Kenya Public Debt 2020 & Cytonn Weekly #29/2020

Real Estate

I. **Residential Sector**

During the week, Shelter Afrique, a Pan-African housing development financier, announced plans to issue a bond in the Nairobi Stock Exchange (NSE) aimed at raising funds to develop new real estate projects. The company's plans to return to the bond market as it turns profitable. The firm reduced its full-year loss by 93.7% for the year ended December 2019 to Kshs 59.0 mn loss, down from the Kshs 940.8 mn reported in 2018, attributed to significant cost reductions. With private sector credit remaining relatively low coupled with the high cost of borrowing, local development firms are bound to continue looking to the capital markets as an alternative way to fund projects such as capital market instruments.

Some of the Locally Issued Bonds Aimed Towards Real Estate

Issuer	Amount	Issue Tenor (Years)	Subscription Rate	Year Issued	Aim
Acorn Holdings	5.0 bn	5	85%	2020	Financing sustainable and climate-resilient student accommodation in Kenya
Shelter Afrique	3.5 bn	5	143%	2013	Funding low-cost urban housing projects across Kenya
Shelter Afrique	2.5 bn	3	100%	2011	Funding low-cost urban housing projects across Kenya

In our view, alternative sources of funding will facilitate the supply of additional housing units through long term funds raised from the bond market in Kenya and are critical to help meet the housing demand and real estate needs for the country. However, Kenya's capital market faces various challenges such as;

?. There is a limited number of companies listed in the Nairobi Stock Exchange (NSE) compared to well-established stock markets in developed countries, presenting an investor with limited options,

i. Investors have little confidence in the Kenyan capital markets due to losses that have been experienced in the past, and,

ii. The lack of investor education for retail investors as some SMEs have a poor understanding of the capital markets and are unaware of ways in which they can use them to raise funds thus investor education/ awareness campaigns are important to educate SMEs on how they can use the stock exchange better and build their confidence in the financial system of the capital markets.

Also during the week, Stima Sacco, a local deposit-taking SACCO, announced that it had retracted its plans to raise Kshs 5 bn through a corporate bond to finance its mortgage business. Instead, the SACCO will partner with Kenya Mortgage Refinancing Company (KMRC), a State-backed home loans financier, in its goal of acquiring long term financing for onward lending. The SACCO has been developing residential properties for its members with the new plan meant to finance buyers by issuing long term mortgages of between 20-25 years. KMRC is expected to advance cash to financial institutions at an annual interest of 5% for onward lending to homebuyers at 7%, nearly half the current market rates. Once operational, we expect KMRC to partner with local primary lenders to create liquidity making it possible for mortgage originators to offer long-term mortgages, at relatively low-interest rates and better terms and conditions.

II. **Retail sector**

During the week, Artcaffe restaurant opened its third store in Nairobi's Central Business District (CBD), located in Chester House, along Kimathi Street. This is the restaurant's 30th branch in Kenya (*according to online sources*) and is part of its expansion plan to further strengthen their share in Kenya's rapidly growing fast-food sector. Artcaffe first opened shop in Kenya in 2009 and has expanded rapidly with new openings in Nairobi's high-end shopping malls. The Artcaffe Group is owned by US private equity firm Emerging Capital Partners (ECP) who acquired a majority stake in the group in 2018 for Kshs 3.5 bn, an acquisition which also gave it control over Artcaffe's business that consists of bakeries, coffee houses, and, eatery brands such as Dormans, Tapas Ceviche Bar, Urban Gourmet, and, Oh Cha Noodle Bar. The continued expansion by the retailer in Nairobi despite the COVID-19 pandemic which has especially slowed down operations in the foodservice sector signals investor confidence in Kenya's fast food retail sector which is among the fastest-growing industries in the country driven by the growth of Kenya's middle class and changes in household consumer behaviours. This has seen recent investments worth millions of dollars by global and local restaurant chains such as Java House, Café Espresso, Café Arabika, Dominos, Subway, and, Café Deli. In our opinion, Nairobi presents a viable opportunity for the fast-food industry as it hosts high to middle-income earners with high purchasing power, which will sustain demand from the restaurant's target market. The continued expansion of Artcaffe and other restaurants such as Java in Nairobi is also expected to result in increased uptake of retail real estate developments thus improving the overall performance of the sector.

III. **Industrial Sector**

During the week, Cold Solutions Kenya Limited, a leading temperature-controlled warehouse and logistics service provider, announced that it will invest Kshs 7.5 bn in constructing, grade 'A' temperature-controlled cold storage warehouses in Tatu City Development special economic zone. Cold Solutions Kenya Limited is a portfolio company of ARCH Cold Chain Solutions East Africa Fund, a private equity fund who will be backed by the African Development Bank (AfDB) for the project. The 15,000 SQM cold storage complex is set to be developed on 6 acres at Tatu City and is expected to be commissioned in 12 months, where it will provide storage for fresh fruits, vegetables, perishable goods, pharmaceuticals, and, vaccines. The facility will be the second grade 'A' warehouse facility in Tatu City after Africa Logistics Properties' (ALP) ALP North warehouse, a 50,000-SQM warehousing facility developed on 22 acres. We continue to see increased interest in Grade A warehouses especially in areas such as Ruiru, Machakos and Limuru, driven by; (i) availability of development land in bulk and at relatively affordable prices, (ii) improved infrastructure such as the Eastern and Northern Bypass and the ongoing expansion of Mombasa Rd, and, (iii) government support with regards to tax rebates offered in Special Economic Zones (SEZ) such as Tatu City. We expect to see an increase in demand for modern industrial park space fueled by improved business conditions which are expected to draw in more industrial firms both local and international, increased port throughput after the completion of the Naivasha Inland Port, and, various emerging trends during the COVID-19 pandemic which are expected to lead to higher demand for warehousing such as increased online shopping and increased near sourcing of inputs by local industries and retailers due to the current disruption in global supply chains.

Other Highlights:

During the week, Nairobi Metropolitan Services (NMS) Director-General, Mohammed Badi, announced the formation of the Railway City Development Authority (RCDA), a special purpose vehicle created under the State Corporations Act and under the Companies Act, which is expected to lead the implementation of the Nairobi Railway City, a 425-acre urban development on the area between Haile Sellasie Avenue, Uhuru Highway and Bunyala Road that is part of the Nairobi integrated urban development plan. The project is estimated to take 20 years (2020 to 2040) and will be implemented in 3 phases at an estimated cost of Kshs 27.9 bn. The city will comprise of commercial and residential buildings expected to accommodate approximately 28,000 residents. According to the World Bank's Kenya Urbanization Review 2016 report, urban services provided in Nairobi are unable to keep up with the rate of urbanisation in the city and other urban centres in the country due to congestion, with the Nairobi hosting 4.4 mn people. Once completed, we expect the city to transform the CBD and help solve persistent issues such as traffic congestion, lack of affordable housing, congestion, and, water supply problems, with the implementation of new infrastructure.

We expect the real estate sector to continue on an upward trajectory with activity driven by demand for affordable housing and differentiated concepts coupled with the expansion of local retail stores and the continued development of high-quality warehousing.