Accelerating Funding to Affordable Housing, & Cytonn Weekly #21/2020

Real Estate

I. **Residential Sector**

During the week, the Ministry of Transport, Infrastructure, Housing and Urban Development published the National Housing Development Fund Regulations 2020, for stakeholder input. The regulations are aimed at guiding the operationalization of the National Housing Development Fund (NHDF), which was established in 2018 in line with the government's affordable housing initiative and under the mandate of the National Housing Corporation (NHC), to help bridge the affordable housing gap in Kenya by:

i. Guaranteeing offtake to affordable housing by private developers, thus giving them the necessary liquidity to construct more units,
ii. Enabling end-buyer uptake by providing affordable housing finance solutions such as Tenant Purchase Schemes (TPS), and,
iii. It will also allow mortgage and cash buyers to save towards the purchase of an affordable home, in addition to issuing them with loans at an interest rate of up to 7.0% p.a. on a reducing balance basis,

In 2018, the government introduced the mandatory housing fund levy through the Finance Act 2018 but was faced with a lot of legal hurdles leading to the president's directive in December 2019 to the National Treasury and Housing Ministry to make the contribution voluntary with immediate effect. The proposed regulations are, therefore, an alteration to the 2018 regulations, which have been revoked. The main differences are as below:

Housing Fund Regulations Alterations

Factor	2018 NHDF Regulations	2020 NHDF Regulations
Contributions	• The government had proposed a 1.5% levy on employee's monthly basic salaries up to Kshs 5,000 p.m. and the employer expected to match the same amount • Informal and self-employed citizens wishing to take part in the fund would be required to contribute Kshs 100 towards the fund	• Self-employed citizens, formal and informal employees are expected to voluntarily contribute a minimum of Kshs 200 per month
Registration	• All employers and employees were required to register with the Fund, failure to which would attract imprisonment for two years or a fine of Kshs 10,000 or both	• Each Kenyan that fits the criteria set by the regulations is expected to register with the Housing Fund. However, the registration is not mandatory and no penalty has been spelt out for failure to do this
Loan Eligibility	• No borrower was eligible for more than one loan within five years	• No borrower is eligible for more than one loan entirely from the NHDF

Housing Fund Regulations Alterations

Factor	2018 NHDF Regulations	2020 NHDF Regulations
Access to Contributions	• Contributions by individuals could only be accessed for: - Purposes of offsetting housing loans, - Mortgage security, or - Housing development after five years of uninterrupted contribution and would attract such an annual return as determined by the Corporation.	• The Regulations allow members to, at any time, transfer their contributions to: - A pension scheme registered with the Retirement Benefits Authority, - A registered home ownership savings plan, - Any member Registered under the National Housing Development Fund, - Their dependents. - Members may also receive their contributions in cash. However, this will be included in the member's taxable income for the year and be subjected to tax at the prevailing rates
Qualifications for a Home Under the Affordable Housing Scheme	• To qualify for a home, members were required to: - Be at least 18 years of age, - Have proof of registration with an affordable housing scheme, - Have proof of remittance of the contribution - be first-time homeowners under the affordable housing scheme	• In addition to being 18 years of age and having proof of registration with an affordable housing scheme, members will only be required to: - Have contributed for at least 6 months, and - Have contributed 10% of the price of the house
Offences and Penalties	• A person convicted of an offence for misappropriating funds was liable to imprisonment for a term not exceeding two years or a penalty not exceeding Kshs 10,000	• A person convicted of an offence will be liable to imprisonment for a term not exceeding three years or a fine not exceeding Kshs 1.0 mn (however, the new regulations are not clear on what constitutes an offence) • For misappropriating the NHDF's funds, a person will be liable to a penalty equivalent to twice the amount lost

In our view, the Kenya National Housing and Development Fund is a great move by the government towards the actualization of affordable housing provision in Kenya, especially when the initiative is far behind its target timelines head of 2022. If well governed and implemented, we expect the fund to be successful in raising the targeted funds and the same channeled to facilitating housing in the country. However, for the government to realize its goal of delivering 500,000 affordable housing units, there is still a need to provide the right environment for private sector investment to supplement government initiatives.

II. Retail Sector

During the week, Car and General Kenya, a local supplier of power generation, automotive and engineering products, announced that it had secured Carrefour supermarket as the anchor tenants for its refurbished Nairobi Mega property on Uhuru Highway. The 170,000 SQFT property was previously anchored by Nakumatt, which had occupied 40,000 SQFT. Carrefour is expected to set up by June this year, marking its 8th store in the country. The multinational retailer has continued to record massive growth in Kenya since its first store in 2016 and this has been due to; (i) ability to leverage its scale and operation know-how to become one of the leading retailers locally, which saw it record Kshs 18.7 bn in revenues as of 2019, 28.0% increase from 2018, (ii) adequate funding such as the Kshs 3.0 bn loan from Standard Bank Group earlier this month, and, (iii) availability of prime locations vacated by struggling supermarket chains such as Nakumatt and Uchumi. For retail sector investors, the continued expansion of stable local and international retailers such as Carrefour and Quickmart is a welcome move, especially following the increased vacancy rates in the sector driven by the fall of struggling retailers namely, Nakumatt, Uchumi and Choppies. We expect global retailers to continue showing interest in the Kenyan retail sector, mainly attracted by the increasing change in consumer tastes & preferences, relatively low formal penetration rates at 35.0%, and fast economic growth enabled by infrastructural developments.

Car and General also commenced the planning of the second development in Shanzu, Mombasa (details undisclosed) alongside other plans to divest non-core businesses as it seeks to expand its property portfolio. Local firms are increasingly diversifying their portfolios by venturing into real estate. Last week, 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 down its loss-making tyre distribution business. This 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.

III. **Infrastructure**

During the week, Water and sanitation Cabinet Secretary, Sicily Kariuki unveiled a Kshs 1.3 bn Kiambu-Ruaka water supply and sewerage project. The project will be implemented by the Athi Water Works Development Agency through funding by the African Development Bank (AfDB), under the Kenya Towns Sustainable Water Supply and Sanitation Programme and will involve the rehabilitation of Kiambu's water treatment plant and the construction of 108 km of trunk and reticulation sewers in Kiambu and Ruaka. In our view, the provision of reliable water supply and sanitation will enhance the appeal of Ruaka and Kiambu supporting the continued real estate growth and performance in both areas. The newly unveiled project is expected to benefit more than 100,000 residents of Kiambu and Ruaka with the expansion of the sewerage infrastructure expected to increase the county's wastewater management capacity while reducing pressure on the current systems, thus supporting the areas' rapid population growth that is largely driven by Kenya's workforce stationed in Nairobi.

Nairobi Metropolitan water and sewerage coverage in 2018

County	Water coverage	Sewerage coverage
Nairobi	78%	50%
Kiambu	77%	16%
Machakos	54%	19%
Murang'a	52%	5%
Kajiado	43%	0%
Average	61%	18%

Source: Water Services Regulatory Board

The improvement of infrastructure is expected to spur the growth of real estate in the Kiambu County through;

- **Opening up the County for Development** – Prospective developers are likely to buy or rent properties in well-developed areas. A developed neighbourhood assures the buyer of property appreciation at a rate higher than the prevailing market rates, thus better returns in the case of an investor. Consequently, it opens up areas which were otherwise unattractive not only for settlement but also trade and commerce thus uplifting economic prospects,
- **Reduced Development Costs** - Infrastructural costs in Kenya account for approximately 25.6% of construction costs, according to a report by the Centre for Affordable Housing Finance in Africa. Therefore the provision of the same relieves the cost burden that would have otherwise been incurred by the developer, and this has been noted to significantly facilitate the development of affordable housing units, and
- **Higher Property Values -** availability of services and utilities in the county will enhance demand for property in the county thus resulting in increased property values.

IV. **Statutory Review**

During the week, the Ministry of Transport, Infrastructure, Housing, Urban Development and Public Works gazetted the National Construction Authority (Defects Liability) Regulations 2020, which introduced various changes to the defects liability period with regards to commercial buildings. Amongst the changes introduced, was a latent defects liability period for commercial buildings which shall be a minimum period of six years from completion of the regular defects liability period (which will now be referred to as the patent defects liability period). If approved, the regulations will give commercial buildings owners up to seven years to recall contractors back to the site to rectify flaws in projects. Key highlights from the regulations include:

i. Every contract for the construction of a commercial building shall prescribe a patent defects liability period which shall be a minimum period of twelve months after practical completion (this is seen as an extension of the traditional defects liability period which usually lasts 6 months in Kenya),
ii. Every contract for the construction of a commercial building shall prescribe a latent defects liability period which shall be a minimum period of six years after the completion of the patent defects liability period,
iii. The contractor, sub-contractor and other relevant professionals shall be liable for the rectification of defects that become apparent during the latent defects liability period, and,
iv. The contractor and sub-contractor will obtain insurance cover for defects that may become apparent during the latent defects liability period while other relevant professionals shall obtain a professional indemnity cover for the same.

The regulations have been proposed to safeguard commercial property developers' interests against sub-par construction work by negligent contractors, sub-contractors and project consultants. However, lack of adequate public participation before the drafting of the regulations is apparent as they contain a lot of grey areas which, if not addressed, may become the source of future site conflicts due to misinterpretation of the regulations. Consequently, during the week, the Institution of Construction Project Managers of Kenya (ICPMK), through a letter to Transport, Infrastructure, Housing, Urban Development and Public Works Cabinet Secretary James Macharia, raised concerns on the gazetting of the Regulations by the cabinet secretary, citing lack of public participation prior to the publication of the gazette notice. Below are areas that may need further clarification:

i. The regulations only apply to commercial buildings. As per the regulations, a commercial building means "premises occupied wholly or partially for trade or business or rendering services for money or money's worth". This omits buildings such as residential buildings, buildings by non-profit organizations, government buildings etc. It is not clear why the limitations of the defects liability period either patent or latent are restricted to commercial buildings only,
ii. The regulations define an owner as, "a person who enters into a contract with a contractor for the construction of a commercial building." This does not address a situation where an agent enters into a contract on behalf of the owner or an occasion where the owner sells the commercial building before the latent defects liability period is over (6 years),
iii. The regulations state that the contractor, sub-contractor and other relevant professionals shall be liable for the rectification of patent defects that become apparent during the latent defects liability period. It, however, doesn't specify the extent to which either of the stakeholders will be liable. It is not clear whether they will all be liable or whether a party is only liable where the defects cover their area of expertise,
iv. The regulations state that upon correction of defects by the relevant professionals, the owner shall certify that the relevant professional or sub-contractor has made good the defects identified. An assumption seems to have been made that all owners are construction savvy which then undermines the role of the architect who is considered to be the 'supervisor' in a construction project,
v. The extension of the patent defects liability period from the previous 6 months to 12 months appears to be an unnecessarily long time which will make contractors wait longer for their last

moiety of retention and certificate of completion, and,

vi. The contractor and sub-contractor will be required to obtain insurance cover for defects that may become apparent during the latent defects liability period whereas other relevant professionals shall obtain a professional indemnity cover for the same. It is not clear whose expense this will be.

In our view, there is need for extensive negotiations and all-inclusive participation by stakeholders in the construction sector to ensure proper integration of any new regulations with the existing construction laws thus limiting any grey areas.

V. **Listed Real Estate**

During the week, Fund manager, ICEA Lion Asset Management (ILAM) announced that it had completed a transaction with Stanlib Kenya Limited (SKL) that will see it acquire the latter's role of managing property fund Stanlib Fahari I-REIT, from South Africa based Liberty Holdings Ltd. ILAM will now acquire all rights, obligations and benefits of SKL in connection with SKL's role as promoter and REIT manager. The Stanlib Fahari I-REIT, which is the only publicly traded REIT in Kenya, was launched in November 2015, at a share price of Kshs 20.75 and currently owns and manages four properties, namely: Greenspan Mall in Donholm, 67 Gitanga Place in Lavington, Bay Holdings, along Enterprise Road, Industrial Area, and Signature International, along Pokomo Road, Industrial Area. The instrument has, however, continued to record a decline in performance since its listing in November 2015, trading at an average of Kshs 8.4 per unit as at April 2020, and 59.5% lower than its initial value of Kshs 20.75 per unit. As per Stanlib Fahari I-REIT- Audited Results FY'2019, the I–REIT's performance in terms of dividend yield was 8.3% in 2019 compared to the commercial real estate market average of 7.8%, with 7.8% rental yield for retail space and 7.7% yield for office space in Q1'2020. However, the earning per unit recorded a 9.4% decline to Kshs 0.97 from Kshs 1.07, attributed to a 9.0% decline in net profits to Kshs 175.2 mn in 2019 from Kshs 193.5 mn in 2018 mainly due to the reduction in fair value gain on revaluation of investment property compared to the prior year, on the back of a sluggish performance in the real estate sector and continued downward pressure on rental income, especially in the retail sector.

Source: Cytonn research

REITs in the Kenyan market, most notably the Stanlib Fahari I-REIT have continued to record poor performance, with key challenges being: (i) opacity of the exact returns from the underlying assets, (ii) inadequate investor knowledge, and, (iii) lack of institutional support for REITs. The REIT market in Kenya has the potential for growth if a supportive framework is provided. Some of the measures that may boost the REIT market include; (i) teaming up with market players and regulators to offer constant training to the investing public, (ii) Continuous improvement on the regulation, and, (iii) government support for REITs. Currently, the average Kenyan investor is left to invest in informal, unregulated real estate schemes that have exposed them to risks. For more, see our REITs topical.

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 expansion of local retailers in addition to supportive government policies geared towards enhancing homeownership as well as the continued investment towards infrastructure.