Unit Trust Fund Performance FY’2020, & Cytonn Weekly #18/2021

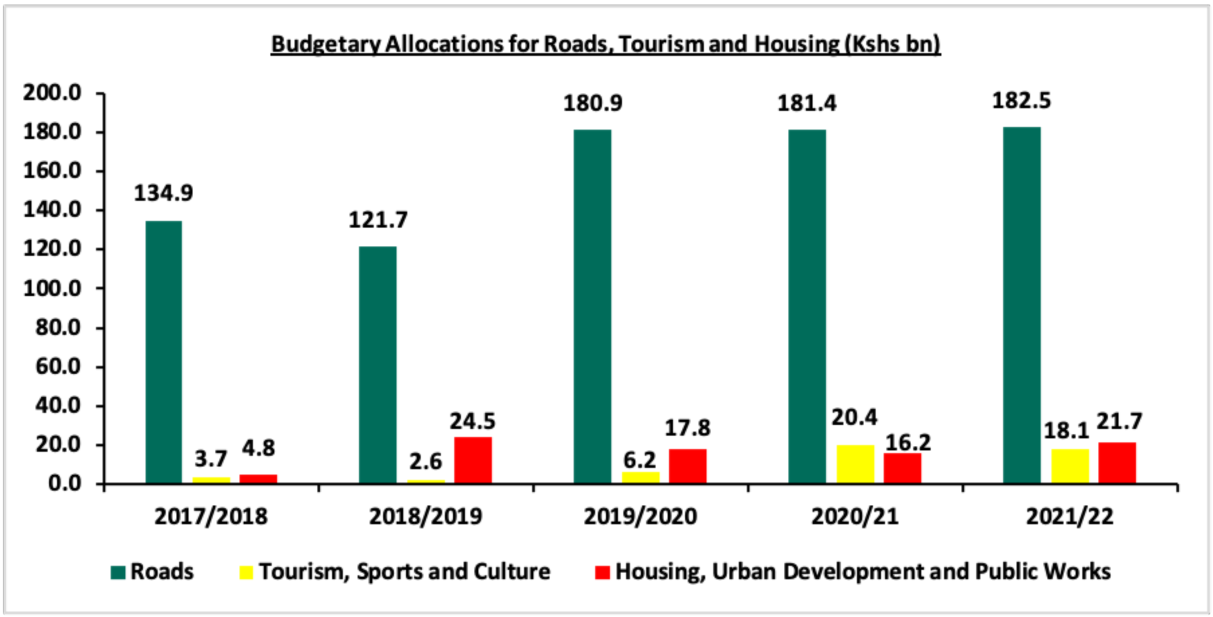
Real Estate

I. **Industry Reports**

With the budget set to be read, some of the key beneficiaries in the real estate sector include:

i. Roads received a total of Kshs 182.5 bn, with Kshs 92.3 bn allocated for construction of new roads and bridges while rehabilitation and maintenance works were allocated a total of Kshs 90.2 bn. The allocation for roads increased by 0.6% from Kshs 181.4 bn in FY’2020/21 to Kshs 182.5 bn in FY’2021/22 which is expected to make the real estate supply chain efficient and lower the transport costs for investors,
ii. Housing, Urban Development and Public Works received a total of Kshs 21.7 bn, a 33.9% increase from FY’2020/21 with Kenya Mortgage Refinance Company (KMRC) receiving Kshs 8.0 bn to fund affordable housing projects and Kshs 3.5 bn for operationalization with other key areas in the residential sector including construction of urban housing units and Kenya Informal Settlement Improvement Phase II receiving an allocation of Kshs 1.2 bn and Kshs 3.5 bn respectively. The affordable housing programs are expected to increase Kenyan home ownership percentages from the current 21.3% as at 2019 to level with its peers such as South Africa who had a 53.0% home ownership percentages at the same period, and,
iii. The tourism sector received a total allocation of Kshs 18.1 bn with the Tourism Promotion Fund (TPF) receiving Kshs 0.6 bn and Tourism Fund getting receiving Kshs 2.4 bn with other allocations going to improvements of supporting infrastructures. The allocation for the tourism sector decreased by 11.3% from Kshs 20.4 bn in FY’2020/21 to Kshs 18.1 bn in FY’2021/22 as the sector looks to bounce back gradually after being one the hardest hit sector by the COVID-19 pandemic.

The graph below shows comparison among road, tourism and housing budgetary estimate allocations in the last five fiscal years;

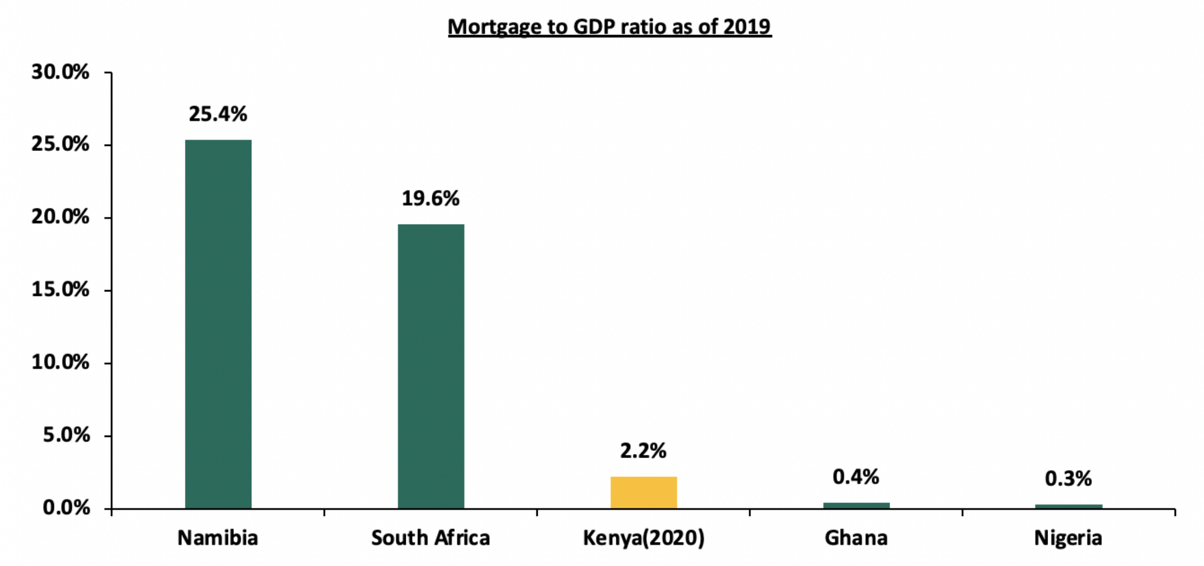


Source: National Treasury of Kenya

II. **Residential Sector**

During the week, Kenya Mortgage Refinance Company (KMRC), a treasury backed lender, appointed three advisors namely; NCBA Investment Bank, Lion's Head Global Partners and Mboya Wangong'u & Waiyaki Advocates, to guide it during its planned green bond issue targeted for July to September this year whose proceeds will be channelled to banks and SACCOs to offer affordable home loans. The advisors are considering a number of market factors before settling on the amount to be raised, such as the returns to be offered to investors and the repayment periods that will be favourable in promoting high subscription rates of the bond.The KMRC green bond will be the second of its kind after property developer Acorn Holdings issued the first green bond in January 2020, which raised Kshs 4.3 bn at a rate 12.3%. KMRC is expected to issue the bond at a rate of 5.0% enabling primary mortgage lenders (PMLs) mainly banks and SACCOs to offer mortgages at 7.0% which is 6.0% points lower than the market average of approximately 13.0%. The targeted rates are too low for the capital markets given that the government which is considered risk free raised a 25 year bond this month at a rate of 13.9%. To be able to get capital at those prices, the institution may have to consider partnering with development institutions like the World Bank. The move by KMRC is a step in the right direction towards facilitating home ownership by promoting easier access to mortgages in Kenya which has been considerably declining with the current mortgage to GDP ratio being 2.2% as at 2020, a 0.3% points decline from 2.5% in 2019, while other countries' ratios such as Namibia and South Africa are at 25.4% and 19.6%, respectively. The initiative is also expected to increase mortgage uptake which has remained low with 27,993 mortgage loan accounts in the Kenyan market as at December 2019 out of an adult population of more than 24 million.

The graph below shows mortgage to GDP ratios of different countries compared to Kenya as of 2019;

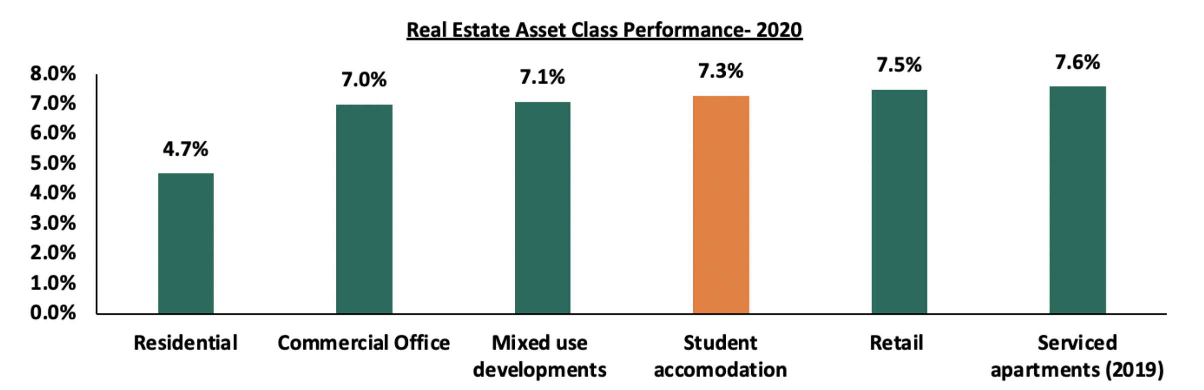


Source: Centre for Affordable Housing Finance in Africa

Also during the week, property developer Acorn Holdings announced plans to restrict construction of their student hostels to within a 3.0 km radius of targeted institutions in order to attract more students and to reduce students' transport costs. The company has been making efforts to put purpose-built student accommodation hostels in various strategic locations such as Madaraka, Parklands and Jogoo Road with the latter being located as far as 7.0 km from the target institutions such as University of Nairobi making it difficult for students to commute to and from due to frequent traffic jams hence affecting the occupancy.

The company's upcoming projects include the Kshs 810.0 mn Nairobi West Qwetu hostels targeting Strathmore University, the Kshs 880.0 mn Qwetu 3 and Kshs 740.0 mn Qwetu 4 developments targeting United States International University Africa (USIU Africa) set for completion by May 2021. Qwetu Hurlingham Phase I costing 990.0 mn is expected to be completed by May 2021 while the Kshs 970.0 mn Qwetu Chiromo Phase I will be completed by January 2022. Modern student housing continues to gain momentum, with investors looking to profit from the high returns on offer in the face of rising demand for student housing as a result of the increasing student population. According to the Kenya National Bureau of Statistics, the number of available student housing in 2020 were 300,000, compared to a university enrolment of 509,473 with the exclusion of technical colleges. This implies that there is a huge deficit of student accommodation which has been accelerated by i) High land rates, ii) Insufficient access to funding, and, iii) Inadequate expertise to build and manage student housing. Student accommodation has relatively high yields of 7.3% as per the Cytonn Student Housing Market Kenya Research compared to other real estate sectors like the residential and mixed-use developments which have an average rental yield of 4.7% and 7.1% respectively.

The graph below shows the performance of different real estate classes in 2020;



Source: Cytonn Research

We expect investment in student accommodation to continue gaining traction as it continues to attract high returns on their investment, with reopening of learning institutions expected to lead to higher occupancies and rental yields for the student housing sector.

III. Retail Sector

During the week, Naivas supermarket, a local retail chain, announced plans to open 3 stores by mid-June 2021, in an expansion drive that will see it take up spaces previously occupied by Tuskys Supermarket, ie Muindi Mbingu Street in Nairobi's Central Business District (CBD), and Simba Club Hall in Kisumu, and Githurai 44 on Kamiti Road. This will bring the retailer's operational outlets to 74, having opened 2 outlets so far this year. The decision to open the stores is supported by; i) a rising middle class with increased disposable income, ii) the exit of local retailers such as Tuskys Supermarket leaving prime retail space to let, iii) stiff market share competition with closest rival QuickMart and Carrefour having a total of 40 and 13 branches respectively nationwide, and, iv) improved infrastructure such as roads creating easier and faster access to the retail outlets.

In terms of performance, according to our Kenya Retail Sector Report 2020, Nairobi recorded an average rental yield of 7.5% against the market average rental yield of 6.7% implying that Nairobi continues to offer an attractive investment opportunity for retail chains. Moreover, Naivas is leveraging on lower rental rates in Kisumu of Kshs 97.2 against the market average rental prices of Kshs 115.1 which offers attractive opportunity for space uptake by the retail chains due to affordability.

The table below shows the summary of the retail performance of key urban centres in Kenya;

Summary Performance of Key Urban Cities in Kenya

Region	Rent/SQFT 2020	Occupancy % 2020	Rental Yield 2020
Mount Kenya	125	78.0%	7.7%
Nairobi	168.5	74.5%	7.5%
Mombasa	114.4	76.3%	6.6%
Kisumu	97.2	74.0%	6.3%

Summary Performance of Key Urban Cities in Kenya

Region	Rent/SQFT 2020	Occupancy 2020	Rental Yield 2020
Eldoret	130	80.2%	5.9%
Nakuru	55.7	76.6%	5.9%
Average	**115.1**	**76.7%**	**6.0%**

Source: Cytonn research

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	Highest number of branches that have ever existed as at FY, 2020	Highest number of branches that have ever existed as at FY, 2019	Highest number of branches that have ever existed as at FY, 2018	Category
Naivas	69	61	46	Local

Main Local and International Retail Supermarket Chains

Name of Retailer	Highest number of branches ever existed as at FY, 2020	Number of branches opened in 2021	Highest number of branches ever existed as at FY, 2019	Closed branches	Highest number of branches ever existed as at FY, 2018	Current number of Branches	Category
Tuskys	64	0	64	61	53	3	Local
QuickMart	37	3	29	0	10	40	Local
Chandarana Foodplus	20	0	19	0	14	20	Local
Carrefour	9	4	7	0	6	13	International
Cleanshelf	11	1	10	0	9	12	Local
Uchumi	37	0	37	35	37	2	Local
Game Stores	3	0	2	0	2	3	International
Choppies	15	0	15	13	13	2	International

Main Local and International Retail Supermarket Chains

Name of Retailer	Highest number of branches that have ever existed as at FY'2020	Highest number of branches that have ever existed as at FY'2019	Highest number of branches that have ever existed as at FY'2018	Category
Shoprite	[illegible]	[illegible]	[illegible]	International
Nakumatt	[illegible]	[illegible]	[illegible]	Local
Total	[illegible]	[illegible]	[illegible]	

Source: Online Research

Additionally, Tuskys supermarket, announced plans to sell its non-essential assets including furniture, fixes and fittings in 19 of its branches. The sale of these assets is expected to generate Kshs 911.0 mn, which will be used to settle some of the creditor's debts even as the firm continues to pursue external financing. The retailer continues to struggle to stay afloat having signed a deal with an undisclosed Mauritius based private-equity firm in August 2020 to raise Kshs 2.1 bn short-term debt for stabilizing its operations. However, Tuskys allegedly only received Kshs 500.0 mn and continues to be faced with financial woes and legal tussles arguing that its financial position remains redeemable and its business commercially viable. In our view, for Tuskys to survive, they need to i) ensure proper corporate governance independent of the owners, ii) partner with more private equity funds to help in offsetting debts and giving access to working capital, iii) diversify sales through e-commerce to increase revenues, and, iv) ensure proper supply chain management.

Kenya's retail sector performance continues to be affected by the exit of troubled retailers such as Tuskys. However, we expect the sector to be cushioned by expansion of local and international retailers such as Naivas and Carrefour taking up space hence reduce the oversupply of approximately 2.0mn SQFT in the Kenyan retail market.

The real estate sector performance is expected to record increased activities following focus on affordable housing options through the KMRC and expansion of local and

international retail chains taking up space left by troubled retailers.

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