COVID-19 Economic Containment Policies, & Cytonn Weekly #15/2020

Real Estate

I. **Residential Sector**

During the week, The Tax Laws (Amendment) Bill 2020 was set to be tabled before parliament. However, this did not happen following postponement of the legislature's sitting to an undisclosed later date. Among other amendments, most of which are set to caution the economy in the wake of the COVID- 19 pandemic, the bill outlines a proposed amendment to the Income Tax Act (Cap 470) through the deletion of Section 22C, which provides for tax incentives to individuals saving towards purchasing of a house through a registered home ownership savings plan (HOSP). If the amendment is adopted and approved, this will mean that individuals making savings through all HOSP approved institutions, will cease to benefit from; (i) tax exemption on income to a maximum of Kshs 8,000 per month or Kshs 96,000 per annum, and (ii) tax exemption for any interest income earned by a depositor on a HOSP deposit of up to a maximum of Kshs 3.0 million. We expect this to negatively impact on homeownership levels in the country, by resulting in an increased tax burden especially among the low and middle-income earners who are the main beneficiaries of the HOSP platforms. The amendment also goes against the government's affordable housing initiative, under the Big Four Agenda, which aims to enhance homeownership, by empowering both the demand and supply side of the housing sector, mainly for the low and middle-income market segments. Currently, Kenya has a cumulative housing deficit of 2.0 mn units growing by 200,000 units per year. Homeownership remains low with the key challenge being unaffordability and unavailability of financing, where a significant percentage of the population are not able to secure home loans provided by banks given their low-income levels with statistics showing that approximately 74.5% earn Kshs 50,000 per month and below. In addition, 83.4% of total employment is in the informal sector, which is characterised by small-scale activities, relatively unpredictable incomes and limited job security, and thus they are not able to afford to buy a house. Therefore, the HOSP platforms have been a move in the right direction as mortgage and cash buyers can save towards the purchase of a home, through a flexible and low- cost mechanism such as through Money Market Funds. In our view, there is, therefore, the need for Parliament to relook at the amendment, as it is likely to significantly impact on homeownership and an overall slowdown of the government's Big Four Agenda.

II. **Commercial Sector**

During the week, Fusion Capital, a local real estate developer, announced that it would offer a 3-month 30.0% rent relief to tenants in its Flamingo Towers development in Upper-Hill as a result of the Coronavirus pandemic, which continues to affect the sector. This in our view comes as a relief for tenants in light of business shutdowns owing to the Coronavirus lockdowns. The office sector like other real estate sub-sectors is experiencing a short- term disruption due to the Coronavirus pandemic and has presented some downside risk for the sector forcing property developers to employ creative strategies such as; (i) reduction of rental prices by a percentage to occupants, (ii) rent relief for some of the occupants, and (iii) extending of deadlines for rental payments for some occupants.

Globally, the pandemic has resulted in reduced demand for commercial properties as a result of the disruption of business operations and employers embracing remote work. In some countries, authorities have introduced legislative measures to support tenants whose purchasing power has been negatively affected by the pandemic. In the US for example, states such as New York and California have temporarily banned commercial evictions with landlords being encouraged to revise payment plans with tenants. Some of the flexible payment plans revisions by property managers to retain clients include:

i. Reducing rent for a set period with no repayment or reducing rent for a set period, then amortizing for the remainder of the term,
ii. Reducing rent for a set period then including additional months on to the end of the term,
iii. Reducing the rent to a percentage of sales for retail tenants.

We expect landlords to continue to adopt various strategies to attract and retain tenants, which will cushion the performance of the sector in the wake of reduced demand for commercial spaces.

III. **Hospitality Sector**

During the week, the Kenyan Government implemented a 21-day ban on movement in and out of the Nairobi Metropolitan Area effective Monday 6th April 2020, with an exception of cargo to curb the spread of the Coronavirus to the rest of the country. In line with this, local airline carriers, Jambojet and Safarilink announced that they would temporarily suspend their local flights.

The hospitality sector, which is largely reliant on the travel industry, continues to grapple with the effects of the Coronavirus as travel restrictions and social distancing rules continue to reduce the number of tourists, cancellation of meetings, conferences and events and suspension of operations by hotels. Following the National Government’s ban on all international flights from 25th March 2020, several key players in the hospitality sector suspended their operations including major hotels such as the Tribe Hotel, Serena Hotels, and Ole Sereni.

In our view, the reduced number of tourist arrivals in Kenya coupled with the restricted movement of local tourists within will lower 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. However, the magnitude of the impact will depend on the duration of the outbreak and counteracting measures taken by both the government and the private sector. We expect the sector to cushioned by the ongoing domestic flights and the ministry’s post corona recovery strategy fund of Kshs 500.0 mn

IV. **Infrastructure Sector**

During the week, the Kenya Roads Board (KRB) disbursed Kshs 539.0 mn for maintenance of roads in the coastal region for counties such as Mombasa, Kilifi, Lamu and Taita Taveta. The fund is part of the Kshs 4.4 bn conditional grant for the maintenance of roads in all the 47 counties in this 2019/2020 financial year. Conditional grants, which is money transferred from the national government to the county governments for a specified purpose, have become the major source of development funds in counties as disbursements from equitable share mainly go into recurrent expenditure and consumption of fixed capital. We continue to see increased efforts by the government to diversify its sources of funds to finance infrastructure projects such as floating of bonds, and acquiring grants from foreign institutions and governments.

We expect continued efforts by the government in improving infrastructure in a bid to open up the coastal region. Notable infrastructural upgrades include the construction of the Dongo Kundu Bypass, which is in its phase II, and will integrate the Port of Mombasa, Moi International Airport, Standard Gauge Railway Mombasa Terminus, and the Nairobi-Mombasa Highway. We expect this to stimulate the tourism sector's performance at the Coastal region, as inadequate infrastructure particularly between North and South Coast has been a key challenge, and ultimately lead to growth in property prices rise in the region. Overall, we expect the nationwide infrastructural development to support the real estate sector's growth by opening up new opportunities for investors. According to KNBS Economic Survey of 2019, the infrastructure sector's contribution to GDP increased by 0.4% points to 8.5% in 2018 from 8.1% in 2017, indicating steady growth in the sector which was fueled by; (i) presence of funds to facilitate development, (ii) establishment of the government's public-private partnerships unit, and (iii) enhanced government incentives towards the development of the sector.

We retain a neutral outlook for the real estate sector as we continue to witness the effects of the COVID-19 pandemic. However, we expect the sector to pick once the pandemic ceases owing to continued investment in infrastructure, constant housing deficit and the government's recovery strategy.
