Nairobi Metropolitan Area (NMA) Land Report 2021, & Cytonn Weekly #29/2021

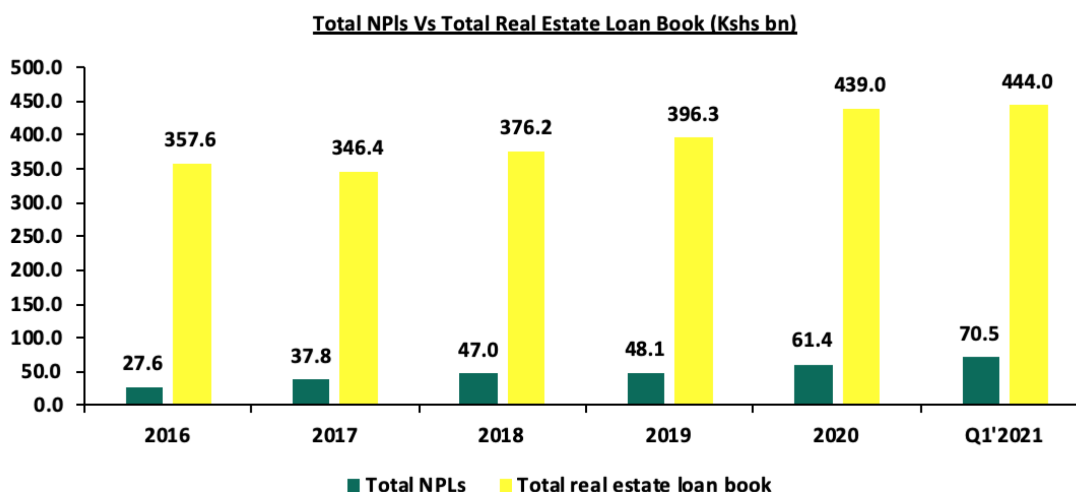
Real Estate

I. **Industry Reports**

During the week, the Central Bank of Kenya (CBK) released the Quarterly Economic Review Report January- March 2021 and the key take outs for the real estate sector included;

i. The gross loans advanced to the real estate sector increased by 11.4% to approximately 444.0 bn in Q1'2021 from approximately Kshs 439.0 bn advanced in Q4'2020. The gross loans advanced to buildings and constructions sector increased from 123.0 bn in Q4'2020 to 125.0 bn in Q1'2021 while loans advanced to the tourism sector increased from Kshs 102.0 bn to Kshs 104.0 bn during the same period under review. The increase is attributable to layoffs, business closures affecting the commercial and retails sectors and travel restrictions triggered by the pandemic affecting the performance of the hospitality industry,
ii. The gross non-performing loans to the real estate sector increased by 14.8% to Kshs 70.5 bn in Q1'2021 from Kshs 61.4 bn recorded in Q4'2020, accounting for 15.9% of the total real estate loan book. The increase was attributed to economic disruptions by the Covid-19 pandemic reducing cash flows and the ability to service debt, and,
iii. With regards to the loans to the sector, real estate accounted for 14.6% of the total loan advances valued at Kshs 444.0 bn compared to the total Kshs 3.0 tn, while building and construction, and tourism sectors accounted for 4.1% and 3.4% of the total loan book, respectively;

The graph below shows the number of real estate non-performing loans compared to the total real estate loan book from 2016-Q1'2021;



Source: Central Bank of Kenya

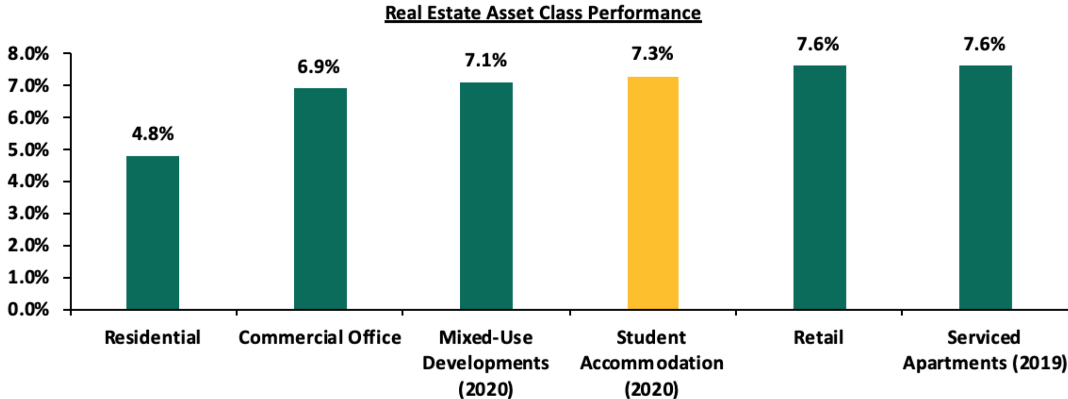
The resultant impact of this is that lenders are expected to exercise a more conservative approach in loan provision such as tighter risk provisions as a strategy to cushion themselves against high loan default rates.

II. Residential Sector

During the week, Acorn Holdings, a student hostels developer, announced that it had raised Kshs 2.1 bn from a corporate bond, to develop 2 new hostels expected to avail 2,654 beds in addition to the 4,695 bed capacity currently being developed under the bond funding. This will bring the total number of developments funded under their bond programme to 8. The amount raised represents a 145.8% oversubscription from the targeted Kshs 1.4 bn, incentivized with partial credit guarantee of 50.0% of the principal and interest by GuarantCo, a fund backed by the governments of the UK, the Netherlands, Switzerland, Australia, Sweden, Germany and the International Finance Corporation (IFC). Acorn Holdings had initially floated a Kshs 5.0 bn first green bond in October 2019, with the first tranche raising Kshs 4.3 bn against the minimum expected Kshs 2.0 bn which was deployed towards construction of 6 environment friendly purpose-built student accommodations (PBSA) under the Qwetu and Qejani brands. Additionally, in March 2021, Acorn received Kshs 2.1 bn when it split its portfolio into two, a development and an investment trust. The firm currently has 3,000 beds under management with a target aim of 30,000 beds under management by 2030, with Qwetu having 4 properties under development to provide 5,700 beds while Qejani has two flagship projects, Qejani Chiromo and Qejani Catholic, whose development began in April 2021, in an aim to add an additional 3,000 beds. The launch of the construction of the 3,591 room-hostels in Nairobi Karen in June 2021, is the most recent development by the firm, in a project that is expected to cost Kshs 1.9 bn, and set for completion in December 2022.

The oversubscription of the Acorn bond is expected to set good precedent for investors regaining their confidence in corporate bonds which is one of the key methods of real estate financing. Acorn Holdings remains committed to bridging the gap between the increasing demand and the low supply for student's hostels in the country, supported by i) the high deficit of student accommodation at of 209,473 students according to the Kenya National Bureau of Statistics, with exclusion of technical colleges, ii) the inability of individual learning institutions to host enrolled students into their premises, iii) the need by students for secure but affordable housing near the learning institutions from the high cases of insecurities, and iv) the high returns from this thematic sector at 7.3% as at 2020 compared to other real estate classes such residential and commercial sectors with H1'2021 rental yields at 4.8% and 6.9%, respectively.

The graph below shows the performance of rental yields in student housing compared to the different real estate asset classes in H1'2021;



Source: Cytonn Research

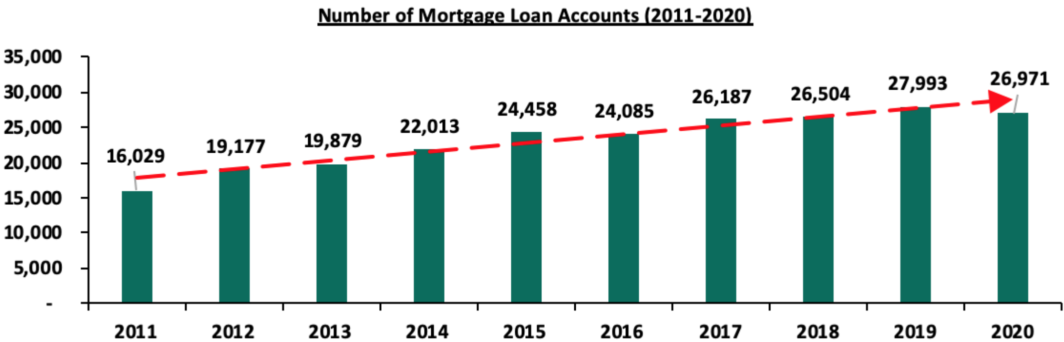
Investment in student accommodation is expected to continue gaining traction supported by the continued acceptance of corporate bonds and the high returns, leading to higher developers'

interests in the sector compared to other real estate classes.

Additionally, Standard Chartered Bank of Kenya announced that it had cut the interest on new mortgages and waived legal and valuation fees for clients moving existing facilities from other banks, in a bid to grow home loans. This will see new customers seeking mortgages of between Kshs 1.0mn to Kshs 100.0 mn in the next three months up to October, enjoy a discounted variable rate such as benchmark average lending rates of approximately 10.9% from the 13.9% average that the bank is currently charging. To encourage those moving from other banks, StanChart will meet fees from lawyers averaging at 1.2% of the value of the mortgage and valuation fees usually charged at about 2.0% on the first Kshs 2.0 mn of the mortgage plus 0.3% on any amounts beyond this.

This move is expected to increase the bank's 9.2% share of Kenya's mortgages having last reported 1,942 mortgage accounts as at 2020, and remove constraint for individuals moving mortgage facilities due to the high legal and valuation fees. Moreover, it will support increase the number of mortgage accounts for the country, currently standing at 26,971 as at 2020, representing a 3.5% decline from 27,943 in 2019 due to the economic disruptions that came about from the Covid-19 pandemic.

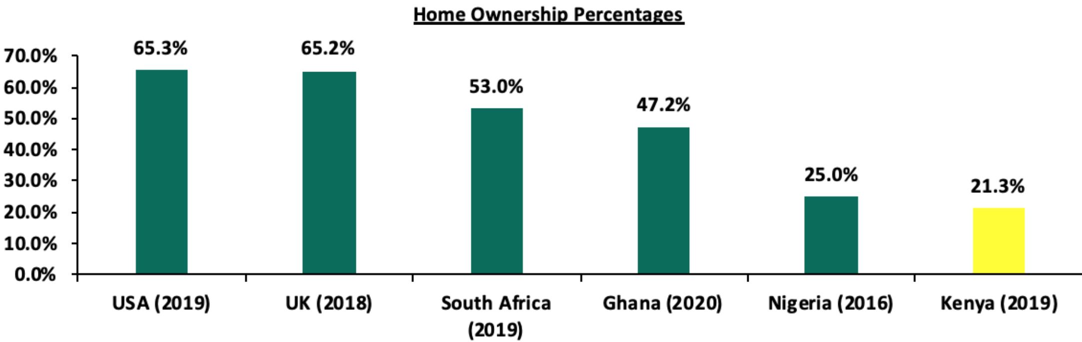
The graph below shows the number of mortgage loan accounts in Kenya over the last 10 years;



Source: Central Bank of Kenya

With the increase in mortgage accounts, this will boost the home ownership percentage in the country which continues to remain relatively low at 21.3%, compared to other countries such as USA and UK at 65.3% and 65.2%, respectively as at 2020.

The graph below shows the percentage of home ownership in different countries compared to Kenya;

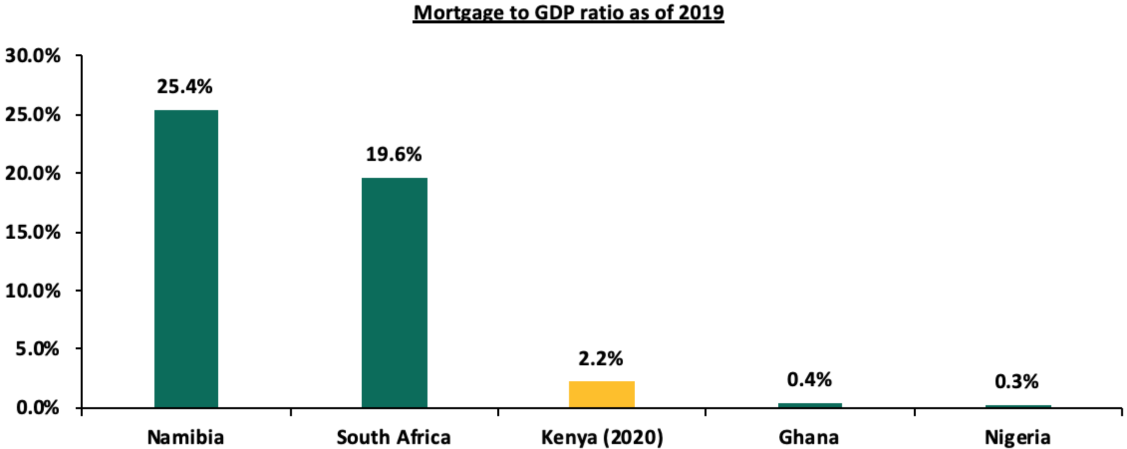


Source: Centre for Affordable Housing Finance in Africa

Kenya has continued to record slow mortgage penetration, resulting to a relatively low mortgage to GDP ratio which stands at 2.2% as at 2020, compared to other African countries such as Namibia at 25.4%. The low mortgage uptake has been due to; i) the high interest rates and high deposit requirements, ii) soaring of property prices, iii) low-income levels making it hard to service loans,

and, iv) lack of credit risk information for those in the informal sector leading to their exclusion. However, the Kenyan government is working on improving this through the Kenya Mortgage and Refinance Company (KMRC) which advances credit to mortgage lenders at a rate of 5.0% for onward lending at rate of 7.0%, 3.9% lower than the average market lending rate of 10.9% as at 2020. However, it is not clear how KMRC will sustainably access funds at the such low rates, yet even the government can only access 20-year funds at a 13.2% rate.

The graph below shows the mortgage to GDP ratio for Kenya compared to other countries as at 2019;



Source: Center for Affordable Housing Africa

The residential sector is expected continue recording increased activities following focus on development of student housing and private players such as the banking sector availing mortgage solutions to Kenyans, aiming to raise mortgage accounts and increase home ownership.

III. **Retail Sector**

During the week, Naivas Supermarket, a local retailer, opened a new store in Githurai 44, along Kamiti Road, taking up 28,000 SQFT of space previously occupied by Tuskys Supermarket, which shut down due to cash flow setbacks. This brings the retailer’s total operational outlets to 74, having opened 4 other outlets this year in various parts of the country, with the latest being an outlet in Nairobi Central Business District (CBD) along Muindi Mbingu street in June 2021. Naivas aims to cement its position as the top retailer in the country in an expansion spree to serve a larger number of clientele thus boosting profits, while competing against other expanding retailers such as Quickmart and Carrefour who have each opened 4 outlets this year. Moreover, Naivas also announced plans to open a new outlet in Kisumu’s Simba Hall by the end of August 2021.

The retailer’s entry into Githurai 44 is supported by i) financial muscle to drive growth after a Kshs 6.0 bn financing by Amethis Capital, a France based private equity firm, for sale of 30.0% stake in August 2020, ii) the market niche in the specific area, currently being served by Khetias Supermarket, iii) the accessibility of the area by both suppliers and shoppers through Kamiti Road which is off Thika Super-Highway, and, iv) the availability of prime space left by troubled retailers. According to our Cytonn H1’2021 Markets Review, the average rental rates for retail spaces within Thika Road area, where Githurai 44 is categorized, came in at Kshs 159 per SQFT in H1’2021, 5.9% lower compared to a market average rent of Kshs 169 per SQFT, thus offering relatively affordable retail space for Naivas and hence suitability for uptake.

The table below shows the average retail rents per SQFT in the Nairobi Metropolitan Area in H1’2021;

Nairobi Metropolitan Area Retail Performance H1'2021

Area	Rent/SQFT H1'2021 (Kshs)	Occupancy % H1'2021	Rental Yield H1'2021
Westlands	209	80.0%	**9.7%**
Karen	217	80.6%	**9.5%**
Kilimani	173	82.8%	**8.9%**
Ngong Road	178	78.8%	**8.0%**
Kiambu road	178	68.8%	**7.1%**
Thika Road	159	73.3%	**6.7%**
Mombasa road	139	73.0%	**6.3%**
Satellite towns	134	74.0%	**6.2%**
Eastlands	136	70.0%	**5.8%**
Average	**169**	**75.7%**	**7.6%**

Source: Cytonn Research 2021

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

Main Local and International Retail Supermarket Chains

Name of Retailer	Category	Highest number of branches that have ever existed as at FY'2018	Highest number of branches that have ever existed as at FY'2019	Highest number of branches that have ever existed as at FY'2020	Number of branches opened in 2021	Closed branches	Current number of Branches	Number of branches expected to be opened	Projected number of branches FY'2021
Naivas	Local	46	61	69	5	0	74	1	75
QuickMart	Local	10	29	37	4	0	41	4	45
Chandarana Foodplus	Local	14	19	20	0	0	20	0	20
Carrefour	International	6	7	9	4	0	13	2	15
Cleanshelf	Local	9	10	11	1	0	12	0	12
Tuskys	Local	53	64	64	0	61	3	0	3
Game Stores	International	2	2	3	0	0	3	0	3
Uchumi	Local	37	37	37	0	35	2	0	2
Choppies	International	13	15	15	0	13	2	0	2
Shoprite	International	2	4	4	0	3	1	0	1
Nakumatt	Local	65	65	65	0	65	0	0	0
Total		**257**	**313**	**334**	**14**	**177**	**171**	**7**	**178**

Source: Online Research

The performance of the retail sector is expected to improve supported by i) consistent expansion by local and international retailers taking up prime retail spaces left by cash-strapped retailers, ii) increased clientele base aiming to increase footprint and boost profits, iii) international financing deals and partnerships to increase funding, and, iv) the increasing middle income population with high need to finance their lifestyles, taste and preferences. However, performance is expected to continue being constrained by factors such as e-commerce reducing need for physical space, the

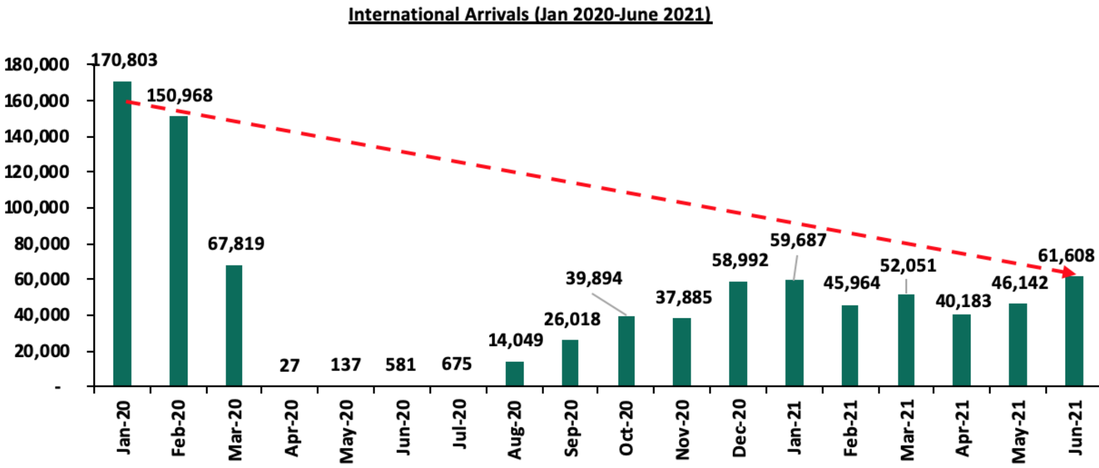
current oversupply of retail space at 3.1 mn SQFT in the Nairobi Metropolitan Area (NMA) and tough economic times reducing disposable income for majority of Kenyans.

IV. **Hospitality Sector**

During the week, the British government announced that the United Kingdom has retained Kenya in its 'Red List' of countries whose nationals are barred from entering the United Kingdom (UK) due to concerns of the Covid-19 Delta variant. The Kenyan ban came into effect in April 2021 and has now been extended for a further 21 days with the next review expected on 5th August. The ban comes after 50 other countries decided to deny access to tourists bearing Kenyan passports into their territories for the same reasons despite increasing demand for tourists due to summer vacations in Europe. Kenya had lifted the ban on flights between Nairobi and London in May 2021 after a retaliation ban in April 2021, and reduced the restrictions for self-isolation in June 2021, after bilateral talks with the UK.

The move by the UK is expected to reduce the expected number of international arrivals and activities in the tourism sector as tourists shy away from the country due to fears of contracting the Delta Covid-19 variant, worsened by the current lockdown and curfews in the Western side of the country to curb the spread of the same. According to International Tourism Performance Report January to June 2021, by the Tourism Research Institute (TRI), Kenya registered a 21.7% decline in the number of international arrivals between January and June 2021 compared to a similar period in 2020. The report indicated that the UK was the fifth highest source market of tourists in the country with 16,264 persons representing a 5.3% of the 305,635 total arrivals. The highest number of visitor arrivals were from the United States of America (USA) and Uganda, which registered total number of tourists at 49,178 and 31,418, respectively.

The graph below shows the number of international arrivals from January 2020 to June 2021;



Source: Tourism Research Institute

The hospitality sector performance is expected to continue being affected by its reliance on the tourism industry which is expected to continue recording a lower number of international arrivals compared to the pre-Covid period, attributed to travel bans and restrictions. Despite the low numbers, we expect better performance in the second half of 2021 to following the government's continued efforts to boost the sector through favorable budgetary allocations, increase in activities such as the recently concluded World Rally Championships (WRC) which has been announced to run every year up to 2026, and the priority of the sector players in vaccination plans.

The real estate sector performance is expected to be supported by increased funding for the student housing sector, the mortgage solutions provided by key financial players in the

market such as banks, and the expansion by local retailers taking up prime retail spaces left by troubled retailers. However, increase in loan defaults in the real estate sector, and the travel bans and restrictions will have an impact on the number of tourists arriving into the country, thereby constraining performance real estate sector.