Cytonn Monthly - May 2020

Real Estate

I. **Industry Reports**

During the month, the Kenyan Bankers Association (KBA) released their Housing Price Index Q1’2020 report, and the key take-outs from the report were as follows:

i. House prices contracted by 0.5% in Q1’2020, 0.1% points lower than the 0.6% recorded in Q4’2019. The sluggish growth is attributed to the normalization of house prices as the market comes into balance after a prolonged period of sustained price growth, and,
ii. Townhouses accounted for 45.0% of the units sold during the quarter while apartments, bungalows and maisonettes accounted for 33.0%, 12.0% and 10.0%, respectively, with 78.0% of market activity occurring in cluster 2 which included areas such as: Thindigua (Kiambu Road), Kiambu, South B, South C, Kabete, Komarock, Ngong Road, Lang’ata and Waiyaki Way, fuelled by the affordability of the units mainly to the middle class population.

This is in line with our Cytonn Q1'2020 Markets Review report, which showed, returns to investors in Q1’2020 recorded a 1.0% points decline coming in at 5.1%, compared to 6.1% recorded in Q4’2019, attributable to a 0.1% correction in prices owing to a decline in demand in the face of a challenging economic environment. Moreover, the upper mid-end market of the detached housing segment recorded the highest returns coming in at 5.1%, 0.9% points and 0.4% points higher than 4.2% and 4.7% recorded by the high-end and lower mid-end segments, respectively. We expect a decline in transaction volumes and an overall dampening of the sector’s performance going forward owing to the COVID-19 global pandemic. However, we expect the high demand for affordable housing and positive demographics to cushion the sector.

Other real estate related reports released during the month include:

	Theme	Report	Take-outs
1.	Residential	Hass Property Index Q1’2020 report, by Hass Consult	· Detached units and apartments recorded an average y/y price correction of 1.6% and 2.0%, respectively, and a 1.3% q/q appreciation for detached units and a 0.4% correction for apartments, · Semi-detached units registered a q/q and y/y price appreciation of 0.9% and 5.8%, respectively. For more analysis see, Cytonn Weekly #19/2020.
2.	Land	Land Price Index Q1’2020 Report, by Hass Consult	· Land prices recorded a marginal decline for both suburbs and satellite towns in Q1’2020, at 0.9% and 0.2%, respectively, · Annually, land prices in Nairobi's suburbs marginally increased by 0.3% while for the satellite towns prices increased by 6.5%. For more analysis see, Cytonn Weekly #19/2020.

II. **Residential sector**

During the month, the National Government, through the Treasury, failed to allocate funds to the

State Department for Housing for disbursement of loans to Civil servants under the Civil Servants Housing Scheme (CSHS), marking the second consecutive year that the government has failed to do so. The Civil Servants Housing Scheme fund, a tenant purchase scheme, was established by the government in 2004 to provide housing loan facilities to civil servants for the purpose of either; (i) purchase, improvement or development of a residential house for the occupation of the applicant, (ii) purchase of land for development, and, (iii) equity release for the improvement or development of a residential property. Since its inception, CSHS has facilitated more than 3,000 civil servants' access to housing through housing finance loans or sale of houses constructed through the Scheme. The Scheme has also partnered with two mortgage finance institutions, Home and Loan of KCB and Housing Finance, who have advanced loans worth Kshs 2.95 bn and Kshs 1.52 bn, respectively, as at June 2018. Housing loans provided under the scheme have the following features;

i. The maximum amount of loan that can be granted to a civil servant ranges between Kshs 4 mn to Kshs 20 mn depending on seniority and affordability,
ii. The loan is repayable within a period of twenty (20) years or before the loanee attains the age of 60 years whichever is earlier,
iii. The interest payable on the loan is at the rate of 5.0% per annum on a monthly reducing balance,
iv. The applicant is facilitated up to 90.0% of the property value but is expected to pay a down payment of 10.0%, and,
v. The loan repayment is through a check-off system which reduces lending risk and administrative cost.

In our view, the delay of government funding to the Civil Servants Housing Scheme is part of its austerity measures geared towards plugging fiscal gaps brought about by reduced revenue collection, high debt payments and redeployment of funds towards efforts to mitigate the impact of COVID-19 on the economy. This, in addition to a slash on development expenditure for the current fiscal year, will further retard the progress of the National Government's development of affordable housing as one of its pillars under the big four agenda, dealing a blow to its earlier intention of offering civil servants subsidized housing which was intended to divest the government of the responsibility of direct housing to employees except those involved in essential services,

Shelter Afrique, a Pan-African housing development financier, announced that it had restructured loans worth Kshs 3.1 bn granted to seven Kenyan home developers after the latter requested for a deferral, citing construction delays, stoppages and shrinking returns in the wake of the COVID-19 pandemic. The adverse effects of the pandemic continue to be witnessed across all sectors in real estate as demand for commercial retail space, offices and residential units remains low due to a slowdown in economic activities, declining disposable incomes and changing consumer behaviour through measures such as working from home and e-commerce. Some of the challenges experienced by the real estate and construction sector include;

i. Constrained financing for developers as financiers such as banks aim to limit exposure amidst increasing loan deferrals and defaults,
ii. Slow uptake of housing units and probable low returns from available occupied units either from tenant turnover or downward pressure on effective rents from the existing tenants through delayed payment,
iii. Creation of pending bills as a result of contracts running through the COVID-19 period,
iv. Shortage of labour as employees avoid work to avert contracting the virus in addition to adhering to government directives on social distancing, and,
v. Supply chain constraints as the import of supplies required by builders and developers are interrupted.

The real estate and construction sectors continue to experience the adverse effects of the ongoing pandemic evidenced by reduced borrowers' inability to service their loans on time. In April this year, Kenya's seven largest banks restructured loans worth Kshs 176 bn, with real estate and construction sectors accounting for 34.2% of the total loans restructured which will give borrowers tailored terms such as suspension of interests and/or principal, change of collateral or extension of the tenor. The pandemic has continued to impact on the real estate sector, resulting in reduced development activities and uptake. However, we expect liquidity in the sector to be cushioned by, among others, the National Government's economic stimulus programme intended to enhance economic activity and the decision by the Monetary Policy Committee (MPC) to retain the Central Bank Rate (CBR) at 7.0% a step that has seen the private sector credit grew by 9.0% in the 12 months leading to April 2020 with building and construction accounting for 7.7% of the same.

The Kitui County Government rolled out an affordable housing program 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. For more information, see Cytonn Weekly #20/2020, and,

The Ministry of Transport, Infrastructure, Housing and Urban Development published the National Housing Development Fund Regulations 2020. 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. For more information, see Cytonn Weekly #21/2020.

We expect the residential sector to record increased public-private partnerships between the national government, county governments, and private developers geared towards developing more affordable housing units. However, on overall, we expect a decline in transaction volumes and a sluggish growth of returns owing to the COVID-19 global pandemic.

III. **Retail Sector**

During the month, the retail sector recorded several activities;

i. Local retailer, Tuskys Supermarket, closed down their branch in Mtwapa, Mombasa, 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. For more information, see Cytonn Weekly #20/2020,
ii. Quickmart Supermarket, a local retailer, opened its first store in Nairobi's Central Business District (CBD), along Tom Mboya Street, taking up space previously occupied by Botswana-based Choppies, who has since exited the Kenyan market due to financial difficulties in an increasingly competitive retail market. In our view, the retailer will leverage on the relatively high footfall within the CBD. For more information, see Cytonn Weekly #20/2020, and,
iii. 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 off Uhuru Highway. The 170,000 SQFT property was previously anchored by Nakumatt, which had occupied 40,000 SQFT. For more information, see Cytonn Weekly #21/2020.

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IV. **Hospitality Sector**

During the month, Fairmont Hotels and Resorts, which owns the iconic Norfolk Hotel in Nairobi, announced plans to close its local hotels indefinitely and fire its staff due to uncertainties and financial constraints in the wake of the coronavirus pandemic. Hotels expected to be closed include; Fairmont Mount Kenya Safari Club, Fairmont the Norfolk, and, Fairmont Mara Safari Club. This follows the suspension of operations in other major hotels such as The Tribe and Ole Sereni, as the hospitality sector continues to grapple with the effects of the Coronavirus pandemic, mainly due to its reliance on tourism, as travel restrictions and social distancing rules continue to result in reduced demand for hospitality services, coupled by the current ban on international flights, reduced local direct flights, and, cancellation of meetings, conferences, and events.

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 as a result of reduced demand for hotel accommodation due to the COVID-19 pandemic. For more information, see Cytonn Weekly #19/2020.

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, the Ministry of Tourism's post-corona recovery strategy fund of Kshs 500.0 mn, the government's 8-point stimulus programme which, among others, seeks to offer soft loans to hotels and related establishments through the Tourism Finance Corporation (TFC) thus stimulating the hospitality sector, and, the tourism sector's plan to repackage their products in order to appeal to a wider scope of domestic tourists.

V. **Industrial Sector**

During the month, 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. The move indicates the continued demand for modern industrial space fuelled by, among other factors, the government focus on boosting the manufacturing sector under the Big Four Agenda. For more information, see Cytonn Weekly #19/2020,

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 signaling the continued growth of local production of construction materials. We expect this to help reduce construction costs thus relieve the financial burden on developers and boost the government's goal of providing affordable housing. For more information, see Cytonn Weekly #20/2020, and,

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 move is an indication of investor confidence in the real estate sector which has continued to record growth despite a tough economic environment. For more information, see Cytonn Weekly #20/2020.

We expect to see an increase in demand for modern industrial space fuelled by; (i) Increased online shopping trends and the resultant growth of e-commerce businesses, (ii) government focus on manufacturing as part of its Big 4 Agenda, (iii) improving infrastructure, 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.

VI. **Infrastructure**

During the month, 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). We expect this to enhance the appeal of areas such as Ruaka and Kiambu, subsequently supporting the areas' continued real estate growth and performance. For more information, see Cytonn Weekly #21/2020.

We expect the continued improvement of infrastructure to boost the real estate sector as the availability of facilities such as sewerage systems remains a key factor of consideration by both investors and homebuyers.

VII. **Statutory Review**

During the month, National Treasury Cabinet Secretary, Ukur Yatani published regulations aimed at guiding the new amendment to Section 38 of the Retirement Benefits Act which was amended through the Tax Act 2020, allowing pensioners to use a portion of their pension savings to purchase a residential home. As per the 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 purchasing a home, in addition to the using 60.0% of their accumulated pension savings as mortgage collateral. For more information, see Cytonn Weekly #19/2020,

The Ministry Of Lands and Physical Planning invited the public for participation in the regulatory impact statement for the proposed Land Transactions (Electronic) Regulations 2020. The proposed regulations seek to affect the development and implementation of a National Land Information System and the maintenance of a land register, with the aim of enabling Kenyans to access land-related information electronically through the use of online portals and carry out all registry transactions under the Act through the electronic registry system. For more information, see Cytonn Weekly #20/2020,

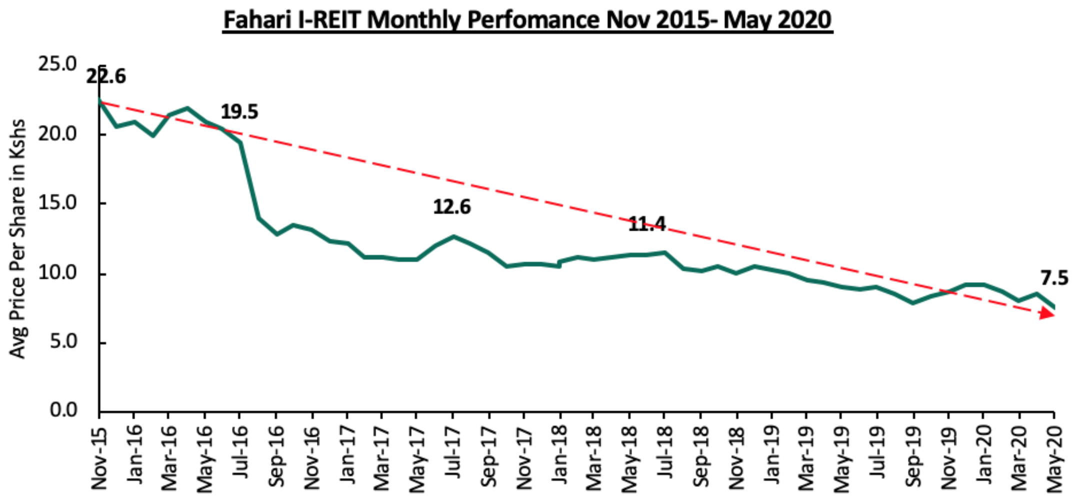
The Nairobi City County Government announced the suspension of the existing e-construction development application pending development of a new system, and, annulment of all applications processed through the e-construction development management system from 18th March 2020 going forward (The County Government later announced that all applications processed between 18th March and 14th May would be valid but would be subjected to verification). This followed the handing over of the functions of the Nairobi County Government to the National Government in February this year, with the changes aimed at enhancing the efficiency of operations especially with the current delays in the issuance of construction permits. For more information, see Cytonn Weekly #20/2020, and,

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). For more information, see Cytonn Weekly #21/2020.

We expect the government to continue formulating policies geared towards enhancing the ease of doing business in addition to enhancing homeownership, thus a resultant boost to the real estate sector.

VIII. **Listed Real Estate**

On the bourse, Stanlib Fahari I-REIT's price per share declined by 30.0% to close at Kshs 6.3 at the end of May, from Kshs 9.0 at the end of April 2020. On average, the REIT traded at Kshs 7.5 per share, a 10.7% decline from an average of Kshs 8.4 per share in April 2020. We expect the performance of listed real estate to be in line with the general performance of the markets due to the ongoing COVID-19 pandemic.



During the month, 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. For more information, see Cytonn Weekly #21/2020.

Despite the continued negative impact of the COVID-19 pandemic on the real estate sector and the economy as a whole, we expect the sector to be cushioned by; (i) the expansion of local retailers, (ii) continued public-private partnerships between County governments and private developers with the aim of driving the affordable housing initiative, (iii) supportive government policies geared towards enhancing homeownership, (iv) continued investment towards infrastructure, and, (v) the National Government's use of monetary and fiscal policies to sustain liquidity in the economy.