Cytonn Annual Markets Review - 2020

Real Estate

In 2020, the real estate sector recorded moderate activities with a general decline in closed transactions. The effects of the pandemic were mainly felt in the sector from Q2’2020 with the real estate and construction recording growth of 6.1% in Q2’2020, compared to 13.2% growth recorded in Q2’2019, according to KNBS Quarterly Gross Domestic Product Report - Q2’2020.

Some of the challenges that affected the performance of the real estate sector included:

?. Reduced revenue due to slow market uptake and downward pressure on prices and rents,
i. Constrained financing to developers as financiers such as banks aimed to limit exposure amidst increasing loan deferrals and defaults,
ii. Decrease in the value of building approvals for the first nine months of the year to Kshs 120.8 bn compared to Kshs 176.5 bn recorded over a similar period in 2019, with no approvals made in June and July owing to Covid-19 lockdown restrictions that led to closure of the National Lands Commission offices,
iii. Travel restrictions which mainly affected the performance of the hospitality sector,
iv. Constrained consumer spending due to low purchasing power, and,
v. Oversupply of 6.3mn SQFT and 3.1mn SQFT of commercial office space and retail space, respectively.

Nevertheless, the performance of the real estate sector was cushioned by:

?. The government’s continued focus on affordable housing projects to serve the middle and low income earners with the aim of increasing home ownership,
i. Operationalization and licensing of the Kenya Mortgage and Refinance Company to provide relatively cheap mortgage facilities,
ii. Introduction of the Land Information Management System (LIMS) in April 2020 aimed at eliminating fraud and enabling digitization of processes at the lands ministry,
iii. Improvement of infrastructure with ongoing select projects such as construction of the Nairobi Expressway and construction of phase two of the Standard Gauge Railway, among many others, and,
iv. Easing of travel bans and restrictions in Q3’2020 coupled with the government’s stimulus package such as post-COVID recovery funds, intended to enhance the recovery of the hospitality sector.

In terms of performance, residential, commercial office, retail, mixed-use developments and serviced apartments sectors registered average rental yields of 4.7%, 7.0%, 7.5%, 7.1%, and 4.0%, respectively, resulting to an average rental yield for the real estate market of 6.1%, 0.9% points lower compared to 7.0% recorded in 2019. Existing properties recorded a (0.2%) price correction thus the resultant average total returns came in at 5.9%, down from 9.0% recorded in 2019. The decline is attributed to subdued performance across all sectors due to reduced sale and rental rates in a bid to attract and retain tenants.

Annual Real Estate Returns Summary Table, for Existing Properties

	2017	2018	2019	2020	Y/Y Change (% Points)
Average Rental Yield	7.6%	7.4%	7.0%	6.1%	(0.9%)
Average Capital Appreciation	6.5%	3.8%	2.0%	(0.2%)	(2.2%)
Total Returns	**14.1%**	**11.2%**	**9.0%**	**5.9%**	**(3.1%)**

- ***In 2020, average rental yields in the real estate sector came in at 6.1%, bringing the average total returns to 5.9%, a 3.1% points decline from 9.0% recorded in 2019***

Source: Cytonn Research 2020

For the detailed real estate market review report, see our Real Estate Annual Markets Review 2020 Note.

I. Residential Sector

In terms of performance, the residential sector recorded a decline in performance in 2020 with average total returns coming in at 4.7% down from 6.1% recorded in 2019. Rental yields recorded a 0.1% points marginal drop to 4.9% as a results of reduced rental rates amid a tough economic environment while average annual uptake stagnated at 19.3%, as buyers held on to money amid market uncertainty. Apartments performed better than detached units, recording average total returns of 5.2% in comparison to the detached average of 4.2%. The better performance is attributed to the higher rental yield averaging 5.7% in comparison to 4.1% for the detached units. However, in terms of prices, apartments recorded higher price decline compared to detached units owing to slow uptakes as potential buyers face liquidity pressures amid reduced disposable income.

Detached units recorded a decline in performance in 2020 compared to 2019 with average returns to investors coming in at 4.2%, down from 5.3% recorded in 2019. This was attributed to reduced house prices in the wake of market uncertainty amid the Covid-19 pandemic that saw low transactional volumes hence reduced uptakes with the average annual uptake coming in at 16.9%, a 1.8% points decline from 18.7% recorded in 2019.

Apartments registered subdued performance with average total returns of 5.2% in 2020, a 1.6% points decline from 6.8% recorded in 2019. Satellite towns was the best performing segment with an average total returns of 5.5% attributed to the relatively high rental yield averaging 6.1% as more people opted to rent in areas such as Thindigua, which was the best performing node in terms of rental yield averaging 8.2%, followed by Kitengela at 6.7%. The growing popularity of housing in satellite towns is attributable to growing focus on affordable housing options among buyers amid reduced disposable income.

All Values in Kshs Unless Stated Otherwise)

Residential Market Performance Summary FY'2020

Segment	Average Price per SQM	Average Rent per SQM	Average Occupancy	Average Annual Uptake	Average Rental Yield	Average Price Appreciation	Annual Total Returns
Detached Units							
High-End	195,524	720	82.9%	17.3%	3.8%	0.6%	4.4%
Upper Mid-End	135,403	597	86.3%	16.5%	4.5%	(0.3%)	4.2%
Satellite Towns	75,610	306	81.8%	17.0%	3.9%	0.1%	4.0%
Average	**135,512**	**541**	**83.7%**	**16.9%**	**4.1%**	**0.1%**	**4.2%**
Apartments							
Upper Mid-End	123,608	697	83.7%	20.3%	5.2%	0.0%	5.2%
Lower Mid-End	95,310	530	88.1%	22.3%	5.8%	(0.9%)	4.9%
Satellite Towns	75,187	408	85.8%	22.5%	6.0%	(0.6%)	5.5%
Average	**98,035**	**545**	**85.9%**	**21.7%**	**5.7%**	**(0.5%)**	**5.2%**
Residential Market Average	**116,774**	**543**	**84.8%**	**19.3%**	**4.9%**	**(0.2%)**	**4.7%**

· ***Average annual total returns came in at 4.7%, 1.4% points lower than 6.1% recorded similar period in 2019. Consequently, rental yields recorded a 0.1% points marginal drop from 5.0% in 2019% to 4.9% in 2020 due to reduced rental rates.***

Cytonn Research 2020

Our outlook for the residential sector is NEUTRAL supported by the continued launch of affordable housing projects, and, operationalization of the Kenya Mortgage and Refinance Company (KMRC) to provide the much needed mortgage facilities aimed at increasing home ownership. However, we expect the tough economic environment to continue affecting transaction volumes. For detached units, investment opportunity lies in areas such as Rosslyn, Ridgeways and Ruiru while for apartments, investment opportunity lies in satellite towns such as Thindigua and Syokimau, as well as the upper mid-end segment in areas such as Kilimani.

II. Commercial Office Sector

The commercial office sector recorded an average rental yield and occupancy rate of 7.0%, and 77.7%, lower than the 7.5% and 80.3% recorded in 2019, respectively. The decline in the rental yields and occupancy rates is attributable to reduced demand of commercial spaces brought about by the ongoing COVID-19 pandemic as some businesses restructured their operations hence scaled down while other organizations adopted work from home strategies. The asking rents also declined by 3.2% to an average of Kshs 93 per SQFT in 2020 from Kshs 96 per SQFT in 2019 while the average asking price declined by 2.9% to Kshs 12,280 per SQFT in 2020 from Kshs 12,638 per SQFT in 2019. The decline in rates is attributable to discounts or concessions offered by landlords in a bid to cushion their clients amid a tough financial environment.

The table below highlights the performance of the Nairobi Metropolitan Area (NMA) Commercial Office sector over time;

(All values in Kshs unless stated otherwise)

Nairobi Metropolitan Area (NMA) Commercial Office Returns Over Time

Year	Q1' 2019	H1' 2019	Q3' 2019	FY' 2019	Q1'2020	H1"2020	Q3' 2020	FY'2020	Δ FY'2019/FY '2020
Occupancy %	82.4%	81.0%	80.5%	**80.3%**	81.7%	80.0%	79.9%	**77.7%**	**(2.6%) points**
Asking Rents (Kshs/SQFT)	100	97	96	**96**	97	95	94	**93**	**(3.2%)**
Average Prices (Kshs/SQFT)	12,574	12,637	12,638	**12,638**	12,535	12,516	12,479	**12,280**	**(2.9%)**
Average Rental Yields (%)	8.0%	7.8%	7.7%	**7.5%**	7.8%	7.3%	7.2%	**7.0%**	**(0.5%) points**

· *The commercial office sector has seen major declines in the occupancy rates, asking prices, asking rents and average rental yields attributable to reduced uptake and demand for commercial spaces, and pressure on landlords to reduce the rental charges to attract clients and maintain the existing clients, additionally, the existing oversupply of commercial spaces of 6.3 mn SQFT as at 2019 has also affected the performance of the sector.*

Source: Cytonn Research 2020

Our outlook for the NMA commercial office sector is NEGATIVE attributed to the reduced demand for commercial spaces brought about by the COVID-19 pandemic amid the tough economic environment as some firms downsize due to financial constrains while others embrace the working from home strategy. The asking prices and rents are also expected to decline as landlords continue giving discounts and concessions to attract and retain clients. Currently the best areas for investments in commercial spaces are Gigiri, Westlands, and, Karen with relatively high returns compared to the market averages in addition to availability of high quality spaces suitable for the high-end and middle income clients.

III. Retail Sector

The retail sector performance recorded a 0.3% decline in rental yields to 7.5% in 2020 from 7.8% in 2019. The average occupancy dropped by 0.7% points from 75.9% in 2019 to 75.2% in 2020, while the average monthly rental rates declined by 4.1% to Kshs 169 per SQFT from Kshs 176 per SQFT in 2019. The general decline in performance in 2020 is as a result of; i) exit by some retailers, both local and international to cushion themselves against the pandemic, ii) reduced demand for physical retail spaces as a result of the shifting focus to e-commerce by some retailers, iii) reduced consumer spending attributed to the tough economic environment, and, iv) the current existing oversupply in the retail sector of 2.0 mn SQFT in the Kenyan retail market and 3.1 mn SQFT in the NMA Metropolitan Area.

The table below shows the performance of the retail sector in Nairobi over time;

(All values in Kshs unless stated otherwise)

Summary of NMA Retail Sector Performance Over Time

Item	Q1' 2019	H1' 2019	Q3' 2019	FY' 2019	Q1'2020	H1'2020	Q3'2020	FY'2020	Δ FY'2020
Average Asking Rents (Kshs/SQFT)	174	170	167	**176**	173	170	169	**169**	**(4.1%)**
Average Occupancy (%)	76.8%	75.6%	74.5%	**75.9%**	76.3%	74.0%	74.20%	**75.2%**	**(0.7%) Points**
Average Rental Yields	8.5%	8.2%	8.0%	**7.8%**	7.7%	7.4%	7.4%	**7.5%**	**(0.3%) points**

• The performance of the NMA retail sector softened recording declines in average rents by 4.1% to Kshs 169 per SQFT in 2020 from Kshs 175.6 per SQFT in 2019
• The average occupancy rates also decreased by 0.7% points to 75.16% in 2020 from 75.9% in 2019

Source: Cytonn Research 2020

Other notable highlights during the year included; see our previous reports Cytonn Q1' Markets Review, H1'2020 Markets Review, and, Cytonn Q3'2020 Market Review. For Q4'2020;

?. Big Square, a local 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. For more information, please see Cytonn Weekly #41/2020,
i. Naivas Supermarket opened several braches among them; Rongai Branch, Lifestyle Mall Branch in Nairobi CBD, Hazina Towers, and, Ananas Mall in Thika town bringing the total number of outlets 69 with 8 outlets opened during the year thus completing the series of outlets they had initially announced that will be opened earlier this year. For more information, see Cytonn Weekly #51/2020 , Cytonn Weekly #48/2020, and, Cytonn Weekly #42/2020,
ii. QuickMart, local retail chain, opened an outlet in Nanyuki Mall situated in Nanyuki town, bringing the total number of Quickmart's outlets to 35, with 6 outlets opened in 2020. For more analysis, see Cytonn Weekly #46/2020,
iii. Tuskys Supermarket a local retail chain, shut down five of its branches namely; Tuskys Magic branch in Nakuru Town, Tuskys Pioneer on Moi Avenue Street in Nairobi, Adams Arcade branch on Ngong Road and the Kitengela branch, Tuskys Shiloah Kakamega Branch. The retailer also announced plans to close down half of its branches, in an attempt to stabilize operations amid financial woes. For more analysis, see Cytonn Weekly #45/2020, Cytonn Weekly #47/2020, Cytonn Monthly-October 2020, and, Cytonn Weekly #43/2020, and,
iv. Carrefour Supermarket, opened its first outlet in Mombasa County at City Mall in Nyali, bringing its total number of operational outlets to 9 countrywide. For more information, see Cytonn Monthly-November 2020,

The table below shows the summary of the number of stores of the key local and international retail supermarket chains in Kenya as at December 2020;

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	8	0	69	0	69
Tuskys	64	2	14	52	27	25
QuickMart	29	6	0	35	0	35

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
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**	**19**	**127**	**194**	**31**	**171**

Source: Online Research

We have a NEUTRAL outlook for the Kenyan retail sector with factors such as; i) reduced demand for physical space due to shifting focus to online shopping, ii) reduced purchasing power among consumers amid a tough economic environment, iii) reduced rental rates as landlords offer rental concessions to retain tenants and exit by some local retailers such as Tuskys, affecting the performance of the sector. However, continued expansion by local and international retail chains is expected to cushion the performance of the retail sector 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, iv) the growing middle class with increased purchasing power.

IV. Mixed-Use Developments (MUDs)

In 2020, Mixed-Use Developments recorded average rental yields of 7.1%, 0.3% points higher than the respective single use retail, commercial office and residential themes with 6.8%. retail, offices and residential spaces in MUDs recorded rental yields of 7.8%, 7.3% and 6.2%, respectively, compared to the single-use average of 7.5%, 7.2%, and 5.6%, respectively. The relatively better performance by MUDs is attributed to the prime locations, mostly serving the high and growing middle class supported by the concept's convenience as it incorporates working, shopping and living experience.

Westlands was the best performing node recording an average MUD yield of 8.5% with the retail, office and residential spaces recording rental yields of 9.8%, 8.2% and 7.0%, respectively, 2.0%, 0.9% and 0.8% points higher than the sector averages of 7.8%, 7.3% and 6.2%, respectively. The performance was driven by the prime office and retail spaces, in addition to Westlands being a prime commercial node with high demand for commercial and residential space supported by the improved infrastructure; i.e., construction of the Nairobi Expressway along Waiyaki Way which will increase business activities in the area.

Eastlands was the worst performing node recording an average rental yield of 5.5% attributed to low rental charges attributable to unavailability of quality space and relatively high competition from informal Mixed-Use Developments.

The table below shows the performance of Mixed-Use Developments by node in 2020:

(All values in Kshs Unless stated otherwise)

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	Retail Performance				Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occupancy (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occupancy %)**	**Rental Yield (%)**	**Price/SQM**	**Rent/SQM**	**Annual Uptake %**	**Rental Yield %**	**Average MUD yield**
Westlands	15,833	178	70.8%	9.8%	12,667	117	73.3%	8.2%	211,525	1,226	24.5%	7.0%	8.5%
Limuru Rd	23,900	223	85.0%	9.5%	13,500	130	65.0%	7.5%	147,496	1,166	20.0%		7.3%
Karen	23,333	143	88.5%	6.7%	13,200	123	80.0%	9.0%					7.3%
Kilimani	17,400	143	75.0%	7.5%	13,250	108	68.8%	6.6%					7.2%
UpperHill	15,485	120	65.0%	6.0%	12,500	107	65.0%	6.7%					6.6%
Msa Rd	20,000	150	70.0%	6.3%	13,000	100	70.0%	6.5%	157,440	874	14.3%	6.7%	6.5%
Thika Rd	26,250	200	85.0%	8.5%	13,750	105	64.0%	5.9%	143,803	705	22.5%	5.9%	6.4%
Eastlands	20,000	110	80.0%	5.3%	12,000	100	55.0%	5.5%	72,072	333	18.0%	5.6%	5.5%
Average	**18,857**	**157**	**75.7%**	**7.8%**	**12,957**	**112**	**69.9%**	**7.3%**	**146,023**	**835**	**20.3%**	**6.2%**	**7.1%**

- ***Westlands was the best performing node recording an average MUD yield of 8.5% with the retail, office and residential spaces recording rental yields of 9.8%, 8.2% and 7.0%, respectively, 2.0%, 0.9% and 0.8% points higher than the sector averages of 7.8%,7.3% and 6.2%, respectively***
- ***Thika Road and Eastlands were the worst performing areas recording yields of 6.4% and 5.5%, respectively attributed to low rental charges as a result of competition from informal Mixed-Use Developments***

Source: Cytonn Research 2020

The outlook for Mixed-Use Developments (MUDs) is NEUTRAL supported by the relatively high returns offered by the residential spaces amid subdued performance of the retail and office themes mainly constrained by oversupply 0f 3.1 mn SQFT and 6.3mn SQFT of retail and office spaces, respectively, within the Nairobi Metropolitan Area. The investment opportunity within the Nairobi Metropolitan Area lies in areas with relatively high returns such as Westlands which recorded an average MUD rental yield of 8.5%, and, Limuru Road and Karen recording average MUD yields of 7.3% each.

V. Hospitality Sector

During the year, the hospitality sector recorded subdued performance attributed to the COVID-19 pandemic which resulted in reduced demand. The sector's contribution to GDP through accommodation and food services declined by 83.3% during the second quarter of 2020 compared to an expansion of 12.1% during the same period in 2019, according to the KNBS Quarterly Gross Domestic Product Report -Q2'2020,. The total number of international arrivals through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) recorded a 71.5% decline from 1.2 mn persons between January to September 2019 to 0.3 mn during the same period in 2020. However, this was an increase from 13,919 persons in August 2020 to 20,164 persons in September 2020.

In terms of developments, 106-room Emara Hotel Ole Sereni located along Mombasa Road came into the market this year as a key accommodation facility targeting visitors landing through the Jomo Kenyatta International Airport. Hyatt, a US-based hospitality chain announced plans to build a 225-room facility in Nairobi along Mombasa road, marking the brand's entry into the Kenya hospitality market. Additionally, Accor Hotels announced that they would continue with their expansion plans in Kenya and the African region despite the COVID-19 pandemic affecting the sector. The entry and expansion plans by the various brands signals investor confidence in the Kenya's hospitality industry despite being one of the hardest hit by the COVID-19 pandemic.

In terms of performance, we tracked the performance of serviced apartments in 7 nodes in the Nairobi Metropolitan area. According to the Nairobi Metropolitan Area Serviced Apartments Report, serviced apartments recorded subdued performance in 2020 with the average rental yields declining by 3.6% points to 4.0% in 2020 from 7.6% in 2019. The decline in performance is attributed to low demand due to the decline in the number of tourist arrivals. The occupancy rates also declined by 31.3% points to 48.0% from 79.4% while the monthly charges per SQM declined by 14.9% from Kshs 2,806 to Kshs 2,448 as facilities offer discounts to attract and maintain clients amid a tough economic environment.

The table below shows market performance summary;

(All values in Kshs Unless Stated Otherwise)

NMA Serviced Apartments performance 2020

Node	Occupancy 2019	Occupancy 2020	Occupancy rates Δ	Monthly Charge per SQM (Kshs) 2019	Monthly Charge per SQM (Kshs) 2020	% Change of Monthly Charges	Rental Yield 2019	Rental Yield 2020	Δ in Rental Yield
Westlands& Parklands	80.8%	49.4%	**(31.4%)**	3,884	3,578	**(8.6%)**	10.8%	**6.1%**	**(4.7%)**
Kilimani	80.0%	48.4%	**(31.6%)**	3,353	2,783	**(20.5%)**	9.5%	**4.8%**	**(4.7%)**
Limuru Road	88.2%	51.4%	**(36.8%)**	3,430	2,839	**(20.8%)**	9.4%	**4.5%**	**(4.8%)**
Kileleshwa& Lavington	82.4%	48.1%	**(34.3%)**	2,845	2,553	**(11.4%)**	8.2%	**4.3%**	**(3.9%)**
UpperHill	67.8%	48.9%	**(18.9%)**	2,577	2,121	**(21.5%)**	6.0%	**3.6%**	**(2.4%)**
Nairobi CBD	72.0%	42.1%	**(29.9%)**	2,230	2,122	**(5.1%)**	5.1%	**2.9%**	**(2.2%)**
Thika Road	84.4%	48.1%	**(36.3%)**	1,321	1,138	**(16.1%)**	4.0%	**2.0%**	**(2.0%)**
Average	**79.4%**	**48.0%**	**(31.3%)**	**2,806**	**2,448**	**(14.9%)**	**7.6%**	**4.0%**	**(3.6%)**

Source: Cytonn Research 2020

Our outlook of the hospitality sector is NEUTRAL. Despite the sector being the hardest hit by the COVID-19 pandemic, it has begun to gradually recover supported by financial aid from government through the Post-Corona Hospitality Sector Recovery Stimulus by the Ministry of Tourism through the Tourism Finance Corporation (TFC) and other international agencies, repackaging of the tourism sector to appeal to domestic tourists and relaxation of travel advisories. We expect this to fuel resumption of activities and resultant improved performance in the medium term.

VI. Land Sector

The NMA land sector remained resilient in 2020 despite the tough economic environment evidenced by a 2.3% annual capital appreciation and 10.7% 9-year CAGR, indicating that investors still consider land a good investment asset in the long term. Asking land prices within satellite towns outperformed asking land prices in Nairobi suburbs recording an average annual capital appreciation of 5.4% and 0.2%, respectively, attributable to affordability of the former amid reduced disposable income amid economic slowdown, availability of land in bulk and the improving infrastructure opening up areas for development.

The table below shows the summary of the NMA land performance;

(All values in Kshs Unless Stated Otherwise)

NMA Land Performance Trend

Location	*Price in 2011	*Price in 2017	*Price in 2018	*Price in 2019	*Price in 2020	9 Year CAGR	Annual Capital Appreciation 2019/'20
Unserviced land- Satellite Towns	9.0 mn	20.4 mn	22.7 mn	24.9 mn	26.8 mn	12.9%	**7.1%**
Serviced land- Satellite Towns	6.0 mn	14.4 mn	14.3 mn	14.3 mn	14.8 mn	10.6%	**3.8%**
Nairobi Suburbs - Low Rise Residential Areas	56.0 mn	82.4 mn	89.4 mn	91.6 mn	93.8 mn	5.9%	**3.2%**

NMA Land Performance Trend

Location	*Price in 2011	*Price in 2017	*Price in 2018	*Price in 2019	*Price in 2020	9 Year CAGR	Annual Capital Appreciation 2019/'20
Nairobi Suburbs - High Rise residential Areas	46.0 mn	134.6 mn	135.0 mn	137.5 mn	135.7 mn	12.8%	**1.2%**
Nairobi Suburbs - Commercial Areas	156.0 mn	429.8 mn	447.3 mn	428.5 mn	413.0 mn	11.4%	**(3.8%)**
Average	**54.6 mn**	**144.5 mn**	**155.4 mn**	**139.4 mn**	**136.8 mn**	**10.7%**	**2.3%**

Source: Cytonn Research 2020

We have a POSITIVE outlook for the land sector with the performance being cushioned by; (i) the growing demand for development land especially in the satellite towns as developers strive to drive the government's Big Four government agenda on the provision of affordable housing, (ii) improving infrastructure, and (iii) demand for development land by the growing middle-income population.

VII. Statutory Review

In 2020, various statutory reforms were made to facilitate home ownership and simplify land and property transactions, and we expect the changes to impact the real estate sector positively. Notable highlights during the year see our previous reports Cytonn Q1' Markets Review, H1'2020 Markets Review, and, Cytonn Q3'2020 Market Review. For Q4'2020;

i. The president of Kenya, Uhuru Kenyatta signed into law the Sectional Properties Act 2019, and, the Statute Law (Miscellaneous Amendments) 2020 bill.

- The new Sectional Properties Act, 2019 which repeals the Sectional Properties Act of 1987, provides for the division of buildings into units to be owned by individual proprietors and common property to be owned by proprietors of the units as tenants in common and to provide for the use and management of the units and common property and for connected purposes;
- The Statute Law (Miscellaneous Amendments) 2020 Act on the other hand includes; Amendment of the Housing Act (Cap.117) to remove the mandatory nature of contributions to the National Housing Development Fund, and, Amendment of The Kenya Roads Board Act 1999 (No.7 of 1999) to include a minimum number of days the board can hold every year at 4 days in a year hence departing from the current provision where the board is required to hold meetings every month For more information, see Cytonn Weekly #51/2020.

VIII. Infrastructure Sector

Notable highlights for the infrastructure sector during the year see our previous reports Cytonn Q1' Markets Review, H1'2020 Markets Review, and, Cytonn Q3'2020 Market Review. For Q4'2020;

?. The Kenyan government through the Kenya Rural Roads Authority, a state corporation within the State Department of Infrastructure, commenced the tarmacking of the first 7.0 km of Juja Farm Road in Kiambu County at a cost of Kshs 3.9 bn. The road is part of Kshs 30.0 bn Mau Mau roads that are being constructed in Murang'a, Nyeri and Kiambu Counties and set for completion in six months starting November. For more information, see Cytonn Weekly #45/2020, and,

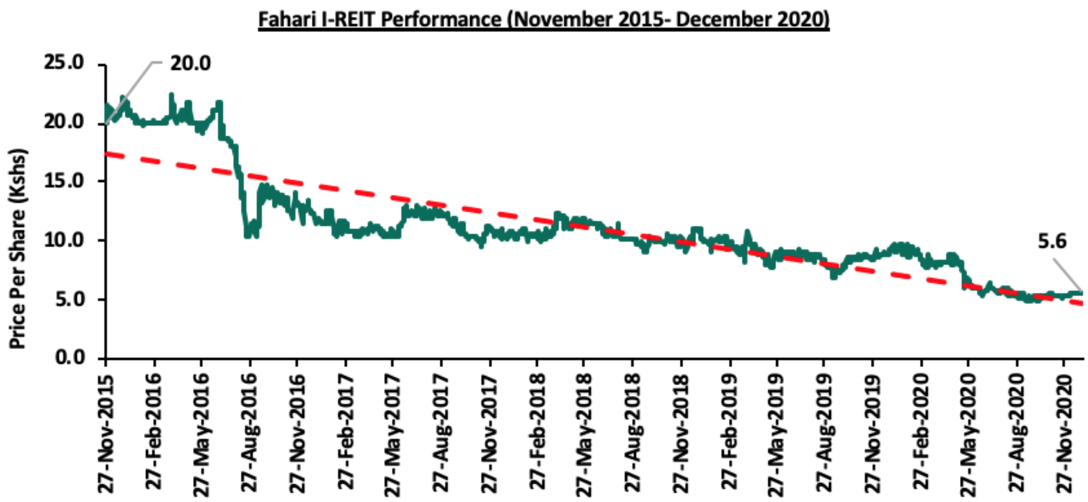
i. Kenya Urban Roads Authority (KURA), announced plans to construct two elevated carriage ways in the Nairobi Central Business District (CBD). The Kshs 2.9 bn project which has been assigned to China Road and Bridge Corporation will take shape after the completion of the Nairobi Expressway which is currently under construction by the Kenya National Highways Authority (KENHA), and is expected to be completed by 2023. For more information, see Cytonn Weekly #48/2020.

Despite the reduced budget allocation for the infrastructure sector with funds being redirected to dealing with the COVID-19 pandemic, the government continues to implement select projects and we expect this to open up areas for developments upon their completion thus boosting the real estate sector.

IX. Listed Real Estate & D-REITs

The Fahari I-REIT closed the year 2020 at Kshs 5.6 per share, trading at an average of Kshs 6.7 during the year compared to Kshs 8.9 in 2019. On a Year-to- date basis, the REIT recorded a 41.7% loss of value from Kshs 9.6 recorded in January 2020, and a 72.0% drop from its initial price of Kshs 20.0 as at November 2015. The REIT market continues to perform poorly attributable to; i) the subdued performance of the real estate market, ii) insufficient institutional grade real estate assets, iii) lack of investor appetite in the instrument, and iv) negative investor sentiments.

The graph below shows the historic performance of the I-REIT since listing;



During the year, Acorn holdings, a real estate developer, announced plans to establish a D-REIT and an I-REIT in the next 3 years with an expected Internal Rate of Return of 18.0%. In line with the same, in November 2020, Acorn Investment Management Limited, a subsidiary of Acorn Holdings, was licensed as a REIT Manager by the Capital Markets Authority (CMA). This was followed by the Authority's approval on the issuance of The Development Real Estate Investment Trust (D-REIT) and Investment Real Estate Investment Trust (I-REIT) in December the same year. 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 sought 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. By October, the firm had secured Kshs 1.0 bn equity investment from one of its anchor investor, InfraCo, a private infrastructure development group. The D-REIT is expected to finance the student hostels whereas the I-REIT will be used to acquire property for rental income.

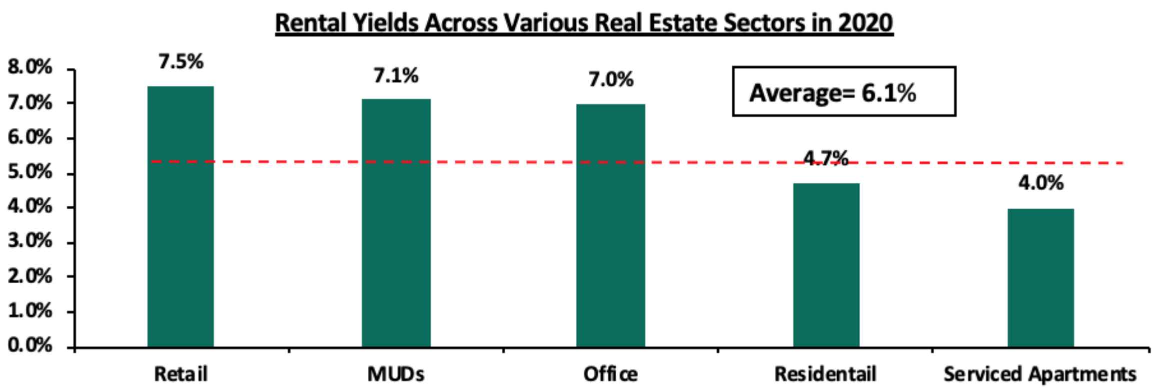
The D-REIT market in Kenya has failed to take off despite the regulations having come into force in 2013. The Fusion Capital D-REIT, which was issued in 2016, failed due to low subscription rates; the Cytonn D-REIT faced delays in approvals given the high levels of capital required for a Corporate Trustee, of at least Kshs. 100m, leading the promoter to discontinue the effort. The poor performance of the D-REITs is attributed to several factors: (i) the high minimum investment amounts set at Kshs 5.0 mn that is over 100x the median income in Kenya, (ii) high minimum capital requirement for a trustee at Kshs 100.0 mn that reduces the pool of approved REIT Trustees, which is currently just three, namely; Housing Finance, Cooperative Bank and KCB Bank, and, (iii) lengthy approval process. Without addressing the two regulatory frameworks, DREITs will continue to be a mirage and there will be continued lack of capital to support housing development.

For more analysis see Cytonn Weekly#50/2020.

Our outlook for the REIT market is NEGATIVE due to the continued poor performance of the REIT market. However, we are of the view that for the REIT market to pick, some of the supportive framework that can be put in place include; i) broadening the pool of trustees by reducing the minimum capital requirement which currently stands at Kshs 100.0 mn, ii) Reducing the minimum investment amount for real state finance vehicles which is currently Kshs 5.0 mn, and, iii) removing the intense conflicts of interest between the governance of the Capital Markets Authority (CMA) and the fund structures so that there is more tolerance to constructive feedback.

Overall, our outlook on the real estate sector is NEUTRAL. We expect the real estate sector performance to record improvement in 2021 supported by launch of affordable housing projects, the Kenya Mortgage and Refinance Company (KMRC) providing relatively cheap mortgage to facilitate increase in home ownership, expansion of local and international retailers, the government's post-COVID stimulus package set to boost performance of the hospitality sector, and, improvement of infrastructure opening up areas for investment. The sector will however continue to experience constraints such as oversupply of 6.3mn SQFT of office space 3.1mn SQFT of retail space and sluggish performance of the REIT market.

The graph below is a summary of real estate performance in terms of rental yields in 2020;



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