Kenya Retail Report 2020 & Cytonn Weekly #47/2020

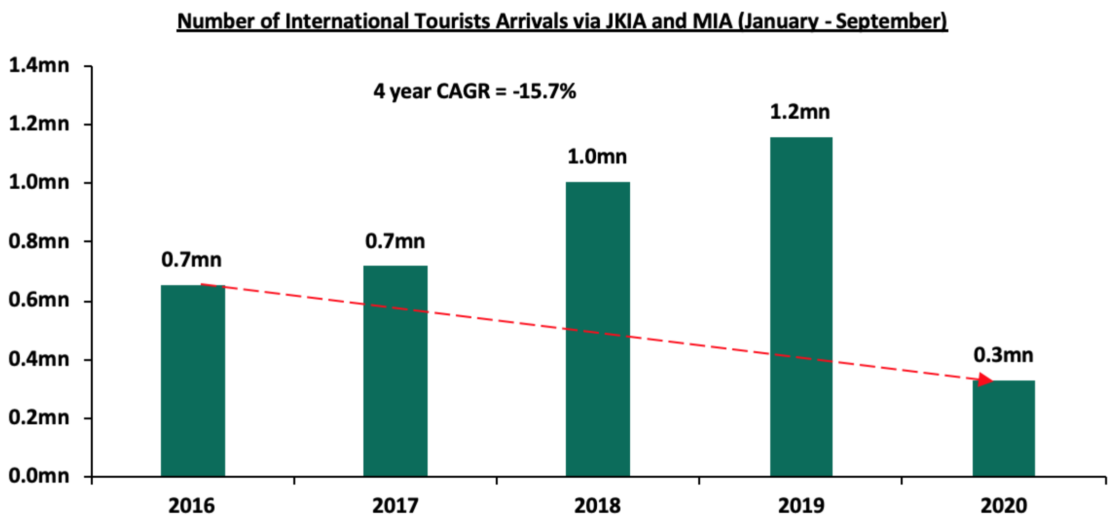
Real Estate

I. **Industry Reports**

During the week, Kenya National Bureau of Statistics (KNBS) released the Leading Economic Indicators - September 2020. The key take-outs were as follows:

i. The total number of international arrivals through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) increased from 13,919 persons in August 2020 to 20,164 persons in September 2020. This is an indication of gradual recovery of the tourism industry which will boost the hospitality sector. The sector recovery is largely supported by 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, relaxation of travel advisories and reopening of Kenya's key tourism markets.

The graph below shows the number of international arrivals in Kenya in the last five years;



Source: Kenya National Bureau of Statistics (KNBS)

ii. Consumption of cement rose by 2.2% from 594,028 metric tonnes in July 2020 to 607,383 metric tonnes in August 2020. This is attributed to an increase in the value of building approvals from 6.0 bn in May 2020 to 7.2 bn in August 2020 with no approvals made in June and July following Covid-19 lockdown restrictions.

Given the above statistics, we expect to the real estate sector to record activities mainly on the hospitality front supported by gradual recovery of the tourism industry. In addition, we expect the reopening of the economy and government offices such as the National Lands Commission to facilitate the issuing of building approvals, which will result in continued increase in development activities within the sector.

II. **Residential Sector**

During the week, Centum Real Estate, through its project development arm, Two Rivers Development Limited, submitted regulatory filings to the National Environmental Management Authority seeking approval to begin construction of a residential development dubbed Mzizi Court in Two Rivers. The development will sit on approximately 6.7 acres bordering the on-going River Bank housing project, and will comprise of approximately 1,650 one, two and three-bedroom (with domestic servant quarters) units (*details of the prices and unit sizes remain undisclosed)*. Some of the other affordable ongoing housing projects by Centum include; 265 Elmer One Apartments in Kasarani, and 365 Pavilion Place Apartments in Ruaraka.

Fairdeal Properties, a real estate developer, announced plans to develop a 229-unit residential project dubbed Fairvalley Heights, to be located in Gimu area, near CITAM Athi River in Mavoko at a cost of Kshs 500.0 mn. The development will comprise of 3 blocks of apartments with 8 floors each and a total of 24 one-bedrooms, 102 two-bedrooms, 85 three- bedrooms and 18 four-bedrooms.

The table below shows a summary of the unit types, sizes and prices for the development;

Fair Valley Heights Development

No. of bedrooms	Unit size (SQM)	Unit price (Kshs)	Price per SQM (Kshs)
1	47	1.9 mn	40,426
2	72	2.9 mn	40,278
3	97	3.8 mn	39,175
4	150	7.5 mn	50,000

Source: Online Research

The above pricing translates to Kshs 42,470 per SQM, 27.2% lower than the Athi River market average of Kshs 58,311 according to Cytonn Q3'2020 Markets Review, indicating that Fairvalley Heights will offer relatively affordable housing units in terms of pricing. In terms of performance, Athi River had the highest rental yield coming in at 6.2% in Q3'2020, 0.6% points higher than the market average of 5.6% indicating sustained demand for rental units. Total returns came in at 4.4%, 1.3% points lower than the market average of 5.7% attributable to a decline in house prices amid a tough economic environment.

The table below shows the performance of apartments in satellite towns in Q3'2020;

Satellite Towns Apartments Performance Q3'2020

Area	Average Price Per SQM Q3'2020	Average Rent per SQM Q3'2020	Average Occupancy Q3'2020	Average Uptake Q3'2020	Average Annual Uptake Q3'2020	Average Rental Yield Q3'2020	Average Price Appreciation Q3'2020	Total Returns Q3'2020
Thindigua	110,224	590	96.4%	93.2%	18.8%	5.8%	2.3%	**8.1%**
Syokimau	69,225	362	88.3%	79.9%	14.2%	5.5%	1.4%	**6.8%**
Ruiru	89,781	495	76.4%	60.7%	20.4%	5.0%	1.3%	**6.2%**
Kikuyu	81,090	416	86.0%	84.4%	26.5%	5.7%	0.1%	**5.8%**
Athi River	58,311	340	84.6%	90.1%	15.3%	6.2%	(1.8%)	**4.4%**

Satellite Towns Apartments Performance Q3'2020

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Kitengela	60,027	325	88.1%	99.5%	13.6%	6.0%	(1.7%)	**4.3%**
Ruaka	100,215	520	89.9%	86.2%	25.6%	5.3%	(1.3%)	**4.0%**
Average	**81,268**	**436**	**87.1%**	**84.8%**	**19.2%**	**5.6%**	**0.0%**	**5.7%**

Source: Cytonn Research 2020

Athi River's attractiveness as an area of investment is supported by; i) availability of affordable development land, ii) industrialization which has led to influx of population hence need for real estate development to accommodate the growing population, and, iii) improved infrastructure with expansion of Mombasa Road, presence of the Standard Gauge Railway station in the town and construction of Athi River interchange attracting developers.

Other highlights during the week;

i. Centum Real Estate floated a Kshs 4.0 bn housing bond to finance projects that would deliver more than 1,400 units to the market. This comes three weeks after their announcement in October to issue the three-year zero coupon bond whose yield will be competitively determined by the market. According to the company's management, the bond will be issued as a private placement, however, it will later be introduced at the Nairobi Stock Exchange (NSE) for trading. The firm's real estate projects will act as security with the pools of deposits collected flowing into a sinking fund as a strategy to protect the bond holder's funds. The move by Centum to issue a bond is an indication that developers have continued to explore diversified sources of financing for their real estate projects. Please see the Cytonn Monthly- October 2020 for more analysis.

We expect the residential sector to record increased activities supported by the continued launch of affordable housing projects in satellite towns such as Athi River supported by availability of affordable development land in bulk, growing population, in addition to some developers seeking to explore structured financing options for the funding of real estate projects.

III. **Retail Sector**

During the week, Tuskys supermarket, a local retail chain, announced plans to close down half of its branches, in an attempt to stay in operation. Tuskys, which currently has 52 operational branches, has been battling financial woes amid supplier debts and mounting rent arrears despite securing financial support amounting to Kshs 2.0 bn from an undisclosed Mauritius-based private equity fund in August. The retailer has so far shut down 14 branches since the beginning of the year and we are of the view that to survive, Tuskys will require an infusion of significant equity capital from a disclosed and credible financier, with the aim of; (i) boosting the cash flows, (ii) helping clear the pressing debt issues, and, (iii) enabling the retailer gain control over its business.

Naivas supermarket, a local retail chain, announced plans to open two outlets to be located at Lifestyle Mall along Nairobi CBD's Monrovia Street, a space previously occupied by Nakumatt while the other outlet will be situated in Rongai town. The retailer is targeting the high number of footfall in Nairobi's CBD and the growing population in Ongata Rongai, in line with its expansion strategy of increasing its footprint in satellite towns. Once opened the two outlets will bring the retailer's operational outlets to 68 with another two outlets expected to be opened by the end of the year. Currently, Naivas has the highest number of outlets locally at 66, five of which were opened this year. With 66 branches, Naivas has for the first time surpassed the 65 number of branches held by Nakumatt in its prime days. The continued expansion of the retailer as well as other retail chains such as QuickMart and Carrefour, taking up prime retail space left behind by troubled chains such as Tuskys and Nakumatt, is expected to cushion the retail sector performance which is currently witnessing; i) reduced demand for physical space due to shifting focus to online shopping, ii) reduced purchasing power among consumers amid a tough economic environment, and, iii) reduced rental rates as landlords offer rental concessions to retain tenants.

The table below shows the summary of the number of stores of the key local and international retail supermarket chains in Kenya;

Main Local and International Retail Supermarket Chains

Name of Retailer	Initial number of branches	Number of branches opened in 2020	Closed branches	Current number of Branches	Branches expected to be opened / closed	Projected total number of branches
Naivas Supermarket	61	5	0	66	4	70
Tuskys	64	2	14	52	27	25
QuickMart	29	6	0	35	0	35
Chandarana Foodplus	19	1	0	20	0	20
Carrefour	7	1	0	8	3	11
Uchumi	37	0	33	4	0	4
Game Stores	2	1	0	3	0	3
Choppies	15	0	13	2	0	2
Shoprite	4	0	2	2	0	2
Nakumatt	65	0	65	0	0	0
Total	**303**	**16**	**127**	**192**	**34**	**172**

Source: Online research

In terms of performance in 2020, Nairobi Metropolitan Area retail sector recorded an average rental yield of 7.5%, 0.5% points lower than 8.0% recorded in 2019. The performance is attributed to high rental rates of Kshs 168.5 per SQFT, which is 46.4% higher than the market average rates of Kshs 115.1 per SQFT amid an oversupply of 3.1 SQFT as at 2020. Satellite towns on the other hand offered the lowest rental rates averaging Kshs 130.0 hence an opportunity for retailers such as Naivas to take up affordable space.

The table below shows a summary of 2020 retail performance in the Nairobi Metropolitan Area;

Nairobi Metropolitan area (NMA) 2020 Retail Performance

Area	Rent/SQFT 2020	Occupancy% 2020	Rental Yield 2020	Rent Kshs/SQFT FY' 2019	Occupancy FY' 2019	Rental Yield FY' 2019	Fy' 2020 Δ in Rental Rates	Fy' 2020 Δ in Occupancy (% points)	Fy' 2020 Δ in Rental Yield (% points)
Westlands	207.5	80.9%	**9.8%**	203.6	84.6%	**9.2%**	1.9%	(3.7%	**0.6%**
Karen	215.5	79.1%	**9.2%**	207.9	77.0%	**9.1%**	3.5%	2.1%	**0.1%**
Kilimani	169.5	83.0%	**8.6%**	170.4	87.2%	**9.9%**	(0.5%)	(4.2%	**(1.3%)**
Ngong Road	179.8	79.3%	**8.5%**	179.4	83.1%	**9.2%**	0.2%	(3.8%	**(0.7%)**
Kiambu road	174.8	65.3%	**6.8%**	166.0	61.7%	**6.8%**	5.0%	3.6%	**0.0%**

Nairobi Metropolitan area (NMA) 2020 Retail Performance

Area	Rent/SQFT 2020	Occupancy% 2020	Rental Yield 2020	Rent Kshs/SQFT FY' 2019	Occupancy FY' 2019	Rental Yield FY' 2019	Fy' 2020 Δ in Rental Rates	Fy' 2020 Δ in Occupancy (% points)	Fy' 2020 Δ in Rental Yield (% points)
Mombasa road	140.8	70.8%	**6.2%**	148.1	64.0%	**6.3%**	(5.2%)	6.8%	**(0.1%)**
Thika Road	160.1	69.0%	**6.2%**	165.4	73.5%	**7.5%**	(3.3%)	(4.5%	**(1.3%**
Eastlands	138.3	69.2%	**6.1%**	145.0	74.5%	**7.5%**	(4.8%)	(5.3%	**(1.4%**
Satellite towns	130.0	73.6%	**5.8%**	131.4	70.3%	**6.0%**	(1.1%)	3.3%	**(0.2%)**
Average	**168.5**	**74.5%**	**7.5%**	**168.6**	**75.1%**	**8.0%**	**(0.1%)**	**(0.6%)**	**(0.5%)**

Source: Cytonn Research 2020

We expect the performance of the retail sector to be cushioned by the continued expansion by local international chains supported by; i) continued improvement of infrastructure opening up areas for investment, ii) relatively high population growth rate, iii) investor confidence due to the ease of doing business in Kenya, having been ranked position #56 by World Bank in the ease of doing business, and, iii) the growing middle class with increased purchasing power.

IV. **Listed Real Estate**

During the week, Acorn Investment Management Limited, a subsidiary of Acorn Holdings was granted a Real Estate Investment Trust (REIT) manager license by the Capital Markets Authority (CMA) following the fulfilment of applicable regulations. This follows the launching of an 8-week roadshow in September by Acorn to woo fund managers to its Acorn student accommodation REITs to be established by the end of this year.

As a fund manager, some of the duties of Acorn will include; i) formulation of prudent investment policies and investment of the fund's assets, ii) valuation of the fund and setting the dealing prices in accordance with the information memorandum, iii) preparing and issuing dividend distributions and financial statements to investors, and, iv) dealing with investors when they wish to invest in the fund or redeem their existing holdings and issuing confirmation of the details of the transactions, among other functions. The licensing by CMA is an indication of confidence in regulated product development which will allow the firm to register their anticipated Development REIT (D-REIT), estimated at Kshs 4.0 bn and Income REIT (I-REIT) estimated at Kshs 4.1 bn, allowing them to access a pool of investor capital that wishes to take specific real estate exposure. 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, having announced that it is set to build two hostels next to the University of Nairobi Chiromo Campus under the Qwetu and Qejani brands, whereas the Investment real estate investment trust (I-REIT) will be used to acquire property for rental income. The REIT market in Kenya has remained underdeveloped mainly due to; i) inadequate investor knowledge on REITs, ii) high minimum amount required to invest in REITS at Kshs 5.0 mn locking out many potential investors, and, iii) shallow investment grade assets pipeline among other challenges.

Following the licensing of Acorn Investment Management, the total number of licensed REIT Managers will be 10. We are of the view that effort in improving the REIT market by licensing more fund managers will encourage investor confidence leading to increased funding for real estate development through structured products such as REITs away from the traditional sources of funding such as bank funding. However, more needs to be done by the regulator to improve the REIT market as currently, the REIT market remains muted as evidenced by the fact there is only an

I-REIT in the market and so far no successful D-REIT in the market. Additionally, Stanlib Fahari I-REIT's performance, the only listed I-REIT on the Nairobi Securities Exchange, has been on a downturn since November 2015 when it was first listed, an indication of the dwindling interest for the instrument by investors. As such, we believe that in order for CMA to improve the REIT Market and make it more attractive to local and foreign investors, the following supportive frameworks need to be put in place;

i. Broaden the pool of trustees by reducing the minimum capital requirement which currently stands at Kshs 100.0 mn. This high minimum effectively limits the eligible trustees to only banks, which is not good for market development. We ought to allow for corporate trustees who are solely focussed on the trustee business,
ii. Remove the intense conflicts of interest in the governance structure of the both CMA and the fund structures so that there is more tolerance to constructive feedback. In normal functioning economies, Capital Markets make up 60.0% of business funding with only 40.0% of it coming from bank funding, while in Kenya Capital Markets make up only a paltry 1.0% with the balance of 99.0% coming from bank funding. In short, our Capital Markets are stifled and hence we need to;
iii. Reduce the minimum investments for real estate finance vehicles. The minimum of Kshs 5.0 mn per investor for the formation of a development REIT is too high for a country where the median income is just Kshs 50,000, hence the minimum investment is 100 times higher than the median income, no wonder there is not a single Development REIT formed so far, making it hard to finance real estate initiatives such as the President's housing agenda, and,
iv. Develop institutional grade real estate assets which will lead to high returns.

We expect the real estate sector performance to register improvement attributable to continued focus on development of affordable housing projects, expansion by local retailers taking up prime retail space left by troubled retailers and increased activities in the REIT market.