Analysis of new CMA guidelines to Collective Investments Schemes, & Cytonn Weekly #41/2020

Real Estate

I. Retail Sector

Big Square, a fast-food retail chain, opened its second branch outside Nairobi, in Eldoret at Rupa's Mall, bringing the total number of stores operated by the retail chain to 12. Big Square has a total of 10 stores operating in Nairobi, and one in Mombasa. The move is part of the retailer's strategy to increase its footprint country wide. Eldoret has remained an attractive investment area for retailers supported by; i) positive demographics with Eldoret having a population of 475,715 an increase by 64.4%, from 289,340 in 2009, ii) a growing middle class, iii) improving infrastructure, and, iv) availability of retail space with Uasin Gishu, where Eldoret is the main town, having a total retail supply of 0.9 mn SQFT as per Cytonn's Kenya Retail Real Estate Sector Report 2019.

In terms of retail sector performance, Eldoret recorded an average rental yield of 7.9%, 0.9% higher than the market average of key towns in Kenya at 7.0%, as shown in the table below;

All Values in Kshs unless stated otherwise

Summary of 2019 Retail Performance in Key Urban Cities in Kenya

Region	Rent 2019	Occupancy Rate 2019	Rental Yield 2019
Mt. Kenya	129.8	80.0%	8.6%
Nairobi	168.6	75.1%	8.0%
Eldoret	131.0	82.3%	7.9%
Mombasa	122.8	73.3%	7.3%
Kisumu	96.9	75.8%	5.6%
Nakuru	59.2	77.5%	4.5%
Average	118.0	77.3%	7.0%

Source: Cytonn Research

We expect the continued expansion of both local retailers and international retailers such as Big Square, Carrefour and Naivas to cushion the performance of the Kenyan retail sector by taking up space left behind by struggling retailers such as Tuskys. The expansion will be supported; by i) improving infrastructure, ii) positive demographics with Kenya's current urbanization and population growth rates at 4.0% and 2.2% against a global average of 1.9% and 1.1%, respectively, according to the World Bank, iii) changing tastes and preferences of consumers, and, iv) shifting consumer trends which have fuelled the entry of international retailers thus increasing demand for formal retail space. In spite of this, key factors likely to negatively impact the performance of the sector include; i) shifting focus to e-commerce thus affecting demand for physical retail spaces, ii) exit by some local and international retailers due to decline in revenues amid tough economic times, and, iii) the existing oversupply of approximately 2.8 SQFT of space as at 2019.

II. Hospitality

During the week, the government of the United States of America, through the United States Agency for International Development (USAID), announced plans to inject approximately Kshs 750.0 mn into Kenya's tourism sector in support of the tourism recovery efforts. The funds which will be disseminated in a three-year local works programme, will be used to support the local communities in the Mara Landscape, Northern, and Coastal areas of Kenya as they recover from loss of tourism and livelihoods as a result of the COVID-19 pandemic. The three year local works programme is also aimed at engaging Kenyan leaders and community members to design solutions that will attract and increase private sector investments and to economically empower the local communities, as well as, enhancing the capacity of community conservancies. The hospitality sector has been the hardest hit by the COVID-19 pandemic mainly because of its reliance on tourism and conferences. This is evident by the closure of most hospitality facilities, particularly major hotels after the onset of the COVID-19 pandemic. The sector has however witnessed steady recovery after lifting of the ban on travel to and from the country thus opening up to key tourism markets such as UK and USA. We expect the financial support through USAID will boost the recovery of the hospitality sector by easing the financial distress faced by local communities relying on the existence of tourism activities as a means of livelihood. This will also complement other government strategies such as the Ministry of Tourism Post-Corona recovery funds aimed at offering financial aid to hotel and other establishments in the hospitality industry through the Tourism Finance Corporation (TFC), repackaging of the tourism sector products to appeal to domestic tourists, and relaxation of travel advisories aiming at increasing the number of international tourist arrivals into the country, all aimed at supporting the recovery of the sector.

III. Land

During the week, the Nairobi Metropolitan Services (NMS), announced that it is set to unveil the new property valuation system that will determine the land rates in Nairobi County based on the market conditions, market value and rates. The new Geographical Information Systems (GIS)-based mass valuation, will be rolled out in the 2020/2021 financial year at a cost of Kshs 160.0 mn as indicated in the Nairobi County Annual Development Plan. The new system is expected to increase the number of properties in the supplementary valuations by approximately 5,000 from 156,000 as at 2019. City hall has been relying on the 1980 valuation roll whose update has been long overdue. The new property valuation system is aimed at enabling the county to; (i) increase the number of parcels of land captured in the valuation roll by including parcels of land that may have been erroneously left out through the previously used manual method, (ii) reset land rates within the county based on market values, and (iii) easily track parcels of land whose land rates have not been paid thus easier debt collection. The expected increased efficiency in the collection of land rates through the help of the GIS system, will result in increased revenues to the county government which has previously reported losses of approximately Kshs 188.0 bn every financial year from uncollected land rates, according to the Commission on Revenue Allocation.

In our view, if successfully implemented, the new GIS based mass valuation system will; i) facilitate easier planning for development within the city, with land details being availed through the system, thus other institutions such as the Ministry of Transport, Infrastructure Housing, Urban Development and Public Works can use the information for planning, ii) streamline the revenue collection of land rates in Nairobi County as it will be easier to identify unpaid land rates through the system, and iii) promote equitable land rates valuation within Nairobi by mapping out land within the same area through the system. We expect the improved revenue collection to increase the county government's financial capability to undertake infrastructural projects within the city such as improvement of roads, expansion of sewer and drainage systems thus improving property value, ease of access into areas for development thus boosting the real estate sector.

IV. Listed Real Estate

Acorn holdings, a real estate developer, announced the launch of an investor roadshow for its Acorn Students Accommodation (ASA) REIT with the aim of establishing a D-Reit and an I-Reit in the next 3 years with an expected Internal Rate of Return of 18.0%. The fund size for the two REITS is estimated at Kshs 4.0 bn for the D-Reit and Kshs 4.1 bn for the I-Reit in the initial fundraising. In their campaign, Acorn is seeking for investors to invest a total of 24.0% equity on the development of student accommodation D-Reit, and up to 67.0% in the I-Reit. So far the firm has secured Kshs 1.0 bn equity investment from one of its anchor investor, InfraCo, a private infrastructure development group. The development real estate investment trust (D-Reit) is expected to finance the student hostels whereas the Investment real estate investment trust (I-Reit) will be used to acquire property for rental income. Acorn has been exploring various financing options having issued a green bond in 2019 worth Kshs 5.0 bn. The green bond, which was cross-listed in Nairobi and London stock markets registered 85.0% subscription, raising Kshs 4.3 bn compared to the target of Kshs 5.0 bn as of October 2019.

The move be Acorn to issue a REIT indicates that developers continue to explore available structured financing options in the capital markets. Currently, there is heavy reliance on bank funding as opposed to funding from the capital markets, with 95.0% of business funding in Kenya being sourced from the banking industry and only 5.0% from the latter. Some of the key emerging structured financing options in real estate include; (i) real estate structured notes which may include project notes, real estate-backed medium term notes and other high yield loan notes, and, (ii) Real Estate Investment Trusts (REITS). In spite of this, the REIT market in Kenya has remained undeveloped with the Fusion Capital D-Reit, which was launched in 2016, having failed due to low subscription rates while the Cytonn D-REIT has faced delays in approvals by the Capital Markets Authority due to the limited number of approved trustees in the market. The poor performance of the D-REITs is attributed to the high minimum investment amounts set at Kshs 5.0 mn, high minimum capital requirement for a trustee at Kshs 100.0 mn, and, lengthy approval process. On the other hand, the only listed I-REIT, Fahari I-REIT is trading at a price of Kshs 5.4 as of 9th October 2020, a 73.0% drop from its issuance price of Kshs 20.0 in November 2015, and the poor performance is mainly attributed to potential investors' lack of knowledge about the products, high fees for the REIT structure and low quality of assets in the REIT. Other challenges facing the REIT market include; lack of institutional development capacity as most of the real estate that is currently under development is not institutional-grade and thus does not have the capacity to take up specialized funding, and the sluggish growth in select sectors within the real estate market.

In our view, the move by Acorn to conduct an investors' roadshow prior to launching the REITs is a noble way of mitigating against the current challenges facing the REITs market, through promoting the products' awareness and enhancing investor confidence, and thus increasing the chances of the products' success through anticipated uptake. In addition, the products are set to be focused on the student accommodation sector, which has continued to offer relatively high yields to investors at approximately 7.4% compared to other real estate sectors like the residential and Mixed-use developments which have an average rental yield of 5.0% and 7.3%, respectively as per the Cytonn Student Housing Market Kenya Research.

The real estate sector is expected to record activities supported by; i) expansion of local retailers, ii) channeling of funds to support the recovery of the hospitality sector, iii) the expected improvement in infrastructure within Nairobi County on account of increased revenue collection through land rates collection, and, iv) the exploring of alternative financing for real estate projects by developers.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com