Unit Trust Funds Performance, Q1’2020, & Cytonn Weekly #32/2020

Real Estate

I. **Retail Sector**

During the week, Shoprite Holdings, a South African based international retailer, announced the closure of its branch in Nyali Mombasa, effective 31st August, revealing that trading at the branch was not viable. This brings the number of remaining outlets in Kenya to 2: at Garden City and Westgate Mall in Nairobi. This follows the continued scaling down of the retailer's operations across the continent has recently announced plans to sell all or a majority stake of its business in Nigeria, citing re-evaluation of its operating model. According to the retailer’s trading statement, its South African division grew by 8.7% while sales at its supermarkets outside South Africa fell by 1.4%. We attribute the reduced revenue inflows to constrained spending power among consumers due to a tough financial environment in the wake of the ongoing pandemic, which has resulted in the slowdown of the global economy. This, in addition to the exit of other retailers such as Botswana’s Choppies, and the existing oversupply of retail space with the introduction of 0.8 mn SQFT of retail space in 2019, has continued to impact on the Kenya retail sector occupancy rates which dropped by 0.3% points to 80.0% in H1’2020, from 80.3% in FY’2019 Cytonn H1’2020 Market Review.

In our view, the scaling down by retailers is attributed to constrained spending power among consumers due to a tough financial environment in the wake of the ongoing pandemic, which has resulted in reduced disposable income. However, we expect decentralization, as in the case of international financial institutions such as International Finance Corporation (IFC) buying into companies such as Naivas, will strengthen the retailers’ financial muscle thus boosting operations. Nevertheless, we expect the sector’s performance to continue being phased by the tough economic environment, in addition to the shift to e-commerce.

II. **Hospitality Sector**

During the week, global chain International Hotels Group, announced the halting of operations and closure of the InterContinental Hotel, located along City Hall Way in Nairobi, amid the coronavirus economic tumble. Intercontinental Hotels Corporation Limited and the Kenya government each own 33.8% of Kenya Hotel Properties (KHP), the holding company that owns the 389- key 5-star hotel. InterContinental Hotel was already struggling before the pandemic outbreak and was declared technically insolvent as it could not service its debts that stood at Kshs 717 million in 2019 and the reduced revenue inflows due to the ongoing pandemic have thus exacerbated the financial strain. This follows the suspension of operations by other players such as Fairmont Norfolk, which had in May announced halting of its operations due to financial constraints but retracted the employees’ redundancy notice after the intervention of the Office of the Attorney General. The strain is also evidenced by the ongoing activities such as the auctioning of hotels such as 56- key Laibon Hotel in South B, as the hospitality sector continues to grapple with the effects of the Coronavirus pandemic, which has seen hotel occupancy rates at record lows, 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 cancellation of meetings, conferences and events.

Despite the hospitality sector being the hardest hit by the COVID-19 pandemic due to its over-reliance on tourism, the sector continues to attract global investors, with global hotel groups, Accor Hotels, and Radisson Hotel Group announcing in July that they would continue with their expansion plans in Kenya and the African region as a whole despite the slump in the sector due to the pandemic. This affirms Kenya's hospitality sector's attractiveness to global investors driven by; (i) heightened security, (ii) recognition of Kenya as a regional hub, (iii) relaxation of travel advisories by governments of key tourism markets, and (iv) political stability that has prevailed in the country. 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 program 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.

III. **Master Planned Developments**

During the week, the Ministry of Transport, Infrastructure, Housing and Urban Development, and Public Works, through the State Department for Housing and Urban Development, published an expression of interest (EOI) inviting strategic partners seeking to collaborate with the government in the development of the "The Nairobi Railway City", a multi-modal, transit-oriented, urban development in the capacity of master developers and developers. The government will provide 425 acres of development land (292 acres of this is owned by the Kenya Railways and currently serving as the Nairobi Railway Station) and off-site infrastructure. The project covers the area between Haile Selassie Avenue, Uhuru Highway and Bunyala road. The development has been designated as a project of strategic national importance and designated a Special Planning Area (SPA); by the conferment of this status;

a. The City has been identified as suitable for intensive and specialized development activity thus provides a framework for its physical development and management, and guides the development control processes within that area,
b. The declaration cuts planning and construction approval bureaucracy for investors and developers and fast tracks the city as a private sector development of national significance, and,
c. The SPA also provides a sound legal basis for the planning process, which in turn strengthens the case for the plan's implementation, which the government is embarking upon, in addition to providing a rallying point and a stronger bargain for an alliance of actors working together.

The project, which is part of the Nairobi Integrated Urban Development Plan, is aimed at expanding the capital's CBD in a manner that is sustainable in line with transit-oriented development practices. The plan includes the building of a new railway station that allows for the integration of Bus Rapid Transit (BRT) and other public transport modes. The project is divided into three main components;

a. Meeting facilities, incentive conferences, and exhibitions, which will be located along Bunyala Road,
b. An economic zone comprising hi-tech industries and small and medium enterprises, and,
c. A residential complex in Landi Mawe and Industrial Area- including a school, park, and affordable housing units to accommodate approximately 28,000 residents.

The implementation of the project is estimated to take a total of 20 years at a cost of Kshs 27.9 billion. Some of the goals of the proposed development include; (i) to promote and further enhance the global competitiveness of Nairobi City, (ii) providing a framework for coordinating public and private investment, (iii) capture land value for the sustainable urban regeneration of the area and development, (iv) transport improvement through the development of an integrated railway transportation network, and (v) serve as critical project and initiative for Kenya's efforts in a post-COVID recovery period.

The call for strategic partners to collaborate with the government on the proposed City indicates that the latter continues to enlist the help of the private sector for financing and development of infrastructure and affordable housing, for instance with the River Estate, a 2,720-unit housing project being developed by Edermann Property Limited, a Kenyan based real estate firm and financed jointly by the national and county government. However, in our view, in the case if the Railway City, requirements such as a developer's ability to mobilize cash or financing amounting to a minimum of Kshs 7.5 billion at any one given time, and have an annual turnover above Kshs 10 billion over the last five years is unfavorable for most local developers especially in the wake of a tough economic environment. Other challenges likely to face the collaboration include; (i) regulatory hindrances such as lack of a mechanism to transfer public land to a Special Purpose Vehicle (SPV) to facilitate access to private capital through the use of the land as security, (ii) lack of clarity on returns and revenue-sharing, and (iii) the extended time-frame of Public Private Partnerships (PPPs) while private developers prefer to exit projects within 3-5 years. Nevertheless, with the conferment of the Railway City as an SPA, we expect some hurdles such as the slow approval processes to be eliminated thus enhancing the successful implementation of the project. If successful, we expect the project to spur economic growth through creation of jobs, opening up of areas for development mainly with the improved transport system and reduced traffic congestion within the Nairobi CBD and neighboring nodes, in addition to complementing the ongoing efforts in the resolving of the existing housing deficit within the low and middle-income segment.

Despite the effects of the COVID-19 pandemic taking a toll on the Kenyan economy, we expect the real estate sector to be cushioned by the resilience of the hospitality and retail sectors, and collaborative development activities between the private sector and the Kenyan government through PPPs.
