Kenya Listed Banks FY'2019 Report, & Cytonn Weekly #16/2020

Real Estate

I. **Residential Sector**

During the week, the Pandemic Response and Management Bill 2020 was tabled before the senate by Nairobi Senator Hon. Johnson Sakaja, which outlines socio-economic protective measures such as tenancy agreements, social safety nets, loans and mortgages, aimed at cushioning business and households in the wake of the COVID-19 pandemic. The Bill, whose principal objective is to provide a framework for the effective response to and management of a pandemic, seeks to address the gridlock between landlords and tenants offering guidelines on how both parties can resolve business relationships during pandemic times. The property related measures are outlined in Section 26- 29 of the Bill and include;

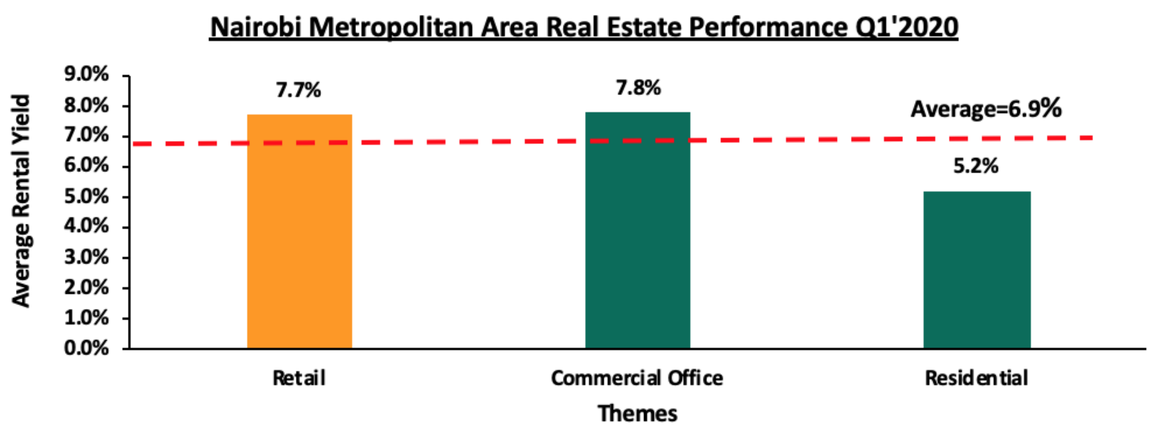
i. **Loans and Mortgages** - The bill seeks to; (i) protect borrowers by preventing lenders from imposing penalties on defaulters during the pandemic, and (ii) protect the defaulter from being listed with a Credit Reference Bureau. It proposes that the borrower and the financial institution enter into an arrangement to review repayment modalities in such an event. Key to note, the measures would apply for a period beginning from the declaration of the pandemic up to three months after the pandemic. With regard to the same, the bill also proposes that the Cabinet Secretary responsible for matters relating to finance may, with the approval of Parliament, also provide measures to cushion lenders and borrowers,
ii. **Moratorium on Penalties -** The bill proposes that a lending financial institution shall not charge fees, interest or any other penalty for non-payment or late payment of obligations during the pandemic period,
iii. **Contractual Obligations** - The bill seeks to prevent lenders from putting properties to auction in addition to preventing any termination of lease or license of immovable property due to non-payment of rent or other monies during the pandemic,
iv. **Tenancy Agreements** - The bill proposes that tenants and landlords may enter into an agreement on how the former may settle rent arrears accumulated during a pandemic. This will give tenants the ability to defer payment of rent until a pandemic is ended, without exempting the tenants from paying rent during the pandemic.

In our view, successful implementation of the Bill would mean that in an occurrence of a pandemic, parties on the receiving end, tenants and borrowers are cushioned against adverse effects of the pandemic, mainly due to the resultant impact on socio-economic activities. However, this could render landlords and financial institutions into an economic plunge, as there are no provisions such as tax incentives to cushion their businesses over the same period.

II. **Retail Sector**

During the week, International Finance Corporation (IFC), World Bank's Private lending arm, acquired a minority stake in Naivas International Limited for Kshs 1.5 bn. The global financier is part of a consortium of investors among them, French private equity firm Amethis, Deutsche Investitions- und Entwicklungsgesellschaft (DEG) - a German Development Finance Institution, and Mauritian Commercial Bank (MCB) Fund, investing in Naivas, a family-owned retail chain which has 62 outlets in Kenya. The move by IFC is an indication of investor confidence in Kenya's retail market and the retailer, in the wake of increasing competition with the entry and expansion of international brands, even as some of its peers struggle to remain in business. Through gaining a stake in the company, we expect that IFC will help optimize business operations and further strengthen the retailer's corporate governance structures, whose lack thereof previously resulted in the collapse of family-owned retail giant, Nakumatt Holdings. This will thus enhance consolidation of the retailer's position and support further expansion. In our view, the continued investor confidence evidenced by increased focus by international institutions on Kenya's retail sector is largely driven by; (i) strong domestic demand driven by the growing middle-class population with a high purchasing power, (ii) the rapid population growth at 2.2% compared to the global average at 0.9%, which has led to international retailers such as Mango setting up shop in the region to satiate demand for quality international products, and (iii) a general improvement in ease of doing business in the region evidenced by Kenya's move from position #61 in 2018 to #56 in 2019 on the Ease of Doing Business Index by World Bank. We expect this to continue resulting in the entry and expansion of retailers, which will boost the retail sector performance, through fueling uptake of space thus driving investor returns. In terms of performance, according to the Cytonn Real Estate Report Q1'2020, the retail sector recorded an average yield of 7.7% in Q1'2020 compared to the office and residential sectors with 7.8% and 5.2%, respectively, with markets such as Westlands and Karen recording relatively high returns of 10.0% and 9.6%, respectively.

The figure below shows a comparison of performance of the retail, residential and commercial office themes in Q1'2020;



Source; Cytonn Research 2020

In addition, during the week, Shoprite Holdings, South African based international retailer, announced the closure of its Waterfront Mall branch in Karen, where it was the anchor tenant, due to the reduced flow of shoppers, and this brings the number of remaining outlets in Kenya to 3: at Garden City, Westgate Mall in Nairobi and City Mall in Mombasa. The retailer set up shop in Kenya, opening their first store in 2018 to take advantage of prime retail locations vacated by collapsing retailers namely, Uchumi and Nakumatt. However, the retailer, who initially had 4 outlets has begun to scale down due to financial constraints. This, in addition to the scaling down of other retailers such as Botswana's Choppies and local retailers Uchumi and Nakumatt, a family-owned business that collapsed as a result of poor corporate governance structures, has continued to impact on the retail sector occupancy rates, which dropped by 0.3% points to 78.4% in Q1'2020, from 78.7% in Q1'2019, according to the Cytonn Real Estate Report Q1'2020. We attribute this to constrained spending power among consumers due to a tough financial environment and an introduction of 0.8 mn SQFT of retail space in 2019, with the addition of malls such as The Well in Karen and the expansion of Sarit Centre in Westlands.

The table below shows the sub-market performance in the Nairobi Metropolitan Area (NMA);

(All values in Kshs unless stated otherwise)

Nairobi Metropolitan Area (NMA) Retail Submarket Performance Q1'2020

Row Labels	**Rent Kshs/SQFT Q1' 2020**	**Occupancy Q1' 2020**	**Rental Yield Q1' 2020**
Westlands	210.3	82.2%	**10.0%**
Karen	220.0	81.9%	**9.6%**
Ngong Road	186.3	80.5%	**8.5%**
Kilimani	164.2	85.5%	**8.5%**
Kiambu Road	175.4	70.3%	**7.3%**
Thika Road	170.4	73.0%	**7.0%**
Eastlands	148.2	71.8%	**6.8%**
Mombasa Road	152.5	69.3%	**6.4%**
Satellite town	135.0	74.5%	**6.0%**
Average	**172.7**	**76.3%**	**7.7%**

Source; Cytonn Research 2020

We expect that financial boost, as in the case of international financial institutions buying into companies such as Naivas, will strengthen the retailers' financial muscle and also enhance good corporate governance thus boosting its operations. Nevertheless, we expect the sector's performance to continue being suppressed by the existing oversupply of space amounting to 2.8 mn SQFT as at 2019, prompting reduced development activity in the sector within the Nairobi Metropolitan Area, with developers shifting to county headquarters in some markets such as Kiambu and Mt. Kenya that have an estimated retail space demand of 0.8 mn and 0.2 mn SQFT, respectively.

Despite the effects of the COVID-19 pandemic taking a toll on the Kenyan economy, we continue to retain a neutral outlook towards the performance of the real estate sector, supported by the continued investor confidence in addition to measures such as proposals within the Pandemic Response and Management Bill which if implemented are set to cushion the sector against serious disarray from the effects of the pandemic.