Currency and Interest Rates Outlook, & Cytonn Weekly #20/2020

Real Estate

I. **Residential Sector**

During the week, the Kitui County Government rolled out an affordable housing programme aimed at developing approximately 1,980 modern houses for its residents. The two housing projects situated at Kalawa Road and Manyenyoni, in Kitui County will be undertaken under a public-private partnership between the county and two private developers, namely, Tecnofin Kenya Limited and Keiwa Group, respectively. The county will provide the development land while the developers will mobilise funding for development. The county will then receive housing units equivalent to the value of the land whereas the remaining units belonging to the developers will be sold off to the public. The Kalawa Road project will consist of 680 units while the Manyenyoni project will consist of 1,300 units. The above is an indication of the government's efforts to drive the Big Four Agenda on provision of affordable housing at the county levels. This follows the signing of a memorandum of understanding, in June 2019, between the National Government and 26 counties to build affordable housing, a deal that will see each of the counties construct at least 2,000 housing units. Some of these counties include; Kiambu, Kitui and Nairobi. So far, several counties have launched their projects such as the Nairobi County's Urban Renewal Project which has 2 projects under construction: a 1,800 unit-project in Ngara to be developed by Jabavu Limited, and a 1,434 unit-project in Jevanjee Pangani being developed by Tecnofin Kenya Limited. Kenya has a relatively high population growth rate at 2.2% p.a. and an urbanization rate of 4.3% compared to the global averages of 1.2% and 2.0%, respectively and this has resulted in an overall increment in pressure on land and housing especially in urban areas. According to the National Housing Corporation, Kenya has an existing housing deficit of approximately 2.0 mn units, growing annually by 250,000 units, yet the annual supply stands at 50,000 units only. This has continued to necessitate the need for the government to partner with private developers with the aim of resolving this deficit through development of approximately 500,000 affordable housing units by 2022. However, despite the progress made towards achieving its goal, in our view, the government may not realize its target due to the current COVID-19 pandemic that has seen the National Government adapt various 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. Nevertheless, we expect to see private sector developers undertaking affordable housing projects targeting the low and middle income earners as the segment presents an investment opportunity supported by the growing demand and the tax incentives associated with the same.

II. **Retail Sector**

During the week, local retailer, Tuskys Supermarket, closed down their branch in Mtwapa, Mombasa. The closure of the branch follows the recent closure of 3 other branches: along Tom Mboya in Nairobi's CBD, the Mega Branch in Kitale, and at Digo in Mombasa with the retailer citing consolidation of its services to other branches which are more spacious so as to implement social distancing and personal hygiene measures more effectively. The closure of the Tuskys Mtwapa branch is however mainly attributed to strained revenues due to reduced demand as a result of constrained spending power among consumers due to a tough financial environment. 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 pandemic. 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.

Quickmart Supermarket, a local retailer, opened its first store in Nairobi’s Central Business District (CBD), along Tom Mboya Street. The retailer has occupied space previously occupied by Botswana-based Choppies who have since exited the Kenyan market due to financial difficulties in an increasingly competitive retail market. This marks Quickmart’s 29th store locally. The retailer seeks to venture into the city centre despite a decreasing footfall as Kenyans comply with the government’s travel restrictions and stay at home directive. In our view, the retailer will leverage from the relatively high footfall within the CBD, and we expect the government to gradually ease the restrictions of movement especially within Nairobi Metropolitan Area, resulting in a slight surge in activity in the CBD and other retail nodes thus providing valuable market for the city’s retailers.

III. **Industrial Sector**

During the week, local construction firm, Jilk Construction Company Limited set up a new plant in Tatu Industrial Park. The plant is expected to produce asphalt concrete, paving blocks and road furniture for civil works and construction projects across Kenya thus signalling the continued growth of local production of construction materials. The ongoing push for industrial expansion, as highlighted by the government’s overarching Big Four Agenda, has witnessed a number of positive developments over the past year. With manufacturing being one of the pillars of the government’s big four agenda, some of the government efforts put in place to support the same include the establishment of Special Economic Zones (SEZs) such as Tatu City, Africa Economic Zones Limited in Eldoret County, Northlands City to the north of Nairobi, Dongo Kundu in Mombasa, Naivasha Industrial Park, Konza City and Lamu Port-South Sudan-Ethiopia Transport (LAPPSET). We expect this to support local production of construction materials which will lead to availability of relatively cheaper construction inputs for use by local developers. In addition, the current disruption of global supply chains due to the ongoing COVID-19 pandemic might act as an incentive for increased local production of construction inputs. This will boost local supply chains, which will ultimately help reduce construction costs which accounts for approximately 60%-70% of development costs in Kenya. This would relieve the financial burden on developers and thus boost the government’s goal of providing affordable housing.

Sameer Africa, a local company whose principal business is the importation and sale of tyres, announced that it would be turning its focus to its real estate business after closing its tyre distribution business citing losses as a result of stiff competition from cheap imports. The company’s current property investments include; (i) a 25% stake in the 500,000 SQFT Sameer Business Park, located along Mombasa Road, (ii) Muthaiga Heights, a residential development along Thika Road, (iii) Rivaan Center, a 58,000 SQFT office complex off Waiyaki Way in Brookside, along Muguga Green,(iv) various land holdings, and, (v) The Sameer Industrial Park situated on the main Nairobi-Mombasa highway. The company expects to return to profitability with returns gained from renting and leasing the various properties, which are spread between various real estate themes thus diversifying their returns. The move is an indication of investor confidence in the real estate sector which has continued to record growth despite a tough economic environment. According to Kenya National Bureau of Statistics (KNBS) Economic Survey 2020 Report the sector recorded improved growth of 5.3% in 2019 compared to 4.1% in 2018, and accounted for 6.9% contribution to GDP.

IV. **Statutory Review**

During the week, Ministry Of Lands and Physical Planning invited the public for participation on the regulatory impact statement for the proposed Land Transactions (Electronic) Regulations 2020. The proposed regulations seek to effect the development and implementation of a National Land Information System and the maintenance of a land register and land documents in a secure, accessible and reliable format. As per the proposed regulations;

i. The National Land Commission (NLC) shall keep and maintain a data base of all public land in electronic form,
ii. The National Land Commission (NLC) shall require public institutions vested with the control, care and management of public land to submit an inventory in electronic form of all land under their control and actual occupation,
iii. Land rent shall be payable to the Cabinet Secretary of the Ministry of Lands and Physical Planning where the head lessor will be the national government and into the County Revenue Fund account where the county will be the head lessor,
iv. Various fees prescribed under the regulations may be paid through authorized electronic means as may be advised by the Cabinet Secretary from time to time, and,
v. The decision to grant or not grant an extension of lease by the County Government shall be communicated to the Cabinet Secretary of the Ministry of Lands for implementation and not the NLC as it was earlier.

In our view, if approved, the regulations will enable Kenyans access information electronically through the use of online portals and carry out all registry transactions under the Act through the electronic registry system. The regulations will speed up land processes in the country, by reducing delays experienced by developers during the pre-construction period thus boosting the real estate sector. Overall, we expect the move to enhance the ease of doing business in Kenya as registration of property is one of the 11 life cycle stages of a business considered by the World Bank when ranking countries, thus attracting foreign investors. Other benefits to be realized upon approval of the regulations include; (i) an efficient and effective land administration system through the establishment of a digital National Land Information System (NLIS), (ii) improved revenue collection by eliminating revenue leakages through the establishment of an electronic payment system, (iii) expediting the process of property registration thus improving the ease of doing business, (iv) cost-effective and reliable paperless transactions in land processes, (v) reduction of paper work and records thus saving space and reduced loss of records, and, (vi) promoting public confidence in the integrity and reliability of electronic records and electronic transactions.

During the week, the Nairobi City County Government announced the disbandment of current Nairobi City County Pre-Technical Committee and the Nairobi City County Urban Planning Technical Committee, where new ones to be constituted within 7 days (from 13th May 2020). Other changes include:

i. The suspension of the existing e-construction development application pending development of a new system, and,
ii. Annulment all applications processed through the e-construction development management system from 18th March 2020 going forward. This includes change of user, extension of user, subdivision and amalgamation, advertisements and renewal of leases.

The new changes come after functions of the Nairobi County Government were handed over to the National Government in February this year. The formation of a new committee will likely speed up approval processes by the county. In our view, the continued delay in the processing of construction permits by the Nairobi County Government continues to affect developers by prolonging project implementation timelines. Currently, construction permits in Kenya can take as long as two years, and the lack of improvements of the administration system has continued to cripple the ease of doing business in the construction industry. Delays in the approval system ultimately lead to unnecessarily high development costs for private developers and loss of revenue for the county. The value of building plans approved in the Nairobi County Government decreased by 1.3% from Kshs 210.3 bn in 2018 to Kshs 207.6 bn in 2019 according to the KNBS Economic Survey 2020. We thus expect the development of the e-system to resolve delays, reduce human interference and thus enhance easy and timely approval.

Other highlights during the week;

i. During the week, pension administrators’ body, Association of Retirement Bodies Authority (ARBS), through a letter to the Retirement Benefits Authority (RBA), announced that it would be seeking an extension of the public participation time to discuss the published draft regulations by the National Treasury Cabinet Secretary, Ukur Yatani, aimed at guiding the new amendment to Section 38 of the Retirement Benefits Act which was amended in the Tax Act 2020. If approved, the amendment will allow pensioners to access up to 40% of their savings to purchase houses, in a bid to improve home ownership in Kenya. This is in addition to the existing law that allows retirement schemes’ members to allocate up to 60% of their benefits towards securing a mortgage loan. Please see our note on Using Pension for Housing Purchase for more details.

We expect the real estate sector’s growth to continue being supported by continued public-private partnerships between County governments and private developers with the aim of driving the affordable housing initiative, continued expansion of retailers, investor confidence and advancement in technological infrastructure aimed at boosting productivity and maximizing revenue collection.
