



Cytonn Weekly #13.2020

Real Estate

I. Industry Reports

During the week, Knight Frank, a local and international real estate consultancy firm, released the **Knight Frank Africa Report 2020/2021**, which provides an overview of the continent's diverse property markets and the key-take outs were as follows;

- i. Kenya's retail market recorded the highest prime yields at 9.0%, compared to the industrial, office, and residential sectors at 8.5%, 8.0%, and 5.5%, respectively. The performance of the retail sector was supported by; (i) an influx of international retailers into the local market such as Carrefour, Game and Shoprite, and (ii) longer letting lead times for new developments, which has resulted to a tenant-favored market thus minimizing the effects of an oversupply of retail space,
- ii. The industrial sector performance was primarily shaped by the continued infrastructural developments in Kenya such as the Northern, Eastern and Western Bypass and the completion of the Phase 2A of the Standard Gauge Railway, which has continued to facilitate the unlocking of new modern industrial facilities in Kenya away from the ones that have been in existence,
- iii. The performance of the office sector was attributed to oversupply in the sector and subdued occupier demand. However, demand for Grade A office space continued to be boosted by the expansion of prime tenants mainly in strategic office nodes, as new trends such as co-working continue to gain traction in the local market.

The above report is in tandem with the **Cytonn's Real Estate Annual Markets Review Note 2019**, according to which, retail, office and residential sectors recorded average rental yields of 7.8%, 7.5%, and 5.0%, respectively, with key trends shaping the commercial and retail real estate sectors including entry of international retailers as well as demand for top-notch office space and serviced offices. For 2020, we expect the real estate sector performance to continue picking up against increased infrastructural upgrades, increase in foreign investments especially with continuing entry and expansion of international retailers, positive demographics.

II. Hospitality Sector

During the week, several adjustments were made by key players in the hospitality sector with the aim of containing the spread of the Coronavirus, which has significantly affected the sector. Some of the key adjustments include:

- i. The government implemented a ban on all international flights effective Wednesday 25th March 2020, with the exception of cargo flights,
- ii. Temporary closure of some major hotels in Kenya, such as Tribe Hotel and Ole Sereni in Nairobi County; Grand Royal Swiss and Sovereign Hotel, in Kisumu County
- iii. Suspension of operations at Maasai Mara Game Reserve in Narok County, due to travel restrictions and strategies aimed at adhering to social distancing rules introduced by the government,
- iv. Villa Rosa Kempinski Hotel limiting its business to room service only, suspending other activities such as hosting of meetings, events, and operations in their restaurant and bars,

- v. Jambo jet, a local airline carrier, combining some of its flights to Western Kenya, mainly trips to Eldoret and Kisumu, to try and boost the number of passengers per flight. Additionally, the carrier reduced its fares in response to the low number of passengers occasioned by the Coronavirus pandemic.

The ban on all international flights and reduced local direct flights as a result of the continued spread of Coronavirus continues to hurt the hospitality sector. This will result in a reduced number of tourist arrivals in Kenya, thus lowering the demand for hospitality services, which is expected to impact the performance of the sector, evidenced by the suspension of operations in several hospitality facilities. Globally, the hospitality industry has been the most affected by the pandemic, for example in the United States, a research done by the American Hotel and Lodging Association showed that the occupancy of hotels has reduced to an average 25.0% in March 2020, from an average of 65.0% in January 2020, representing a 40.0% points drop.

In our view, the hospitality sector will be hit the hardest by the Coronavirus Pandemic owing to its heavy reliance upon tourism and the MICE (Meetings, Incentives, Exhibitions, and Conferencing) sectors. However, unlike hotels, which tend to attract short-stay visitors, serviced apartment revenues will continue to be sustained by the presence of long-stay visitors. In addition, the magnitude of the impact will depend on the duration of the outbreak and counteracting measures. However, we expect the performance to be cushioned by government compensating factors in the wake of reduced demand for hospitality services. The Cabinet Secretary for tourism, Najib Balala, announced that the ministry has set aside Kshs 500 mn for the post-corona recovery strategy, which will be used to restore destination confidence to ensure that Kenya remains a preferred travel destination globally.

III. Retail Sector

During the week, Choppies supermarket put up for sale its retail equipment and property in Kenya, scaling down its local stores from more than 15 to 2. Choppies, which has its roots in Botswana, aims to utilize the proceeds for clearing some of its outstanding liabilities after revealing plans to exit the Kenyan market four years after acquiring 75% Ukwala stores for Kshs 1.0 bn. The retailer has been struggling to grow its market share in an increasingly competitive retail market characterized by the merger of some of its rivals like Quick Mart and Tumaini and the declining fortunes of big players like Uchumi and Nakumatt. Competition in Kenya's retail sector has been growing tough with multinational supermarket chains like Carrefour, Shoprite and Game Stores continuing to increase their local footprint across the country. Key issues facing retailers such as Nakumatt and Choppies include poor governance and expansion strategy as well as supply chain mismanagement leading up to crippling financial constraints.

The continued exits by troubled retailers are expected to result in lower occupancy rates in the retail sector. However, we expect the sector's performance to be cushioned by the continued interest in Kenya's retail scene by international players.

iv. Infrastructure

During the week, the National Government, through the Kenya Roads Board, released Kshs 29.0 bn to road agencies and county governments meant for the first half of the 2019/2020 fiscal year. The funds are to be distributed among the Kenya National Highways Authority (KeNHA), Kenya Urban Roads Authority and the Kenya Rural Roads Authority.

The above development is an indication of the continued government focus on the improvement of infrastructure with the aim of elevating the country to upper-middle-class status by 2030. According to Cytonn's **Nairobi Metropolitan Area Infrastructure Note 2019**, the sector has in the past years experienced a steady growth which was fueled by; (i) availability of various forms of financing to support the sector, (ii) establishment of the governments public-private partnerships unit, and (iii)

enhanced government incentives towards the development of the sector. With the continued government focus on the same, we expect this to support development activities by opening up areas and thus a resultant boost for the real estate sector as the accessibility of an area remains a key factor of consideration by both investors and homebuyers. Despite the reduced development activities in the wake of tough economic times, we still expect the government to continue focusing on infrastructural improvement as it is vital for any economy to grow, thus, equally boosting the real estate market.

We retain a neutral outlook for the real estate sector in Kenya as we continue to witness the effects of the COVID-19 pandemic, which has continued to have a dire impact on the economy. However, the real estate sector is expected to be cushioned by infrastructural development and government's fiscal and monetary policies, such as the recent lowering of the Central Bank rate, which is expected to sustain private sector credit growth.

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