A) will attempt opening new spaces (2,000 to 5,000sqm) in more locations outside Nairobi and Mombasa which have traditionally been the industrial bases for most companies. They are likely to succeed. The consensus is that COVID-19 will not be the last disruptor in the supply global chain and Kenya's leading cities and urban areas will be looking to prepare. COVID-19 drove investor commitment in investing in logistics, data centers and life sciences and we believe this will not change any time soon. Logistics startups will continue the good work of integrating local and regional hubs across the East and Central Africa over inefficient infrastructure. Researchers at DWS Group suggest a gradual shift from last mile to last hour logistics. The way people shop has a huge bearing on the location decisions of logistics operators. Not only has this been driven by competitive pricing, but the increasing convenience of online shopping is also a key

component of this growth. A trend which survey evidence suggests will only intensify. Some retailers are already responding to the challenge of faster delivery. They are reconfiguring supply chains and introducing more points of delivery and this may have a multifaceted effect on the demand for industrial spaces. The demand for more points for delivery would translate to higher uptake of industrial spaces up to a certain tipping point resulting in an oversupply of space.

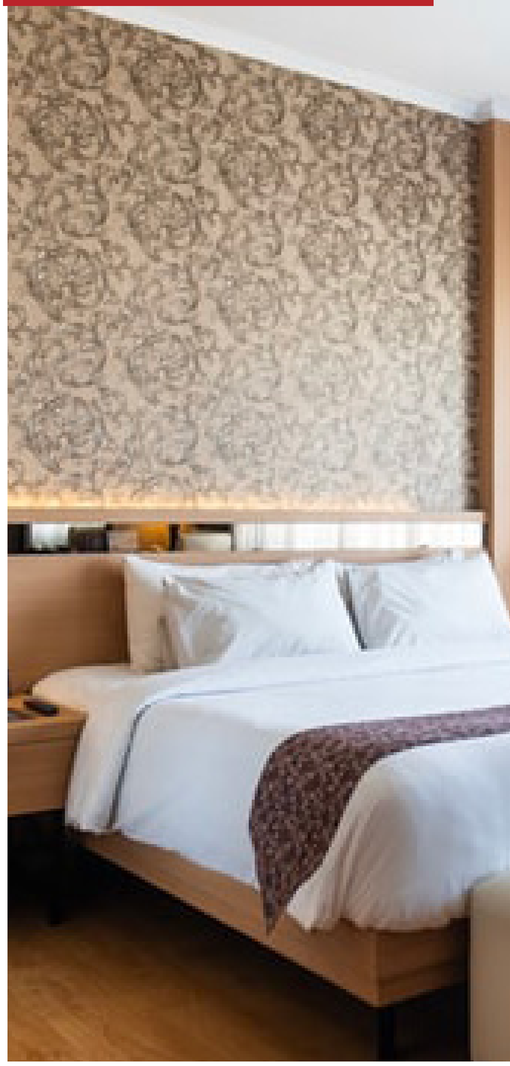
In addition, growing online sales, changing consumer preferences and technology will depend on urban logistics facilities. But not all urban locations are the same and where these facilities are located is important. While retailers and logistics operators are making progress on improving last mile fulfillment, researchers suggest a more permanent movement from last mile to last hour in the not too distant future. This will likely benefit industrial locations in Nakuru, Naivasha, Kisumu, Mombasa and Nairobi that have traditionally been the hubs for industrial development in the country. Thus, our **OUTLOOK** for the industrial segment of the country's real estate sector is **POSITIVE.**

Hospitality

Granted, 2022 offers a small window of opportunity for investors in the hospitality sector to acquire re-priced assets. Given that the hospitality sector is undergoing significant operational challenges, the recovery of Net Operating Income (NOI) back to pre-COVID levels likely to be elongated and bifurcated based on the type of hotel and market. The emergence of new COVID-19 variants is expected to further compound the situation.

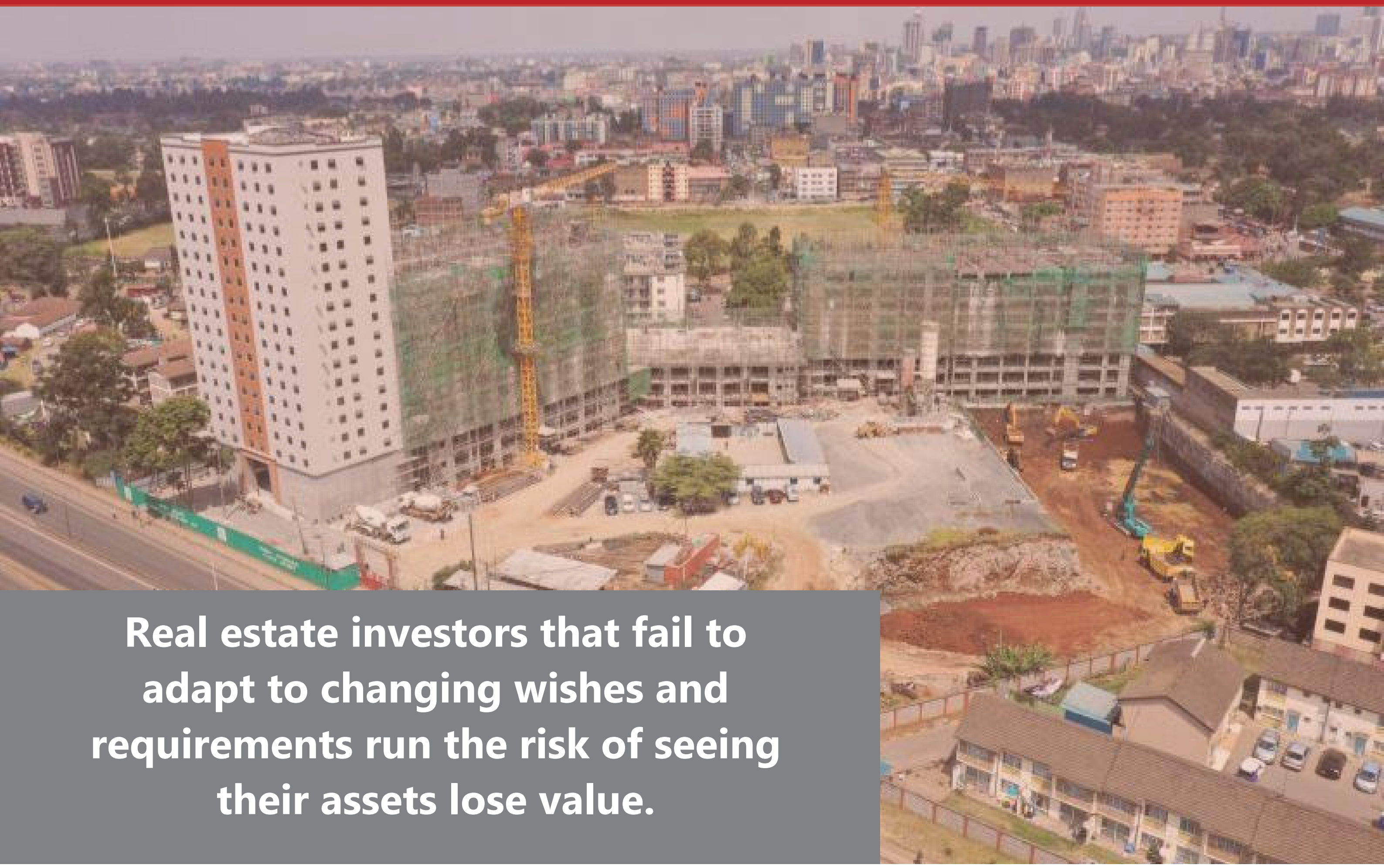
Operational challenges, coupled with the scarcity of debt financing for hotels during downturns, has historically led to significant price declines in recessionary periods followed by significant growth in valuations as operations improve and capital markets recover. Nevertheless, we project that leisure-oriented hotels accessed by local markets will recover before hotels dependent on international and business travel. In addition, hotel operators may be able to keep cost growth subdued due to forced innovations implemented during the pandemic, therefore supporting more robust profit growth as revenues rebound. Consequently, our outlook for the hospitality sector is **NEUTRAL.**

The recovery of Net Operating Income (NOI) back to pre-COVID levels likely to be elongated and bifurcated based on the type of hotel and market.



Conclusion

With the economic recovery that started in the second half 2021, the country seems to be emerging from the Covid-19 crisis in relatively good shape. At the same time, the crisis has triggered a number of structural changes in the real estate market. For instance, if (part-time) home working remains a normal part of working life, this will change the wishes of residents, while the owners of office buildings will have to rethink the function of their offices. Similarly, the retail sector will have to respond to the acceleration of the growth in online sales and hotel operators would be wise to look for alternatives if businesses across the world switch to digital meetings on a larger scale. Meanwhile, the increasing urgency of climate change and the need for greater sustainability will have a major impact on all real estate sectors. The Covid-19 crisis has made it even clearer just how important it is to make the real estate sector more sustainable. People are attaching more and more importance to healthy and conscious living and the increasingly alarming reports of climate change are leading to ever tighter laws and regulations. The built environment is one of the biggest emitters of greenhouse gases and cannot escape the impact of the upheaval ahead. Real estate investors that fail to adapt to changing wishes and requirements run the risk of seeing their assets lose value.



Real estate investors that fail to adapt to changing wishes and requirements run the risk of seeing their assets lose value.

HEAD OFFICE

Architectural Association of Kenya,
Blue Violets Plaza, Kamburu Drive, off Ngong Road.
P.O. Box 44258 Nairobi, 00100
Telephone: +254-020-2420806, 2420582
Mobile: +254 721 691 337
Email: aak@aak.or.ke • Website: www.aak.or.ke
Nairobi Kenya.

ArchKE @arch_KE @arch_KE