Financial Planning For Retirement, & Cytonn Weekly #33/2020

Real Estate

I. **Industry Reports**

During the week, the Kenya Bankers Association released the Housing Price Index Q2'2020 highlighting that house prices contracted by 0.2% in Q2'2020, a slower contraction compared to the 0.5% drop in Q1'2020. The slight decline in house prices is attributed to the economic slump which has affected both demand and supply in the residential market. Other key take-outs from the report include;

?. Demand for apartments increased significantly accounting for 75.6% of the concluded sales during the quarter, compared to 33.0% of the concluded sales in Q1'2020, while bungalows and maisonettes jointly accounted for 24.4%. The increased demand for apartments is attributed to the affordability of the same among buyers as compared to bungalows and maisonettes,
i. Mid-end residential markets within the Nairobi Metropolitan Area such as Thindigua, South C, Kikuyu and Imara Daima recorded the highest activities accounting for 75.0% of the sales during the quarter, while high-end markets such as Kileleshwa, Kilimani, Westlands, Karen, and Kitisuru accounted for approximately 7.8% of the sales, reinforcing buyers' search for affordability.

Hass Consult also released the Q2'2020 House Price Index, and the key take-outs were;

?. House prices dropped by 0.2% q/q but marginally increased by 2.9% y/y, attributable to reduced transactions as investors adopt a wait-and-see attitude in the wake of market uncertainty,
i. Muthaiga recorded the highest increase in asking prices over the quarter at 3.6%, while Riverside recorded the lowest drop with apartment prices reducing by 2.6% q/q,
ii. Overall rents recorded a marginal drop of 0.3%, attributed to pressure on landlords to offer discounts in the wake of reduced disposable income among business owners and employees due to the impact of the pandemic. However, apartments recorded a 2.2% growth in rents q/q indicating sustained demand for rental housing amidst a tough financial environment,
iii. Among suburbs, apartments in Parklands register the highest rent price increased at 2.4% q/q and 7.1% y/, while Donholm recorded the biggest q/q drop in rents at 4.8% while on an annual basis rents in Kitisuru reduced by 7.7%. In the satellite towns, rents in Kiserian and Thika recorded gains of 6.7% and 10.0% q/q and y/y, respectively, while apartments in Mlolongo recorded the biggest drop of 2.6% q/q and 9.8 y/y.

Hass Consult also released Q2'2020 Land Price Index, and the key take-outs were;

?. Land prices softened in both the suburbs and satellite towns declining by a marginal 0.7% q/q and 1.2% q/q respectively, reflecting that investors still view land as a resilient asset class over the long term,
i. For suburbs, Donholm registered the highest increase in land prices at 2.8% q/q, while Parklands posted a 2.7% correction. On a y/y basis, Muthaiga registered the highest appreciation at 4.5%

while Parklands recorded a 7.3% price correction. We attribute the price correction in Parklands to reduced demand for development land especially on the commercial front in addition to competition from neighbouring nodes such as Westlands,

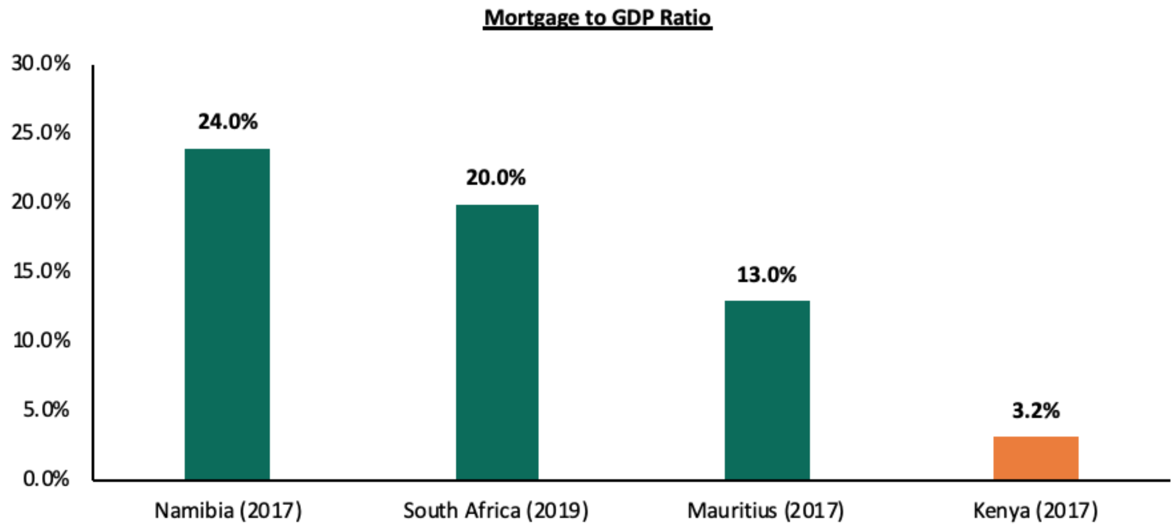
ii. Ongata Rongai recorded the highest appreciation among satellite towns at 1.3%, while Limuru registered the highest drop at 3.9%. Key to note, despite the relatively high decline in Limuru prices q/q, it recorded a 3.4% appreciation y/y. Ruiru registered the highest appreciation y/y at 5.2%, while Thika recorded a 2.2% correction in land prices. We attribute the appreciation of land prices in satellite towns such as Ruiru to demand fuelled by affordability, improving infrastructure and the continued focus on driving the affordable housing initiative.

The indices are in tandem with Cytonn H1’2020 Market Review according to which, the performance of the residential sector softened with a marginal decline in rental yields by 0.1% points from 5.2% in Q1’2020 to 5.1% in H1’2020, on account of stagnation in unit prices in the wake of a tough economic environment. For the land sector, however, land prices recorded an overall annualized capital appreciation of 1.4%, attributed to a growing demand mainly in low rise residential areas and satellite towns fuelled by affordability and improving infrastructure. For investors focusing on the residential sector, Runda Mumwe and Ruiru continue to offer the best opportunity for detached units driven by returns, relatively higher uptake and presence of good infrastructure, while for apartments, the opportunity lies in Ruaka and Westlands which ranked highest in terms of average returns, unit uptake and infrastructure. In the land sector, the opportunity lies in sub-markets such as Karen, Spring Valley and Kasarani which recorded relatively high annualized capital appreciation of 5.6%, 5.4% and 5.7%, respectively, and satellite towns such as Ruaka for un-serviced land, and Ruiru for site and service schemes which were the best performing sub-markets with average annualized capital appreciation of 5.2%, and 5.8%, respectively.

II. **Residential Sector**

During the week, the Kenya Mortgage Refinancing Company (KMRC) announced that it would begin lending in September 2020, following approval to operate by the Central Bank of Kenya. The treasury backed lender, is set to lend money to local financial institutions at an annual interest rate of 5.0%, enabling them to write home loans at 7.0%, 6.0% points lower than the market rate of approximately 13.0%. The subsidized rate will be available to Kenyans earning Kshs 150,000 and below per month, while those earning more than that will continue to borrow house loans at market rates. According to online sources, KMRC has so far mobilized approximately Kshs 40 billion, including Kshs 2.2 billion in equity capital, Kshs 25 billion committed by the World Bank, Kshs 10 billion from African Development Bank, and plans to raise an extra Kshs 5 billion from the capital markets. The facility aims to grow the number of mortgage accounts to 60,000 by 2020.However, with the value of outstanding non-perfroming mortgages at Kshs 27.3 bn as at 2017, we are of the view that the Kshs 40 bn will be a one off and thus the 7.0% interest rate will not be sustainable once the initial capital is exhausted and the facility will need to move back to the market rate of approximately 13%. Uptake and access to mortgages in Kenya has remained relatively low mainly due to; i) low-income levels that cannot service a mortgage, ii) soaring property prices, iii) high-interest rates of up to 18% and high deposit requirements, iv) exclusion of employees in the informal sector due to insufficient credit risk information, v) lack of capital markets funding towards real estate purchases for end buyers, and (vi) lack of long term deposits for lenders to match house loans, thus limited writing of the same.

We expect that operationalization of KMRC will resolve some of the above challenges, thus improving Kenya’s mortgage penetration rate which stood at 3.2% of gross domestic product (GDP) as at 2017.



Source: Centre for Affordable Housing Finance in Africa

During the week, the National Cooperative Housing Union (NaCHU) suspended the implementation of its housing projects citing reduced contributions and repayments by its members due to the ongoing Covid-19 pandemic. To date, NaCHU has constructed 2,000 low-cost housing units for members of the affiliate housing SACCOs with four projects totalling 490 housing units now underway while a further 400 units were earmarked for ground-breaking. The ongoing pandemic has caused unprecedented disruption to the Kenyan economy over the past five months resulting in diminishing disposable income among the majority of Kenyans. This has affected households' ability to cater for their housing needs with approximately 21.5% unable to pay their rent according to the KNBS Socio-Economic Impact of COVID-19 on Households Report, while the number of mortgage defaulters has continued to rise. On the supply end, the economic slowdown has also resulted in a financial strain for developers due to the reduced revenue inflows coupled with supply chains disruption and decline in project financing.

Nevertheless, the housing sector has continued to witness government intervention through the adoption of policy reforms aimed at cushioning the sector. Some of these include; the provision to utilize pension savings towards purchasing a residential house, allowing the use of advanced electronic signatures as a valid mode of execution of documents in Kenya thus easing land transactions as lands registries remain closed, and the proposed loans and mortgage moratorium preventing lenders from imposing penalties or credit reference bureau listing for borrowers unable to meet their monthly payment obligations. In addition, CBK has lowered the Central Bank Rate (CBR) to 7.0%, and the Cash Reserve Ratio (CRR) to 4.3%, to increase the available cash for on lending and setting aside loans for onward lending to various sectors.

In terms of performance, according to Cytonn's Nairobi Metropolitan 2020 Residential Report, the sector has remained resilient evidenced by an improvement in the average annual returns to 5.0% compared to 4.7% last year on account of a vibrant rental market. However, price appreciation remained subdued averaging at (0.1%) compared to 0.3% in FY'19, and this is expected to continue as investors and homebuyers adopt a wait and see attitude in light of the current economic uncertainty. However, we expect the sector to stabilize once the economy recovers and housing demand resurfaces.

Other highlights during the week;

?. The Ministry of Lands announced that land transactions in Nairobi city that include; searches, application for registration of documents, transfer of ownership or lease, caution and withdrawal of caution among others must be done online as per, The Land Registration (Electronic Land Transactions) Regulations 2019. The regulations, which had in May this year been published for public participation, will, for instance, require persons wishing to buy, transfer or lease land in Nairobi register in the online lands registrar by providing details such as their personal identification number (PIN) in the move to curb evasion of tax. In our view, the move to digitalize the land's ministry is a stride in the right direction as we expect this to minimize human interference and save on time through eased processes. We expect this and the general digitalization of the lands ministry to boost the real estate sector through faster land transactions thus reducing delays experienced by developers during the pre-construction period. Please see Cytonn Weekly #20/2020 for more details of the regulations.

We expect the real estate sector to continue on an upward trajectory with activity driven by availability of relatively affordable house loans once the KMRC begins lending, reforms such as the digitalization of the lands ministry and buyer's search for affordable housing options amidst a tough economic environment.

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