Debt Relief Amidst the COVID-19 Pandemic, & Cytonn Monthly - April 2020

Real Estate

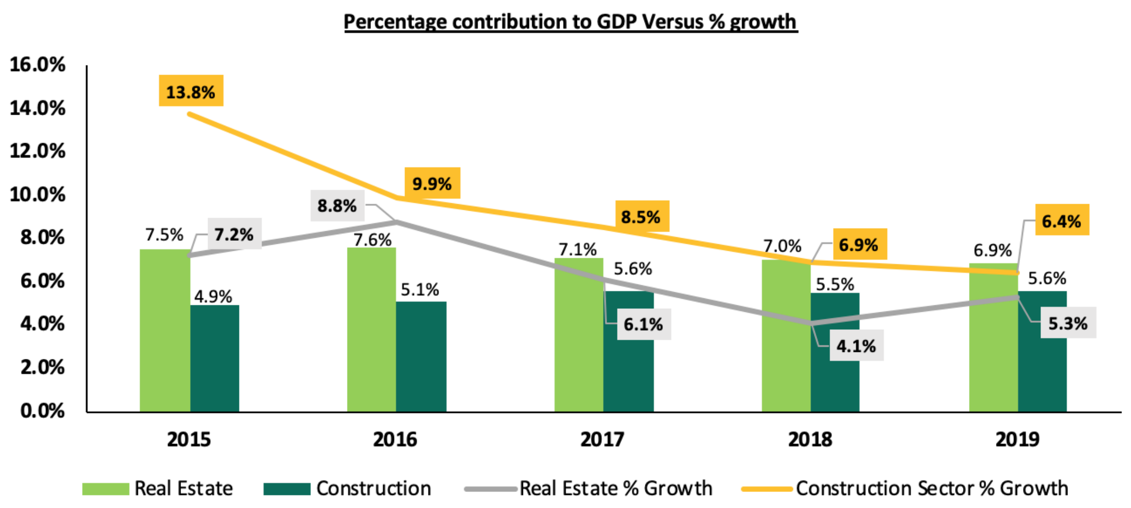
I. **Industry Reports**

During the week, Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2020 Report which focuses on the socio-economic indicators of the Kenyan economy in 2019. The key real estate highlights from the report include;

i. The real estate sector grew by 5.3% in 2019 compared to 4.1% in 2018. In terms of contribution to GDP, the sector recorded a marginal decline of 0.1% points to 6.9% in 2019 from 7.0% in 2018. We attribute the improved growth of the sector to; (i) continued National Government support for the affordable housing initiative, (ii) Increased foreign investments, (iii) infrastructural improvements, and (iv) positive demographics, which continue to support demand in the sector,

ii. The construction sector grew by 6.4% in 2019, 0.5% points lower from 6.9% recorded in 2018, while the sector's contribution to GDP improved slightly by 0.1% point to 5.6%, from 5.5% in 2018. Cement consumption dropped by 2.5% to 5.93 mn tons in 2019, from 5.95 mn tonnes in 2018. Reduced sector growth and the decline in cement consumption during the review period can be attributed to reduced development activities due to illiquidity in the private sector during the interest rate cap regime and delay in the processing of construction permits by counties such as Nairobi, Kisumu, Kiambu, and Mombasa,

The graph below shows the growth of the real estate and construction sectors over the last 5 years;

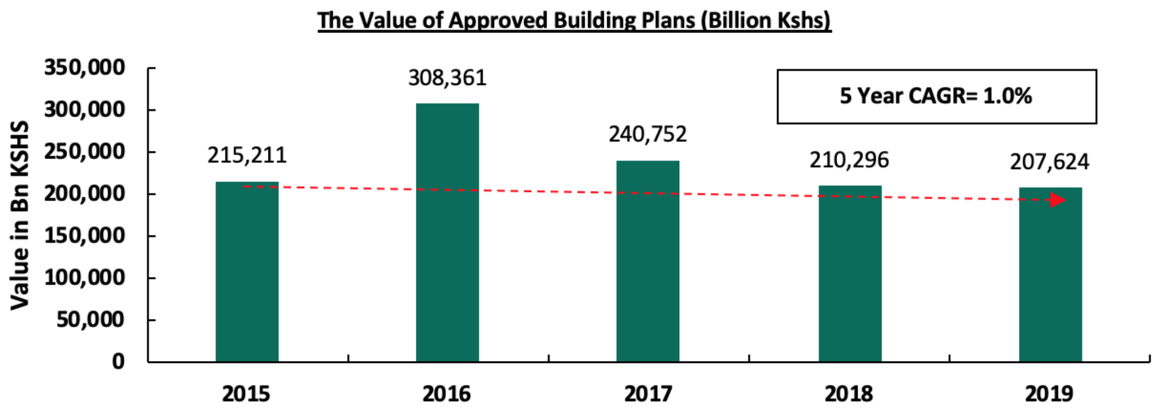


Source: Kenya National Bureau of Statistics

iii. In infrastructure, the total government expenditure on roads decreased by 2.7% to Kshs 154.5 bn in 2018/19, from Kshs 158.6 bn in 2017/18. Notable construction activities evident in 2019 were; the ongoing construction of the 19.3 km Nairobi Western Bypass that connects the Kikuyu and

Ruaka towns estimated to cost Kshs 2.7 bn, James Gichuru – Rironi Road, Mombasa - Mariakani Road and the completion of Nairobi Outer Ring Road improvement project. The reduced government spending on roads is attributed to delayed completion of ongoing projects brought about by delays in obtaining approvals, financial constraints including non-payment to contractors and suspension or termination of some of the contracts,

iv. The value of private building plans approved by Nairobi City County (NCC) decreased by 1.3% to Kshs 207.6 bn in 2019 from Kshs 210.3 bn in 2018, while the value of completed buildings issued with certificates of occupancy by the NCC increased by 4.3% to Kshs 94.0 bn in 2019 from the Kshs 90.1 bn recorded in 2018. We attribute the decrease in the value of private buildings approved to reduced activities in the real estate sector due to oversupply in select sector, evidenced by the decline in the residential sector occupancy rates and an oversupply in the commercial sector, and delayed issuance of approvals by the county government due to downtimes faced by the e-permit systems and the disbandment of the technical committee in charge of approving the permits, and,



Source: KNBS Economic Survey 2020

v. Accommodation and food services contribution to GDP declined marginally to 0.7% in 2019, a 0.1% points drop from the 0.8% recorded in 2018. International visitor arrivals increased slightly by 0.4% from 2.03 mn in 2018 to 2.04 mn in 2019 while the number of international conferences held increased by 6.9% from 204 in 2018 to 218 in 2019, and that of local conferences held increasing by 14.4% to 4,743 in 2019 from 4,147 in 2018. The growth of the sector in the period under review was supported by heightened security, recognition of Kenya as a regional hub, relaxation of travel advisories by governments of key tourism markets and political stability that prevailed in the country.

In 2020, we expect the sector to be constrained by, among others, economic slowdown in the wake of the Covid-19 pandemic, oversupply in select sectors and inaccessibility and unaffordability of off-take financing. However we expect it to be cushioned by the National Government's support for the affordable housing initiative, continued entry and expansion of local and international retailers into the country and improving infrastructure.

II. **Residential Sector**

During the month, a number of regulatory and policy reforms were undertaken through the respective Acts as follows;

i. The Tax Laws (Amendment) Bill 2020 was tabled before parliament, and later on assented by the President His Excellency, Uhuru Kenyatta. Among other amendments, most of which are set to cushion the economy in the wake of the COVID- 19 pandemic, the Act outlined 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). However, the amendment was not adopted as this would work against the government's Big Four Agenda on provision of affordable housing. An amendment to the Retirement Benefits Act was passed into law under the Act, allowing the use of pension savings towards purchasing a residential home in addition to securing a mortgage loan. Previously, the law only allowed the use of up to 60.0% of accumulated pension savings as mortgage collateral. In our view, the new law is a boost to one of the Government's Big Four Agenda, which aims to improve homeownership rates by enhancing the diversification of sources of funds to be used in the purchasing of residential homes by Kenyans. For more information, see Cytonn Weekly #15/2020 and Cytonn Weekly #17/2020, and,

ii. The Pandemic Response and Management Bill 2020, which outlines socio-economic protective measures in the wake of the COVID-19 pandemic, was tabled before the senate by Nairobi Senator Hon. Johnson Sakaja. The Bill, whose principal objective is to provide a framework for the effective response and management of a pandemic, contained various property measures such as; i) a moratorium on penalties during pandemic periods, ii) tenancy agreements between tenants and landlords on settlement of rent arrears accrued during a pandemic period, and, iii)preventing lenders from putting properties on 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 period. For more information, see Cytonn Weekly #16/2020,

We expect the government to continue adopting policy reforms geared towards cushioning the economy which continues to grapple with the impact of the COVID-19 pandemic, in addition to boosting its Big Four Agenda mainly on provision of affordable housing, which we expect to also cushion the real estate sector.

III. **Retail Sector**

During the month, the retail sector recorded various activities such as;

i. International Finance Corporation (IFC), World Bank's Private lending arm, acquired a minority stake in Naivas International Limited for Kshs 1.5 bn. 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. The retailer also opened a new branch in Kilimani. The store, which is located at Kilimani Mall along Tigoni Road, covers 10,000 SQFT (according to online sources) and marks its 64th store and also the third to be launched this year by the retailer after Kamakis along the Eastern Bypass and Mountain View along Waiyaki Way, which were opened in the months of January and March, respectively. Plans are underway, by the retailer, to open a new branch in Imara Daima in Nairobi in the coming months. For more information, see Cytonn Weekly #16/2020 and Cytonn Weekly #17/2020,

ii. Shoprite Holdings, a 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. 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, who initially had 4 outlets has begun to scale down due to financial constraints. For more information, see Cytonn Weekly #16/2020, and,

iii. Tuskys announced the temporary closure of three of its branches in Nairobi, Kitale, and Mombasa. The move is aimed at consolidating the retailer's services to other branches which are more spacious to implement social distancing and personal hygiene measures more effectively. The affected branches include Tuskys Tom Mboya branch, Tuskys Kitale Mega Branch, and Tuskys Digo Branch. For more information, see Cytonn Weekly #17/2020.

We expect occupancy rates of major retail centers to drop during this period as most retailers are shutting down their operations to cushion themselves against the impact of the Coronavirus.

However, we expect to see retailers invest in their e-commerce infrastructure and also decentralize to locations that are easily accessible from people’s homes.

IV. **Commercial Office Sector**

During the month, 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 in the wake of the Coronavirus pandemic. 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 various creative strategies with the aim of retaining and supporting their tenants. For more information, see Cytonn Weekly #15/2020.

In the short term, we expect landlords to continue to adopt various strategies aimed at attracting and retaining tenants, which will cushion the performance of the office sector in the wake of reduced demand for commercial spaces. In the long term, we expect to see a slight reduction in demand with some firms having downsized due to financial constraints resulting from the current pandemic as several others experience working from home and may make it a permanent measure.

V. **Hospitality Sector**

During the month, The Ministry of Health Cabinet Secretary, Mutahi Kagwe, announced that hotels and restaurants in major towns would be allowed to resume operations albeit under strict terms. Some of the measures to be observed by hotels will include; i) all staff will be subjected to a mandatory Covid-19 test and the hotels can only be opened once all the staff have tested negative for the virus, ii) customers are required to wash their hands and wear masks while inside the hotels, iii) a ban on buffets and self-service meals, iv) dining tables to be spaced at least 1.5 metres apart, v) customers to observe social distance, and, vi) workers to also observe social distance in the kitchens. The move is expected to revamp activities in the hospitality sector which has been the hardest hit by the COVID-19 pandemic. Despite being a move in the right direction, we anticipate that these hotels and restaurants will struggle to achieve previous daily customer targets with most sales expected to come from the online meal delivery market through third party delivery platforms such as Jumia food, Glovo and Uber Eats. Generally, the hospitality sector as a whole will continue to experience shocks as a result of the global pandemic and the emphasis by the government on restriction of movement.

In light of the same, the Kenyan Government further extended, by 21 days, the 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 Corona Virus. In line with this, local airline carriers, Jambojet and Safarilink announced temporary suspension of their local flight. For more analysis, see Cytonn Weekly #15/2020.

Despite the hospitality sector being significantly hit by the COVID-19 pandemic owing to its heavy reliance on tourism and the MICE (Meetings, Incentives, Exhibitions and Conferencing) sectors, we expect the sector to be cushioned by the Ministry of Tourism’s post-corona recovery strategy fund of Kshs 500.0 mn coupled by the government’s directive to re-open hotels and restaurants in major towns.

VI. **Infrastructure**

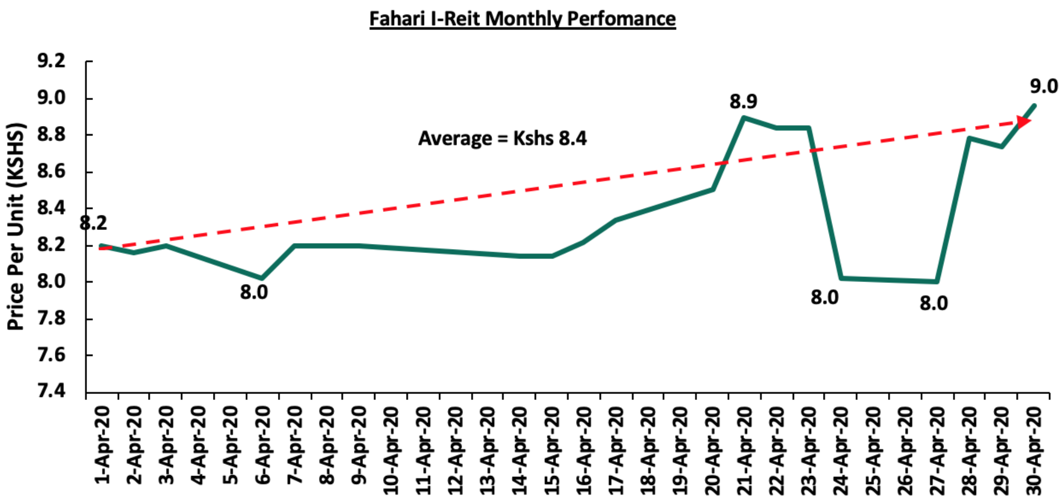
During the month, the Kenya Roads Board (KRB) disbursed Kshs 539.0 mn for maintenance of roads in the coastal region counties such as Mombasa, Kilifi, Lamu and Taita Taveta. The fund is part of the Kshs 4.4 bn conditional grant for the maintenance of roads in all the 47 counties for the 2019/2020 financial year. Conditional grants 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. For more information, see Cytonn Weekly #15/2020.

We expect a slowdown in the government's investment on infrastructure in the short term as it seeks to implement fiscal consolidation measures such as the redeployment of funds meant for the National Development Fund towards efforts to mitigate the impact of COVID-19 on the economy.

VII. **Listed Real Estate**

During the month, the Fahari I-REIT closed the month at Kshs 9.0, 11.1% higher than the previous month's closing price of Kshs 8.0. It continued to perform poorly trading at an average of Kshs 8.4, a 57.5% drop from its initial price of Kshs 20.8 as at November 2015 and 12.5% lower than Kshs 9.6 recorded at the beginning of the year.

Our outlook for listed real estate is negative constrained by the declining performance of the Stanlib Fahari I-REIT as a result of continued lack of investor interest for the instrument.



In addition, Stanlib Kenya Limited released the Fahari I-REIT- Audited Results FY'2019, according to which, the I-REIT's dividend yield came in at 8.3%, compared to the commercial real estate market average of 7.7%, with 7.5% rental yield for retail space and 7.8% yield for office space in Q1'2020. The earning per unit recorded a 9.4% decline to 0.97 from 1.07, attributed to a 9.0% decline in net profits, to Kshs 175.2 mn from Kshs 193.5 mn mainly due to the reduction in fair value gain on revaluation of investment property compared to prior year on the back of a sluggish real estate sector with continued downward pressure on rental income especially in the retail sector. Please see the Fahari I-REIT FY'2019 Earnings Note for the analysis.

We retain a neutral outlook towards the performance of the real estate sector, despite the effects of the COVID-19 pandemic on the Kenyan economy as a whole. We expect the sector to continue being supported by the continued investor confidence in sectors such as retail in addition to supportive government policies.