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High demand for commercial and retail space triggers an investment rush in Nairobi. A Public Service Commission (PSC) audit reveals the persistence of ethnic exclusion in the government. The audit finds that four ethnic groups hold 58% of all government positions. Data shows that Port of Mombasa was the second busiest sub-Saharan Africa port in 2014 with a 12% increase in container traffic.

Demand for commercial space increases

A high demand for commercial space in **Nairobi** has triggered an investment rush. Between August and September 2014, the value of building plans approved by the **City County of Nairobi** increased 58.2% to 12.3 billion Kenyan shillings (KSh) ($134m).[1] The properties are concentrated in the **Central Business District**, **Westlands**, **Kilimani**, **Upper Hill** and **Ridgeways**. Investment in high yield commercial buildings is on the back of the rapidly growing professional services sector and firms using Nairobi as a regional hub (see below). These demographic changes have also driven up the value of the residential property market by 357% between 2000 and 2014.[2]

There has been a related rapid increase in the number of high-class shopping malls. **Two Rivers**, the largest shopping mall in **sub-Saharan Africa** outside **South Africa,** is expected to open its doors in the third quarter of this year. At 62,000 square metres, the mall is twice as big as the now defunct **Westgate Mall**, which may never be rebuilt as legal disputes over its insurance at the time of the September 2013 attack rumble on. Two Rivers is part of a $400 million mixed development by publicly listed **Centum**. Its opening will mark the debut of **France-**based retailer **Carrefour** into the Kenyan market. Carrefour will also be the anchor tenant at **The Hub**, a 36,000 square metre shopping mall under construction in Nairobi's high-end suburb of **Karen**, with the first phase scheduled for completion mid-2015.[3] The sector is of interest to international investors. **United Kingdom (UK)-** based private equity firm **Actis** is putting up **Garden City**, a $205 million mixed development on the **Thika Superhighway** that will have 50,000 square metres of retail space in addition to housing units.

New commercial developments are not limited to Nairobi. **Mauritius-**based and UK-managed real estate developers **Lloyd Capital Investors** are developing **Buffalo Mall** in **Naivasha** town. The first phase will be complete in the fourth quarter of 2015. The towns of **Meru**, **Limuru** and **Nanyuki** are all about to get their first shopping malls.

The trend is a result of rapid urbanisation and a growing consumer class offering handsome returns.

> *"From a retailer's perspective, there is a population concentration that can sustain a mall. The middle class, who are the main partakers of malls, is growing very fast in Kenya and developers are rushing to cash in on that."*[4]

High demand for space is ensuring high returns for investors. Mall rental yields outperform bonds, stocks and other investments, and are more attractive than other commercial properties. Rental yields for shopping malls are between 10 and 12%, higher than for office space which attracts returns

[1] Daily Nation, 9 Jan 2015.
[2] www.globalpropertyguide.com
[3] www.constructionkenya.com
[4] Source, managing partner at retail consultants, Nairobi

of about 8%. Malls attract rent of between $11 and $38 per square metre, higher on average than office rents at $13-$17 per square metre.[5]

> *"I think it is all about capital appreciation and to an extent financing leverage. Today, if you have KSh2 billion ($22 million), the return across all other instruments and sectors is less than 10%. That means you'd rather invest in low maintenance real estate e.g. a shopping mall. It is pure hassle managing residential or office blocks."*[6]

The entry and expansion of international chains is also expected to be a boon for retail developers. These are often anchor tenants who pay lower rent but whose presence is sufficient to attract other fast moving consumer goods retailers.

While the demographic trends encouraging the rapid expansion of malls will continue, the market may become oversaturated, leading to concerns about the sustainability of both rent prices and the number of malls.

> *"There is a disconnect between the distribution of malls and the distribution of Kenya's middle class. Some areas will be oversupplied and others under supplied. We think that in most parts of Nairobi, there is going to be a glut of retail space. So expect some malls to flop."*[7]

Civil service remains ethnically exclusive

A **Public Service Commission (PSC)** survey into the makeup of the civil service has revealed the persistence of ethnic exclusion in the government. The audit is indicative of institutional resistance to the more progressive provisions of the **2010 Constitution** that aims to develop a more inclusive political system. The December 2014 report found that four of Kenya's 42 ethnic groups hold 58% of all government positions at the expense of smaller communities.[8] Members of President **Uhuru Kenyatta's** (2013 – present) **Kikuyu** ethnic group were especially overrepresented, occupying 23% of all appointments across government ministries, departments and agencies. According to the 2009 national census, the Kikuyu form approximately 17.2% of Kenya's population. Members of deputy president **William Ruto**'s **Kalenjin** communities hold 12.8% of jobs in government, despite forming 11.5% of the population. The **Luhya** hold 12.2% of government posts, a slight under-representation of their 13.8% of the Kenyan population. The **Kamba** represent 10.9% of the civil service but make up 11.2% of the population. The national assembly more accurately reflects Kenya's ethnic balance. The Kikuyu hold 17% of seats, the Kalenjin hold 13%, the Luhya 14%, and the Kamba 10%.

Despite the government's active attempts to address the dominance of the largest ethnic groups in the civil service, figures have been largely static. A similar PSC payroll survey in June 2013 revealed that the Kikuyu held 22.3% of government posts, the Kalenjin 15.3%, the Luhya 11.3%, and the Kamba 9.7%. Article 232 of the Constitution calls for the civil service to mirror Kenya's ethnic groups and codifies equal opportunities in appointment and promotion.

The PSC report concludes that wider structural issues continue to affect employment, especially disparities in education provisions, access to higher education, and the number of government jobs available in any region. The government uses legal prescriptions to mitigate this, allowing for affirmative action and for ethnicity to be taken into account in appointments. No group is allowed to hold more than a third of appointments in any one ministry or agency. This is yet to have an effect. The most underrepresented groups are those that have historically been politically and economically marginalised. The **Somali** group is under-represented by 4.4% and the **Turkana** by 2.2%.

Hiring on the basis of anything but the candidate's quality may not improve the effectiveness of the Kenyan government. Political patronage has already hollowed out the capacity of the civil service.

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[5] www.broll.com

[6] Source, retail analyst, Nairobi

[7] Source, retail analyst, Nairobi

[8] Daily Nation, 7 Jan 2015.

"The civil service is the handbrake on Kenya's progress. It contributes to a culture whereby government administrators are more interested in the trappings of office than doing their actual jobs."[9]

Sharp ethnic divisions are a threat to Kenya's long-term political stability. While not inherently dangerous, they provide fault lines which shifting coalitions and economic inequalities have demarcated and which populist politicians have manipulated for their own gain. They are particularly connected with land issues. Political elites have used the uneven distribution of land across communities in both the **Coast Province** and the fertile **Rift Valley** as a political tool, triggering widespread ethnic violence that has flared up several times since the return to multiparty democracy in 1991. While the 2013 general election passed without incident, it demonstrated the persistence of identity politics. In 28 of Kenya's 47 counties, more than 80% of voters supported either Kenyatta or opponent **Raila Odinga** signaling political polarisation. Odinga's support was concentrated in the former **Nyanza Province**, heartland of his **Luo** community, and the former **Eastern Province**, heartland of running mate **Kalonzo Musyoka's** Kamba group. Kenyatta and running mate Ruto won 91.3% of the vote where the constituency was either Kikuyu or Kalenjin.

Port of Mombasa enjoys bountiful 2014

The **Port of Mombasa** was the second busiest **sub-Saharan Africa** port in 2014 with a 12% increase in container traffic.[10] More than one million twenty-foot equivalent units (TEUs) were handled through the year, second only to the **Port of Durban** in South Africa. The Port of Mombasa also posted a new tonnage record of 24 million tonnes of total cargo.[11] A total of 1,700 vessels docked. The increase in traffic is partly due to increased port capacity. The **Kenya Ports Authority (KPA)** has invested in decreasing dwelling times for consignments, increasing discharge times, dredging and widening the turning basin to increase the size of ships calling. Congestion is still an issue but the KPA is improving its anticipation and handling of cargo.

In December, East African governments reached agreement to waive all customs warehouse and port demurrage charges to accelerate the movement of outstanding containers in order to free up space. From 1 January, all government agencies involved in cargo clearance are using the single electronic window system to process standardised paperwork and payments for cross-border transactions.

Capacity is set to increase further. In January, the KPA launched a management tender to operate a new $300m terminal with two berths scheduled for completion in the first quarter of 2016.[12] The **Japan Bank for International Cooperation** has additionally agreed a KSh 25 billion ($273m) loan to finance an additional three berths in the new terminal, land reclamation in **West Kipevu**, and the drenching of access channels.[13] The new terminal will increase capacity to 1.2m TEUs by 2019 and will be fully operational in 2020.

Although the Kenyan government has intervened to improve efficiency, bottlenecks persist. These include limited berths for specialised services (for instance, a single bulk grain discharge terminal), skilled labour shortages that affect labour intensive loading and discharge operations, slower operations during the rainy season, and stretched trucking capacity at times of peak demand.[14] In June 2014, a government directive addressed non-tariff barriers along the northern corridors. Trucks are now only weighed twice between Mombasa and the **East Africa** region. This is partly because the Port of Mombasa is facing a challenge to its position as gateway to the region from the $11 billion **Chinese-**financed and constructed **Bagamoyo Port** which lies to the north of **Dar es Salaam**

[9] Source, business consultant, Nairobi
[10] The Star, 1 Jan 2015.
[11] The Star, 1 Jan 2015.
[12] Daily Nation, 5 Jan 2015.
[13] Daily Nation, 15 Jan 2015.
[14] www.dlca.logcluster.org

(**Tanzania**). The first stage of construction is expected to be completed by 2017 – 2018. Bagamoyo will have the capacity to handle 20 million TEU a year.

Implications

The Kenyan property market is overvalued. The glut of commercial properties contributes to wider instability in a sector whose value means it is prone to corruption and land grabbing. An oversupply of commercial property will slow investment and construction. This raises the risk of foreclosures, increasing the exposure of developers to debt and the financial sector to bad loans. It will also cause problems for investors, many of whom have purchased property as part of a limited liability corporation and have used it as leverage against other assets.

The concentration of government jobs amongst Kenya's major ethnic groups will allow minority grievances to fester. Until addressed, events such as elections will continue to provide a trigger for long-standing ethnic grievances to turn violent. Quotas and other forms of affirmative action may, however, result in the most capable candidates not necessarily being awarded posts. This would further undermine the capacity of the civil service and increase the difficulty of doing business in Kenya.

The threat to Mombasa Port from Bagamoyo has focused the Kenyan government's attention on addressing bottlenecks. Greater capacity and the single electronic window system will improve clearing times. Nevertheless, the regional flow of trade will begin to shift to Tanzania in 2017 especially if there are delays to the construction of the standard gauge railway.