Using Pension for Housing Purchase, & Cytonn Weekly #19/2020

Real Estate

I. **Industrial Reports**

During the week, Hass consult released their Hass Property Index Q1'2020 report, which indicated that the Nairobi Metropolitan Area residential market recorded a slight decline in performance, recording a 0.02% drop in annual price as at Q1'2020, compared to a 3.3% increase recorded in Q1'2019; while q/q prices appreciated by 0.9%, compared to a drop of 2.6% in Q1'2019. Other key take-outs from the report were as follows:

i. Detached units and apartments recorded an average y/y price depreciation of 1.6% and 2.0%, on average, and a q/q appreciation of 1.3% for detached units and a 0.4% depreciation for apartments,
ii. Semi-detached units registered a q/q and y/y price appreciation of 0.9% and 5.8%, respectively,
iii. Ridgeways recorded the highest annual price appreciation at 9.4%, while Loresho recorded the highest quarterly growth at 3.6%. Tigoni recorded the lowest negative quarterly growth averaging 4.7% while Juja posted the lowest negative annual growth averaging 9.3%,
iv. Among Satellite Towns, Limuru and Kiambu were the best performers with annual price appreciation of 5.0% and 4.2%, respectively. Ongata Rongai and Kiserian posted the highest q/q price appreciation at 2.6% and 1.8%, respectively,
v. In terms of rental yields, the market recorded a 0.8% increase to 7.2% in Q1'2020 from 6.8% in Q1'2019, attributable to a rise in apartment rents. Apartments recorded the strongest growth over the quarter with asking rents growing at 2.1% with parklands recording the highest q/q rise at 0.7% and the highest drop recorded by Lang'ata at 3.2%. Annually, the highest rise was recorded by Lang'ata at 6.4% while the highest drop was by Lavington at 3.1%.

Hass Consult also released the Land Price Index Q1'2020 Report, which indicated that Land price indices for the first quarter of 2020 recorded a marginal decline for both suburbs and satellite towns over the period, at 0.9% and 0.2%, respectively. The report attributes the subdued sector performance to temporary closure of Land Registries as a COVID-19 preventive measure thus slowing down land transactions (they have since been partially opened by the Lands Ministry) and a general slowdown in economic activity due to the ongoing pandemic.

Other key take-outs from the report were as follows:

i. Annually, prices in Nairobi's suburbs marginally increased by 0.28% while for the satellite towns prices increased by 6.51%,
ii. Gigiri and riverside recorded the sharpest drop y/y at 7.2% each, whereas Spring Valley and Muthaiga recorded the highest rise with 8.9% and 6.3% respectively,
iii. Muthaiga posted the best q/q performance with average price appreciation of 2.4%, whereas Gigiri recorded the largest q/q decline recording a 2.8% drop in price,
iv. Among Satellite Towns, Kitengela and Ruiru recorded the highest y/y increase at 12.7% and

11.1% respectively with Thika recording the least increase at 0.7%. On quarterly performance, Kitengela also recorded the highest q/q price appreciation at 2.0% while Kiserian recorded the lowest quarterly negative growth at 2.3%.

The indices are in tandem with the Cytonn Q1'2020 Markets Review, according to which, property prices recorded an annual decline of 0.1% in Q1'2020 with returns to investors being boosted by growth in rental yields which came in at 5.2%, compared to 4.4% in Q1'2019; as land prices recorded an annual capital appreciation of 1.0%, 1.0% lower than 2.0% recorded in Q4'2019. However, the market performance is tipped to come under pressure, albeit slightly compared to other asset classes, from the Covid-19 pandemic. As disposable incomes contract due to the economic downturn, rental rates and prices are set to drop as landlords continue to offer waivers and discounts until the economic situation returns to normalcy.

II. **Hospitality Sector**

During the week, Hotel chain Sarova Hotels announced that it would stop managing Sarova Taita Hills Game Lodge and Sarova Salt Lick Game Lodge after 13 years of the management deal. In March this year, the hotel chain also suspended operations in four of its local hotels and lodges indefinitely. The four; Sarova Woodlands in Nakuru, Sarova Lion Hill at the Lake Nakuru National Park, Sarova Mara Game Camp and Sarova Taita Hills Game Lodge were closed as a result of reduced demand for hotel accommodation due to the COVID-19 pandemic. Kenya's hospitality sector is largely dependent on business and leisure tourism, both of which have been stemmed by the global lockdown. According to global hotel research firm, STR, hotel occupancy rates in the USA declined by 68.5% to 21.6% in April, a trend that is expected to continue globally until the pandemic is contained. As such, we expect to see hotel facilities reducing their operations in a bid to cut down on operating costs in the wake of strained cash flows due to the weak demand currently experienced. However, we expect the sector's recovery to commence in the near term on the back of government policies aimed at cushioning the sector such as the government's directive to re-open hotels and restaurants in major towns and the Ministry of Tourism's post-corona recovery strategy fund of Kshs 500.0 mn.

III. **Industrial Sector**

During the week, Africa Logistics Properties (ALP) announced plans to continue investing in modern grade-A warehousing across the country with the planned completion of their 50-acre warehousing complex at Tilisi Industrial Park, Limuru, by December this year. According to the firm, which also owns the 50,000-SQM ALP North warehouse, in Tatu City Industrial Park located in Ruiru, plans have been put in place to protect construction workers at its ongoing projects against Coronavirus in a bid to ensure that the construction goes on even as many construction projects cease due to various factors such as cash flow constraints, reduced labor force and supply chain constraints resulting from the COVID-19 pandemic. We expect to see an increase in demand of modern industrial park space fueled by; (i) Increased online shopping trends and the resultant growth of ecommerce businesses, (ii) government focus on the Big 4 Agenda on manufacturing which is expected to influence demand for warehouses used to manufacture products, (iii) improvement of infrastructure, for instance, the construction of SGR phase two which will increase thorough output of Special Economic Zones, and, (iv) a shift in activities from the existing Industrial Area due to challenges such as poor infrastructure and high land costs, to satellite towns such as Ruiru and Limuru supported by increased demand for centralized warehouses by retailers.

IV. **Statutory Review**

During the week, National Treasury Cabinet Secretary, Ukur Yatani published draft regulations aimed at guiding the new amendment to Section 38 of the Retirement Benefits Act which was amended in the Tax Act 2020 to allow pensioners to use a portion of their pension savings to purchase a residential home. As per the proposed regulations, pensioners will be allowed to use the lower of 40.0% of their pension savings or a maximum of Kshs 7.0 mn towards a home purchase. This is in addition to the old provision which allows members to use 60.0% of their accumulated pension savings as mortgage collateral. Other key highlights from the draft include;

i. Revision of the word "institution" to include institution or projects approved by the housing CS or licensed under the Sacco Societies Act, Insurance Act or a scheme with residential houses for sale. Previously, members could only benefit from the mortgage guarantee from a bank, mortgage or financial institution licensed under the Banking Act, a building society licensed under the Building Societies Act, a microfinance institution established under the Microfinance Act, or the National Housing Corporation,
ii. A member of a scheme shall only be allowed a one-off utilization of their benefits to purchase a residential house,
iii. A member earning a pension from the scheme and/or has attained normal retirement age shall not be eligible to apply,
iv. Trustees of the various retirement schemes will ensure the houses are priced at market value and their ownership will only be transferred under special circumstances such as retirement, death, illness or if the member is emigrating from Kenya to another country without the intention of returning to reside in Kenya, and,
v. Funds applied towards the purchase of a residential house under these Regulations shall first be deemed to have been drawn from the member’s own contributions together with earned investment income and any balance shall be applied from the employer’s contribution and the investment income.

In our view, successful implementation of the draft regulations will lead to diversification of sources of funds to be used in purchasing residential houses as Kenyans will now afford to buy homes or take mortgages for houses which will, in turn, improve homeownership in the country. However, while this is a step in the right direction towards alleviating Kenya’s housing deficit, only 1 in 10 Kenyans belongs to an individual pension scheme other than the National Social Security Fund (NSSF) which is compulsory, with NSSF members contributing Kshs 400 per month, 40.0% of this may not be enough to purchase a house especially with the current undersupply of low-middle income housing in the country. As such, we are of the view that the government should raise the proportion allowed for home purchase to either 60.0%, as is the case for mortgage collateral, or more (as seen in countries like Singapore where members can withdraw up to 120.0% of their home value). See our FOTW below for more on our view.

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 the reopening of the land registry by the Ministry of Lands which may see some activity in the land sector thus stimulating the sector.
