Cytonn 2021 Markets Outlook

Real Estate Outlook

In 2020, the real estate sector recorded moderate activities with a general decline in transactions attributed to the tough economic environment in the wake of the Covid-19 pandemic that had adverse effects on the sector. The effects of the pandemic were mainly felt in the sector from Q2'2020 with the real estate and construction recording a growth of 6.1% down from 13.2% growth recorded in Q2'2019.

The main factors that constrained performance of the real estate sector included;

i. Constrained financing to developers due to the increased perceived risk levels,
ii. Business restructuring with some firms downsizing hence reducing occupancies and overall rental yields, and,
iii. Travel restrictions, attributed to the COVID-19 pandemic that led to a near cessation of international flights in a bid to minimize the spread of the virus which mainly affected the performance of the hospitality sector.

Despite the sluggish growth, performance of the real estate sector was cushioned by;

i. Good demand given the positive demographics with Kenya's high urbanization and population growth rates currently standing at 4.0% and 2.2%, compared to the global averages of 1.9% and 1.1%, respectively,
ii. Continued launch of affordable housing projects,
iii. Improved access to mortgage loans especially through the Kenya Mortgage Refinancing Company (KMRC),
iv. Improved infrastructure opening up areas for investment, and,
v. Towards the end of the year, easing of travel restrictions as well the government's post-COVID stimulus packages boosting the hospitality sector.

In 2020, the real estate sector recorded moderate activities with a general decline in concluded transactions. There was a decline in the performance of all the sectors, 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.

The table below is a summary of thematic performance of average rental yields in 2020 compared to 2019;

Real Estate Thematic Performance- Average Rental Yields

Theme	Rental Yield FY'2020	Rental Yield FY'2019	Y/Y Change (% Points)
Residential	4.7%	5.0%	(0.3%)
Commercial Office	7.0%	7.5%	(0.5%)
Retail	7.5%	7.8%	(0.3%)
Mixed Use Developments (MUDs)	7.1%	7.3%	(0.2%)

Real Estate Thematic Performance- Average Rental Yields

Theme	Rental Yield FY'2020	Rental Yield FY'2019	Y/Y Change (% Points)
Serviced Apartments	4.0%	7.6%	(3.6%)
Grand Average	6.1%	7.0%	(0.9%)

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 amid a tough economic environment, as well as oversupply of approximately 6.3 mn SQFT of office space and 3.1 msn SQFT of retail space in the wake of reduced demand for physical space in the two sectors. For a detailed review of 2020 performance, see our Real Estate Annual Markets Review 2020 Note.

In 2021, we expect the key drivers of real estate to be:

i. The Affordable Housing Initiative: Increased activities are expected on the affordable housing front despite the reduced budget allocation in the FY'2020/21 National Budget, with an allocation of Kshs 6.9 bn, 34.3% lower than the Kshs 10.5 bn allocated in 2019/2020. The Kenyan Government through the Nairobi Metropolitan Service has so far launched phase two of the affordable housing programme in ten city estates under the Nairobi Urban regeneration project while other affordable housing projects such as Shauri Moyo, Makongeni and Starehe houses are underway,
ii. Infrastructural development: The government continues to implement select projects such as the Nairobi Express way, Nairobi-Western Bypass, Lamu Port and Lamu-Southern Sudan-Ethiopia Transport Corridor Project (LAPSSET), and, Mombasa Port Development Project and we expect these to open up areas for developments upon their completion thus boosting the real estate sector,
iii. Attractive Demographic Profile: Kenya has a relatively high population and urbanization growth rate of 4.0% and 2.2% against a global average of 1.9% and 1.1% according to the World Bank, and this is expected to continue to support demand in the real estate sector,
iv. Attractiveness of Kenya as a regional hub due to ease of doing business in Kenya: Kenya has been ranked position #56 by World Bank in the ease of doing business index. This is likely to boost investor confidence in Kenya thus driving foreign direct investment which is likely to boost the performance of the real estate especially on the infrastructure, commercial and retail sectors,
v. Gradual Recovery of the Tourism Industry: The gradual recovery of the tourism industry is expected to boost the hospitality sector supported by financial aid from government through the Post-Corona Hospitality Sector Recovery Stimulus package offered by the Ministry of Tourism through the Tourism Finance Corporation (TFC), repackaging of the tourism sector to appeal to domestic tourists and relaxation of travel advisories, and,
vi. Provision of Affordable Mortgage Loans by Kenya Mortgage Refinance Corporation (KMRC): The establishment of the KMRC is expected to boost the mortgage market in Kenya through lending at relatively low interest rates of 5.0% to Primary Mortgage Lenders (PML's) enabling them to write off loans at an interest rate of 7.0% which is lower than the current average interest rate of 12.0%.
vii. E-commerce: As a result of the government's guidelines on social distancing due to the coronavirus pandemic retailers embraced online shopping evident by 8.6% growth in internet subscription rates according to Economic Survey 2020.This has further been enabled by mobile wallets gaining popularity, hence making online shopping more convenient. E-commerce is also supported by most businesses scaling down on physical retail space to reduce expenses amid tough economic times.

Despite the above drivers, the sector is expected to be constrained by the following factors in 2021:

i. Oversupply in Select Sectors: The real estate sector has witnessed increased space supply over the last 5-years and this is likely to affect the demand of some of these sectors. Some of the affected sectors include;

a. The commercial office sector which has an oversupply of 6.3m SQFT, and,
b. The retail sector, which has an existing oversupply of 3.1 mn SQFT within Nairobi and 2.0 in the Kenya Retail market,

ii. Constrained Financing for Developers: Constrained financing to developers is a factor that is expected to negatively impact the performance of the real estate sector as financiers such as banks aim to limit exposure amidst increasing loan deferrals and defaults in the wake of the pandemic,
iii. Reduced Disposable Income: Reduced disposable income as a result of the tough economic times brought about by the COVID-19 pandemic is expected to affect uptake of property thus impacting on the performance of the real estate market,
iv. Kenya Mortgage and Refinance Company facing a challenge in limitation of housing options: Given the relatively low loan size of Kshs 4.0 for property within the Nairobi Metropolitan Area, potential homeowners will have few or no options of housing units within the NMA due to the relatively high property prices and low supply of affordable housing units thus forcing them to focus on housing units within satellite towns which are relatively affordable,
v. Ineffectiveness of Public-Private Partnerships (PPPs) for Housing Development: This will continue to cause delays in delivery of affordable housing projects due factors such as to 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, lack of clarity on returns and revenue-sharing, bureaucracy and slow approval processes.

The table below summarizes our outlook on the various real estate themes and the possible impact on the business environment in 2021;

Thematic Performance Review and Outlook

Thematic Performance Review and Outlook

Theme	2020 Performance	2021 Outlook	Effect
Residential Sector	• 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	• We expect total returns to investors to improve in 2021 following gradual recovery of the economy which will see improved rental rates and capital appreciation of existing properties • Continued launch of affordable housing projects and availability of affordable mortgage facilities is expected to cushion the performance • The investment opportunity for apartments in satellite towns such as Thindigua and Syokimau, as well as the upper mid-end segment in areas such as Kilimani. For detached units, opportunity lies in investment opportunity lies in areas such as Rosslyn, Ridgeways and Ruiru	Neutral
Commercial Office Sector	• The commercial office sector recorded a decline of 2.6% and 0.5% points in average occupancy rates, and rental yield to 77.7%, and 7.0% in 2020 from 80.3% and 7.5%, respectively in FY'2019 • The decline in the rental yields and occupancy rates was attributed to reduced demand of commercial spaces as businesses restructure their operations hence scaling down while other organizations adopt the work from home strategies thus reducing the need for occupying larger office spaces	• We forecast a decline of the average rental yield to 6.8% from 7.0% in 2020 attributable to the oversupply with the average occupancy rates expected to decline by 2.7% points from 77.7% to 75.0% • The subdued performance is attributable to reduced demand in the office spaces as businesses scale down due to financial constrains while others adopt the working from home strategy • Investment opportunity lies in Karen, Gigiri and Westlands which continue to have relatively high returns compared to the market averages	Negative

Thematic Performance Review and Outlook

Theme	2020 Performance	2021 Outlook	Effect
Retail Sector	• The retail sector performance recorded a 0.3% decline in rental yields to 7.5% in FY'2020 from 7.8% in FY'2019, attributable to; i) reduced demand for physical retail spaces as a result of the shifting focus to e-commerce by some retailers, ii) reduced consumer spending attributed to the tough economic environment, and, iii) the current existing oversupply in the retail sector of 3.1 mn SQFT in the Nairobi Metropolitan Area	• We expect a drop in retail rental yields by 0.6% points as a result of the retail space oversupply currently at 3.1mn SQFT within the Nairobi Metropolitan Area • We expect occupancy rates to decline by 4.2% points to 71.0% and rents to soften by 2.5% to Kshs 165 from Kshs 169 in 2020 • We forecast continued expansion efforts by both local and international retailers such as Quickmart, Carrefour, Naivas etc, due to attractive rents and prime vacant spaces left by troubled retailers such as Tuskys and Nakumatt • The opportunity remains in county headquarters in some markets such as Kiambu and Mt. Kenya that have retail space demand of approximately 0.6mn and 0.7mn SQFT, respectively	Neutral
Hospitality Sector	• In 2020, Serviced apartments within the NMA recorded an average rental yield of 4.0% in 2020, 3.6% points lower than the 7.6% recorded in 2019 attributed to declines in monthly charges per SQM and occupancies from Kshs 2,806 to Kshs 2,445 and from 79.4% to 48.0%, respectively • The decline in performance is attributable to subdued demand for hospitality facilities and services due to the COVID-19 pandemic which has brought about declines in the international arrivals which have affected the performance of the tourism sector	• The hospitality sector has begun to gradually recover supported by reopening of key tourism markets, financial aid from the 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 support the performance of the hospitality sector in the medium term	Neutral
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	• In 2021, we expect an annual capital appreciation of 1.7% fuelled by; (i) the growing demand for development land especially in satellite towns, (ii) improving infrastructure with implementation of select projects such as the expansion of Waiyaki Way and ongoing Nairobi expressway, and (iii) positive demographics • For 2021, the investment opportunity within the Nairobi Metropolitan Area land sector lies in satellite towns such as Limuru, Thika and Athi River; and suburbs such as Ridgeways and Kasarani supported by the relatively high annual capital appreciation of above 8.0%	Positive
Infrastructure Sector	• The sector witnessed the launch of major infrastructural projects in 2020 in line with the country's economic expansion goals to make Kenya the African hub for transportation, industrial, and service sectors • Despite the reduced budget allocation to the sector, the government launched projects such as the Nairobi Express way, two elevated carriage ways expected to link Nairobi CBD to Ngong Road, tarmacking of the first 7.0 km of Juja Farm Road, and, the Mombasa Port Development Project	• We expect the government to continue implementing select projects thus opening up areas for development and boosting property value • However, the reduced revenue allocation of Kshs 172.4 bn, 60.4% lower than the 435.1 bn allocated in the 2019/2020 budget, is expected to slow down implementation activities • Some of the key projects expected to be implemented in 2021 include; the Nairobi Express Way and the Two Carriage Ways expected to link Nairobi CBD to Ngong Road	Neutral

Thematic Performance Review and Outlook

Theme	2020 Performance	2021 Outlook	Effect
Listed Real Estate	• The Fahari I-REIT continued to perform poorly closing the year 2020 at Kshs 5.6 per share, and trading at an average of Kshs 6.7 during the year, compared to Kshs 8.9 in 2019, a 66.5% decline from its initial price of Kshs 20.0 with lows of up to Kshs 5.0 in Q3'2020, the lowest since the I-REIT's inception in 2015 • The REIT market continued 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. • 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%	• We expect listed real estate to continue performing poorly in 2021 with the Fahari I-Reit having opened the year at a relatively low trading price of Kshs 5.8 per share coupled with the expected negative performance of the office sector and lack of investor appetite in the instrument due to negative investor sentiments • We expect the D-Reit market to be constrained by; (i) 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, and (ii) the high levels of capital required of a Trustee at Kshs. 100m	Negative

Out of the seven sectors, the outlook is positive for one sector-land; neutral for four sectors-residential, retail, hospitality and infrastructure; and, negative for two sectors-commercial offices and listed real estate. Therefore, the overall outlook for the real estate sector is NEUTRAL, supported by; continued focus on the affordable housing initiative, the operationalization of KMRC, 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 within the NMA of retail space and sluggish performance of the REIT market.

For the detailed real estate market outlook report, see our Real Estate Sector 2021 Market Outlook Note.

Outlook Summary

Our outlook for Fixed Income is "neutral", and our view is investors should be bias towards short-term fixed income securities, in a bid to reduce duration risk. Our outlook for equities is "neutral", while our outlook for real estate is "neutral". In summary, our Outlook for 2021 Asset Classes is Neutral.

Key: Green – POSITIVE, Grey – NEUTRAL, Red – NEGATIVE

	Fixed Income & Equities Outlook for 2021
Fixed Income	Our view is that investors should be biased towards SHORT-TERM FIXED INCOME INSTRUMENTS to reduce duration risk. The political climate is expected to heat up earlier with the investors expected to retrieve to "Safer" asset classes – Fixed income securities, in the H2'2021 as they closely monitor the political situation. We anticipate upward pressure on interest rates as the government seeks to borrow more to fund infrastructural projects
Equities	We have a NEUTRAL outlook on the Kenyan Equities market in the short term but "POSITIVE" in the medium to long term. We expect an upward recover in earnings growth in 2021, supported by a relatively stable business operating environment, coupled with the improved investor sentiment to support positive performance in the equities market in 2021

Real Estate Outlook Summary

Real Estate Sector	The overall outlook for the real estate sector is NEUTRAL, supported by; continued focus on the affordable housing initiative, the operationalization of KMRC, 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