Cytonn Monthly - July 2021

Real Estate

I. **Industry Reports**

During the month, the following industry reports were released and the key take-outs were as follows:

#	Theme	Report	Key Take-outs
1	General Real Estate	Architectural Association of Kenya Status of the Built Environment Report January-June-2021	• The construction industry is expected grow to 4.5% in 2021, with medium term growth expected to be driven by large-scale road and related infrastructure projects. For more information, see Cytonn Weekly #28/2021.
		Central Bank of Kenya Quarterly Economic Review Report January-March 2021	• 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, whereas 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. For more information, see Cytonn Weekly #29/2021.
2	Hospitality Sector	Tourism Research Institute International Tourism Performance Report January to June 2021	• Kenya registered a 21.7% decline in the number of international arrivals to 305,635 persons between January and June 2021, when compared to a similar period in 2020. For more information, see Cytonn Weekly #28/2021.

The real estate sector is expected to register an improvement in performance supported by improved construction activities. However, the low numbers of visitor arrivals and high loan default rates is still expected to hinder performance of the sector.

II. **Residential Sector**

During the week, Edderman Limited, a local private property developer, announced the completion of its Great Wall Gardens phase 3 project worth Kshs 3.0 bn in Mavoko, Machakos County. The affordable housing development consisting of 664-three bedroom apartments of approximately 170.0 SQM units valued at Kshs 3.7 mn was launched in August 2019 and was completed in July 2021 as per the stipulated time. The developer has been on an aggressive drive defying the pandemic effects to deliver affordable housing units with some of its projects being; i) the Great Wall Gardens phase 4, ii) Lukenya Park C project, iii) River Estate Public Private Partnership (PPP) project in Ngara, and, iv) Great Wall Gardens phase 5 which is expected to kick off in September 2021. The Great Wall Garden phase 3 project will be beneficial through; i) provision of affordable houses to the residents, ii) reduction of informal settlement in the area, and, iii) improve living standards of Kenyans around the region.

The move by the developer to deliver timely affordable housing units further supports the affordable housing initiative as part of the big four agenda by the government which has been gaining momentum despite the pandemic, evidenced by the relatively high number of individuals who have been registered in the boma yangu portal currently at 320,897. However, there are several challenges that have been impeding the successful delivery of the affordable projects including; i) financial constraints, ii) inadequate infrastructure limiting accessibility, iii) high development costs, and, iv) troubled partnership agreements. Despite the challenges, we expect the initiative to continue gaining momentum supported by various factors such as the improving infrastructure opening up areas for accessibility and investment opportunities, availability of land particularly within the satellite towns of the Nairobi Metropolitan Area, and, positive demographics.

In terms of performance, according to our Cytonn H1'2021 Markets Review, Athi River, where the project is located registered average uptake rates 96.9%, a 14.2% points higher than the market average 82.7%, thereby signifying greater demand and uptake rate for apartments in the area, coupled with their affordability rates being that the area registered average selling prices of Kshs 59,145 per SQM in H1'2021 against the market average of Kshs 77,272 SQM. The performance of Athi River is also supported by positive demographics with the area having recorded a population growth of 66.7% to 0.3 mn in 2019 compared to 0.1 mn in 2009 according to the Kenya National Bureau of Statistics (KNBS), and improving infrastructure as the area is served by Magadi Road, among other factors. The table below shows the performance of lower mid-end apartments in the satellite towns in H1'2021;

(All values in Kshs unless stated otherwise)

Nairobi Satellite Towns Lower Mid-End Apartments Performance H1'2021

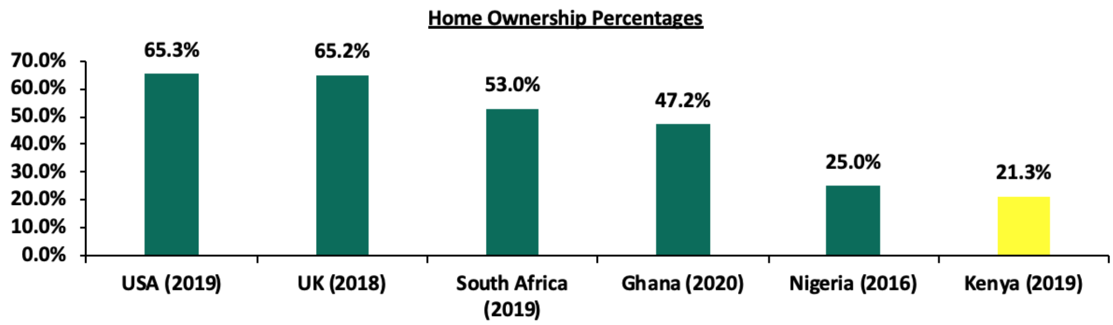
Area	Average of Price Per SQM H1'2021	Average of Rent per SQM H1'2021	Average of Occupancy H1'2021	Average of Uptake H1'2021	Average of Annual Uptake H1'2021	Average of Rental Yield H1'2021	Average of Y/Y Price Appreciation H1'2021	Total Returns H1'2021
Ruaka	105,633	514	63.7%	76.0%	19.0%	5.5%	2.0%	7.5%
Kikuyu	80,766	529	79.6%	79.4%	17.6%	6.4%	0.3%	6.7%
Thindigua	108,551	537	79.3%	79.4%	12.8%	4.9%	1.2%	6.0%
Syokimau	67,967	345	79.0%	77.6%	12.0%	5.2%	(2.2%)	6.0%
Ngong	58,015	306	81.4%	72.3%	11.8%	5.3%	0.7%	5.9%
Kitengela	59,488	284	90.0%	82.8%	10.0%	5.1%	(2.8%)	5.5%
Athi River	59,145	290	97.2%	96.9%	12.6%	5.7%	(1.2%)	4.5%
Ruiru	86,904	528	86.4%	85.8%	23.8%	6.1%	(1.8%)	4.3%
Rongai	68,982	363	87.3%	94.2%	28.6%	6.3%	(3.9%)	2.4%
Average	**77,272**	**411**	**82.7%**	**82.7%**	**16.5%**	**5.6%**	**(0.9%)**	**4.7%**

Source: Cytonn Research

Additionally, President Uhuru Kenyatta signed a Public Private Partnership (PPP) deal worth Kshs 5.2 bn with the United Kingdom aiming at fostering ties between the two countries as well as initiating green affordable home projects. The proposal of the PPP deal which was announced in January 2021 affirms UK's support of the big four agenda on affordable housing initiative, as the aid is expected to finance the development of 10,000 green affordable homes. PPPs have proven to be efficient strategies of delivering projects in Kenya due to ; i) easy access to finance for projects, ii) government access to private sector efficiencies, ii) exposure to large scale projects, and, iv) enhanced ease of doing business in the country. However, PPPs in Kenya have not been performing to the optimum due to; i) inadequate planning for PPP projects, ii) fraudulent procurement processes, iii) inadequate regulatory frameworks to handle PPP transactions, and, iv) high transaction costs. Despite the aforementioned challenges, the government and private sector have been aggressively initiating and implementing affordable housing projects through the PPP strategy with some of the ongoing projects being the Pangani affordable housing project, River Estate project in Ngara, and Buxton Estate project in Mombasa, among many others.

Also, the Kenya Mortgage Refinance Company (KMRC), a state-backed mortgage refinancing firm, announced that it will triple affordable home loans to Kshs 7.0 bn in FY'2021/22, thereby increasing the loan book at 154.7% from the Kshs 2.7 bn offered to banks and savings and credit cooperative society (Saccos) in FY'2020/21. KMRC began operations in September 2021 after officially getting permit, with the sole objective of providing affordable mortgages within the Nairobi Metropolitan Area (NMA) to financial institutions at an average interest rate of 5.0%, enabling the primary mortgage lenders to write them off at a rate of 7.0%, which is 8.0% points lower than the average market lending rate of approximately 15.0% as at 2020. However, it is not clear how KMRC will sustainably access funds at such low rates, yet even the government can only access 20-year funds at a 13.2% rate. The availability of funds to Primary Mortgage Lenders (PMLs) from KMRC at favorable interest rates will encourage prospective home owners to take up loans for development hence boosting current low home ownership rates in Kenya currently at 21.3% as at 2020 implying that approximately 78.7% of the urban population in Kenya are renters as opposed to the 53.0% urban home ownership percentages in South Africa.

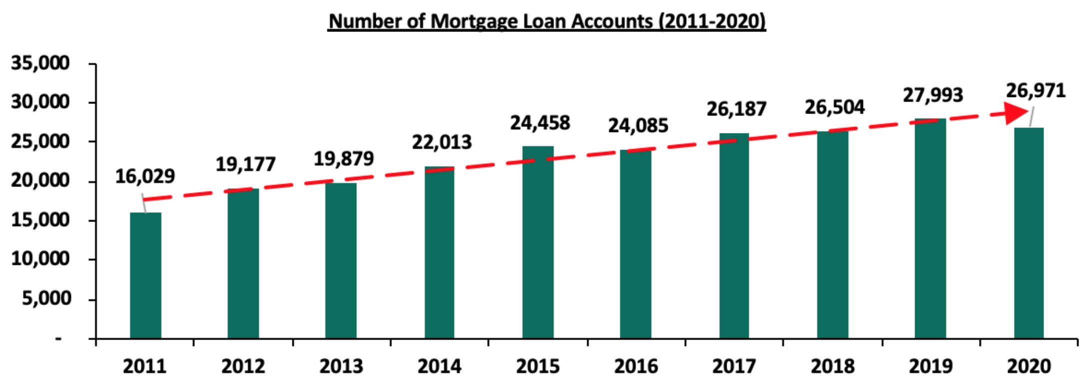
The graph below shows the percentage of home ownership in different countries compared to Kenya;



Source: Centre for Affordable Housing Finance in Africa

The move by KMRC to triple the affordable home loans by Kshs 4.3 mn in the FY'2021/22 to Kshs 7.0 bn is also expected to initiate an improvement in the number of mortgage loan accounts registered in the country, which realized a 3.5% decline to 26,971 in 2020 from the 27,993 recorded in 2019, attributed to the harsh economic environment that saw to it a limited spending power by prospective clients and a decline in the access to loans as creditors continue to take a conservative approach in line with giving out loan.

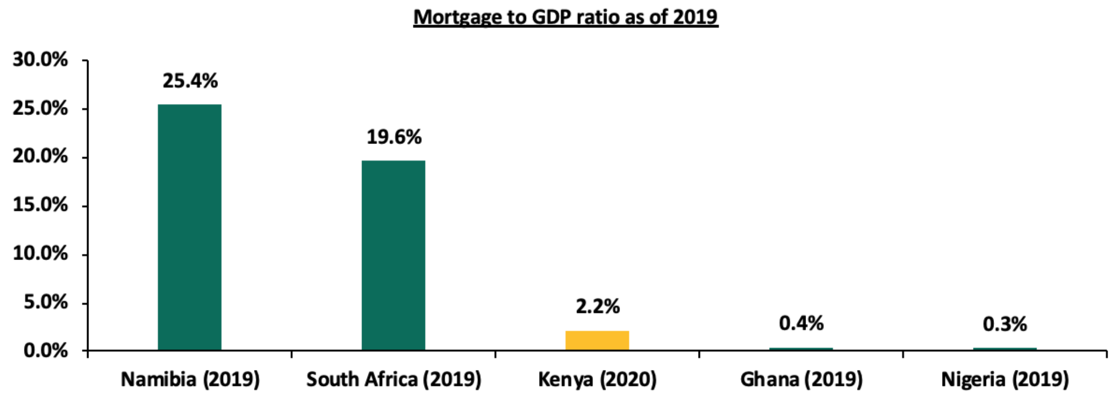
The graph below shows the number of mortgage loan accounts in Kenya over the last 10 years;



Source: Central Bank of Kenya

With the improved mortgage availability by the lender with Kshs 4.3 mn from Kshs 2.7 bn allocated in the FY 2020/21 to the expected Kshs 7.0 bn for the FY'2021/22, we expect that the number of mortgage accounts to increase by approximately 1,229, assuming the average affordable mortgage loan size by KMRC is Kshs 3.5 mn, with some of the factors still hindering mortgage performance in the country being; i) longer transaction timelines, ii) minimal knowledge on the financing structure, iii) relatively low income levels to service the loans, and, iv) inefficient secondary mortgage markets.

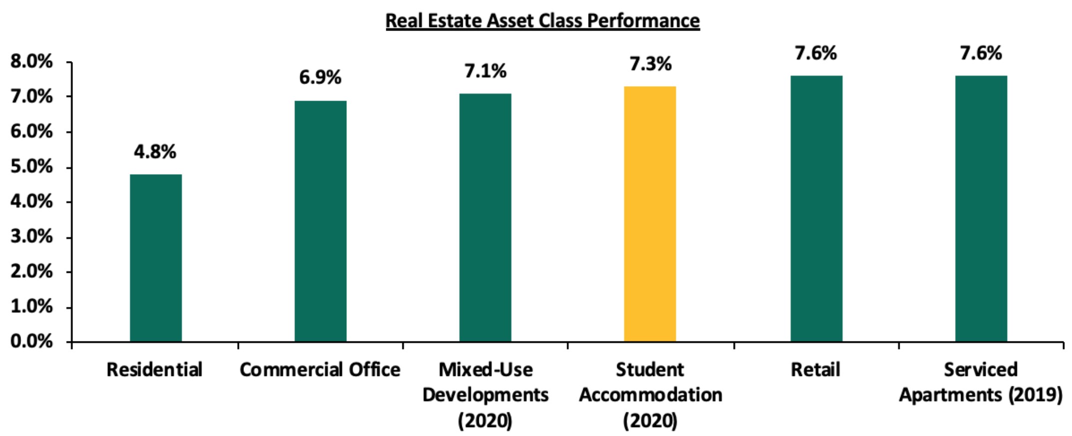
The graph below shows the mortgage to GDP ratio for Kenya compared to other countries as at 2019;



Source: Center for Affordable Housing Africa

Acorn Holdings, a student hostels developer, signed a partnership deal with the United States International University Africa (USIU-Africa), to provide 697 of its students with accommodation, through the development of hostels at a cost of Kshs 1.0 bn. The partnership deal is aimed at decongesting the university's hostels which currently has a bed capacity of just 258 beds out of a total student population of about 7,000. Acorn Holdings has been on an aggressive path to deliver student hostels under its Qwetu and Qejani brands with the aim of providing safer, quality and affordable accommodation to the rising number students. Besides it has completed student projects in Ruaraka, Parklands, Jogoo road and, Madaraka, with others in the pipeline such as; i) the 3,591-room hostels in Nairobi's Karen developed at a cost of Kshs 1.9 bn, ii) the Kshs 810.0 mn Nairobi West Qwetu hostels targeting Strathmore University students, and, iii) the Kshs 880.0 mn Qwetu 3 and Kshs 740.0 mn Qwetu 4 developments targeting USIU- Africa students, among many others.

Student accommodation developments have continued to gain traction in the recent past mainly attributed to; i) the rising population of students against the low supply thus need to tap into the deficit, ii) the need to foster security of students and provide affordable student housing facilities, and, iii) higher returns as student housing facilities generated a rental yield of 7.3% as at 2020 compared to other asset classes such as the residential and commercial office spaces which recorded average rental yields of 4.8% and 6.9%, respectively, in H1'2021. We therefore expect the sector to continue gaining momentum and attracting more investment opportunities further boosting project returns. 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

Other notable highlights during the month include;

i. 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. For more information, see Cytonn Weekly #29/2021,
ii. 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. For more information, see Cytonn Weekly #29/2021,
iii. The Harambee Investment Cooperative Society (HICS), the investment vehicle of Harambee Sacco, announced that it is seeking a joint venture partnership with African Development Bank (AfDB), a regional multilateral development finance institution, to develop affordable housing units for 596 of its members. For more information, see Cytonn Weekly #28/2021,
iv. Kenya joined 24 other African countries in signing the Yaoundé Declaration, a joint declaration that seeks to offer mass production of decent and affordable housing on the African continent for the next 40 years. For more information, see Cytonn Weekly #27/2021, and,
v. Co-operative Bank of Kenya launched a pension backed mortgage facility in partnership with Enwealth Financial Services Limited, a retirement services provider, which will allow clients to own homes through mixed financing of their pension contributions, and a long term loan. For more information, see Cytonn Weekly #27/2021.

The residential sector is expected to continue registering more activities to foster its performance improvement through various ways such as; i) the improved mortgage availability, ii) government and private sector continued focus on the affordable housing initiative, iii) continued focus on the decent and affordable student housing projects, and, iv) the joint venture and PPP strategies aimed at delivering projects in an efficient way.

III. Retail Sector

During the week, Naivas supermarket, a local retail chain, opened a new store in Kisumu at Simba Hall, taking up 30,000 SQFT of prime retail space previously occupied by trouble retailer, Tuskys supermarket. The aggressive move by the retailer comes barely two weeks after they opened a new store in Githurai 44 bringing their total operational outlets to 75, and the 3rd in Kisumu. Moreover, the retailer announced plans to open four more outlets in Migori, Homabay, Meru and Kakamega counties, in its expansion spree to maintain market dominance as a result of the stiff market competition from close rivals Carrefour and QuickMart. The decision by Naivas to take up space in Kisumu is supported by; i) strategic location of Simba Hall along the busy Kisumu-Kakamega Highway providing easy access, ii) exit by troubled retailer Tuskys thereby leaving prime retail space for uptake, and, iii) rapid population growth with Kisumu having registered a 33.3% population increase from 0.9 mn in 2009 to 1.2 mn in 2019 according to the Kenya National Bureau of Statistics. In terms of performance, according to our Kenya Retail Report 2020, Kisumu registered rental rates of Kshs 97.2 against the market average of Kshs 115.1, signifying that Naivas is leveraging on affordability as the main reason for choosing Kisumu as its preferred location.

The table below shows a summary of the performance of the retail sector in key urban cities in Kenya;

Summary Performance of Key Urban Cities in Kenya

Region	Rent/SQFT 2020	Occupancy% 2020	Rental Yield
Mount Kenya	125.0	78.0%	**7.7%**
Nairobi	168.5	74.5%	**7.5%**

Summary Performance of Key Urban Cities in Kenya

Region	Rent/SQFT 2020	Occupancy% 2020	Rental Yield
Mombasa	114.4	76.3%	6.6%
Kisumu	97.2	74.0%	6.3%
Eldoret	130.0	80.2%	5.9%
Nakuru	55.7	76.6%	5.9%
Average	**115.1**	**76.6%**	**6.7%**

Source: Cytonn Research 2020

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	6	0	75	4	79
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**	**15**	**177**	**172**	**10**	**182**

Source: Online Research

Additionally, Java House Africa Group, an international restaurant chain, announced plans to open 30 new Kukito outlets in various parts of Nairobi, in the next five years. This will bring the number of operational outlets by the restaurant chain to 32, having opened two other outlets in Nairobi's Central Business District (CBD) and Gigiri in 2019. The decision plan by the restaurant chain to set up operational outlets in Nairobi is supported by; i) stiff market competition from closest restaurant chain rivals like Kentucky's Finest Chicken (KFC), and Subway restaurant, ii) rapid population growth in Nairobi fostering demand for their products, thereby also improving their financial muscle and the need to expand, iii) fast growing infrastructure developments opening up various areas for investment opportunities, iv) the Nairobi region remaining one of the largest East Africa's business hub, and, v) convenience from online food platforms that initiate easier and faster accessibility and delivery services. According to the Cytonn H1'2021 Markets Review, Nairobi registered a performance improvement in the rental yields to 7.6%, from 7.5% in FY'2020 signifying that the region continues to present a good investment opportunity for the restaurant chain despite the pandemic.

The table below shows the performance of the NMA retail market in H1'2021

All Values in Kshs unless stated otherwise

Nairobi Metropolitan Area Retail Market Performance H1'2021

Area	Rent/SQFT H1'2021	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

Other notable highlights during the month include;

i. 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. For more information, see Cytonn Weekly #29/2021.

Despite the effects of the pandemic and the existing retail space oversupply in the country at 2.0 mn SQFT, the retail market has been on an upward trajectory registering rapid development activities through uptake of space, which is expected to initiate improvement in performance of the sector, coupled by other factors such as improved infrastructure and positive demographics.

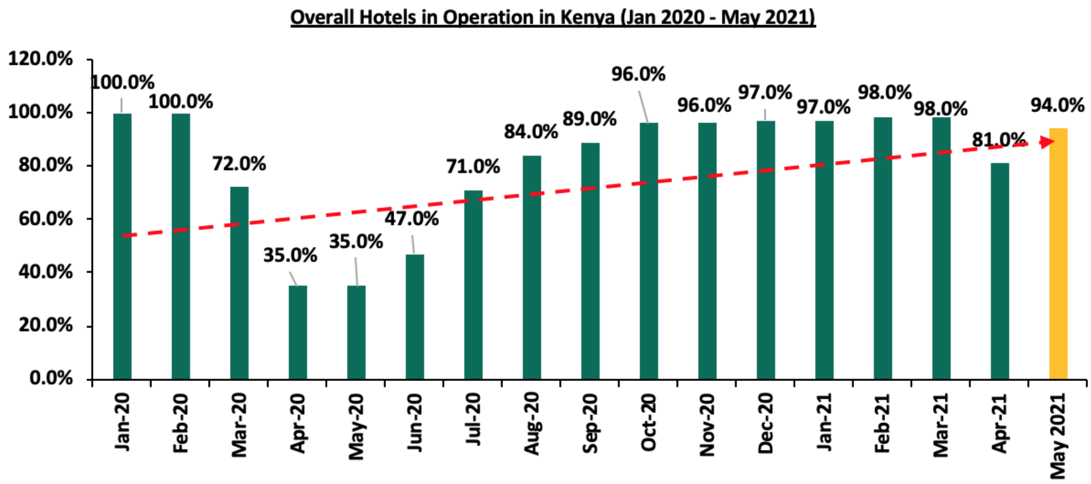
IV. **Hospitality Sector**

During the week, South African's City Lodge Hotel Group, an international hotelier, announced plans to sell its three Kenyan-based hotels namely; the 127-room Fairview Hotel in Nairobi, the 171-room City Lodge Hotel in Two Rivers, and, the 84-room Town Lodge Hotel in Upperhill, to private equity fund Actis, a United Kingdom (UK)-based investment firm. The three hotels which have been in operation for the last seven years are to be sold at a cost of Kshs 1.0 bn amidst the overall operational loss concerns generated mainly by City and Town Lodge hotels due to a slow business environment since December 2019, coupled with the hotel group trying to minimize their existing debt through selling their above aforementioned assets. The opportunity to sell the hotels instead of closure comes at a time when private equity financing and buyoffs has also been realized to be a good alternative financial solution and source for economic development due to; i) ease of financial accessibility, ii) entrepreneurial diversification, and, iii) ability to outperform other asset classes.

The hospitality sector has been the worst hit real estate sector since the awakening of the pandemic, attributable to the imposed restrictions, travel bans and lockdowns as its containment measures. This led to the closure of numerous hotels in the country, their overall decline in performance such as the performance decline for the aforementioned hotels by City Lodge Group among many others, as well as the decline in the performance of serviced apartments in 2020. However, the sector has made remarkable gradual improvement following the slow lifting of the restrictions and lockdowns, thereby leading to an overall improvement in their performance and number of operational hotels in

Kenya. We therefore expect it continue registering more activities to boost its performance going forward.

The graph below shows the overall percentage of the number of operating hotels in Kenya between January 2020 and May 2021;



Source: Central Bank of Kenya

Additionally, during the month;

i. 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. For more information, see Cytonn Weekly #29/2021.

Despite some of the improved activities noted in the sector such as the improving number of hotels in operations signifying a post Covid recovery, we expect the sector's performance will still be impeded by the low number of visitor arrivals as well as financial constraints limiting the consumers spending powers.

V. **Infrastructure**

During the month;

i. The Kenya Roads Board (KRB), the agency overseeing development of roads in Kenya, announced that the estimated value of roads in Kenya is currently stands at Kshs 3.5 tn. For more information, see Cytonn Weekly #28/2021, and,
ii. The Cabinet Secretary for Ministry of Transport, Infrastructure, Housing and Urban Development, Hon. James Macharia, announced that the 27.0 Km Nairobi Expressway project will be completed by February 2022 (six months ahead of its initial December 2022 completion date). For more information, see Cytonn Weekly #28/2021.

With the 0.6% improved FY'2021/22 budget allocation to the infrastructure sector to Kshs 182.5 bn, from Kshs 181.4 bn allocated in FY'2020/21, we expect the sector to register more and more construction activities coupled with government's focus on implementing and concluding projects on the same.

VI. **Statutory Reviews**

During the month;

President Uhuru Kenyatta signed into law the Finance Bill, 2021. A key highlight in the real estate sector was the re-introduction of a 20.0% excise duty on fees and other commissions earned on loans by financial institutions which risks making credit costly for home owners and developers as lenders will transfer the burden to borrowers. For more information, see Cytonn Weekly #27/2021.

VII. **Listed Real Estate**

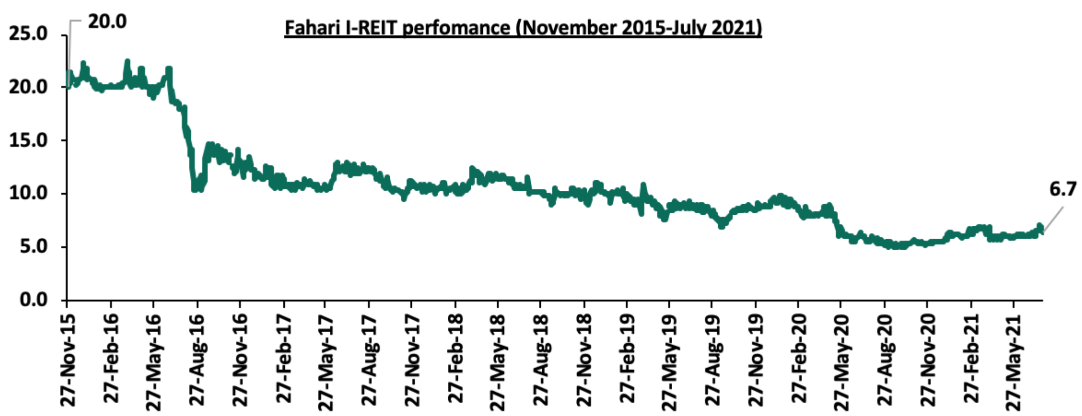
ILAM Fahari I-REIT released their H1’2021 earnings, which registered a 50.9% decline in their basic earnings per unit to Kshs 0.2 from Kshs 0.5 realized in H1’2021, attributed to the 18.4% decline in the total operating income to Kshs 147.1 mn, from Kshs 180.1 mn in H1’2020, coupled with a 4.3% increase in total operating expenses to Kshs 106.3 mn, from Kshs 101.9 mn recorded in H1’2020. The rental income came in at Kshs 136.7 mn, a 21.8% decline from the Kshs 174.7 mn recorded in H1’2020 mainly attributable to the low rental income generated by the retail and commercial offices struggling to attract and maintain tenants due to the impact of the pandemic, as well as the high expenses incurred from poorly performing assets such as the Greenspan mall which lost its anchor tenant Tuskys from bad debts. However, ICEA signed a deal with Naivas as its anchor tenant replacing Tuskys and hence we expect the performance to improve in the second half of the year.

For a more comprehensive analysis, please see our ILAM Fahari I-REIT H1’2021 Earnings Note.

Additionally, Acorn Holdings released their H1’2021 financial statements for the D-REIT and I-REIT Investment arm which have been invested in student accommodation. The Development Real Estate Investment Trust (D-REIT) finances the development of student hostels whereas the Investment Real Estate investment trust (I-REIT) is mainly invested in the respective properties by the firm for rental income. Acorn D-REIT recorded profits of Kshs 266.9 mn in H1’2021 while the I-REIT profits came in at Kshs 141.3 mn. The D-REIT Performance was mainly driven by the Kshs 339.0 mn increase in the fair value of Investment Property.

For a more comprehensive analysis, please see our Acorn Holdings H1’2021 Earnings Note.

On the Exchange, Fahari closed the month trading at an average price of Kshs 6.7 per share, a 15.5% YTD increase from Kshs 5.8 per share, and a 9.8% MTD increase from Kshs 6.1 realized in June. However, the share price represents a 66.5% inception to date decline from Kshs 20.0. The REIT is expected to continue recording subdued performance due to a general lack of knowledge on the financing instrument, as well as investor lack of interest for it. The graph below shows the REIT’s performance from November 2015 to June 2021:

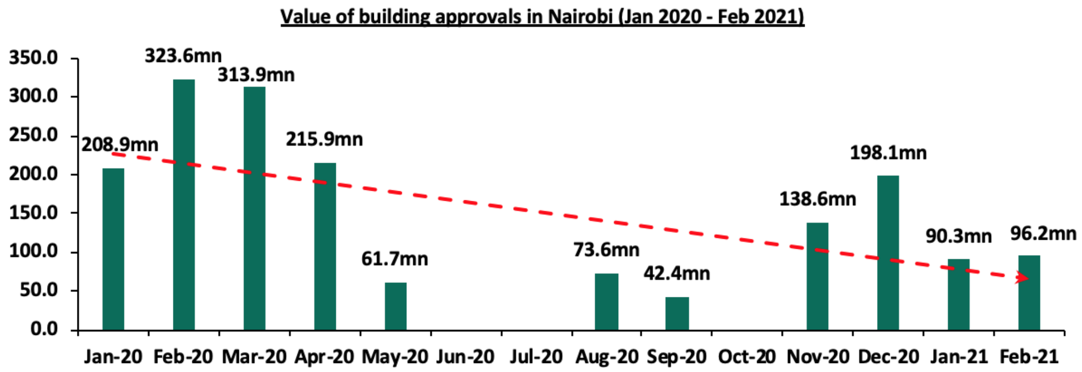


Other Key highlights in the real estate sector include;

i. Nairobi’s City Hall announced plans to waiver submission fees on building plan approvals in addition to allowing some developments above permitted zoning regulations, in a bid to entice property developers into initiating housing projects in the county thereby boosting revenue for the county government. According to City Hall, the waiver plans is also further supported by the increasing demand for approvals by the market forces, hence need to tap into the opportunity to generate more revenue for the government and also purpose for improved building plan approvals and developments in the long run.

The above move by City Hall comes barely less than a month after Nairobi Metropolitan Services (NMS) announced the resumption of the upgraded e-construction permit system which includes the Quick Response (QR) Code System in August 2021, with the aim of facilitating easier and faster approval processes for building plans. According to KNBS' Leading Economic Indicators February 2021 report, NMA registered a 70.3% decline in the value of building plan approvals to Ksh 96.2mn in February 2021, compared to Ksh 323.6mn recorded a similar period in 2020 due to the reduced development activities amidst the tough economic environment. Therefore, with the economy having picked up coupled with the implementation of the waiver plans in place and resumption of the permit system, more development plan approvals are expected to be registered in Nairobi, with more construction activities also expected to be witnessed in the real estate construction industry.

The graph below shows value of building approvals in Nairobi from January 2020 to February 2021;



Source: Kenya National Bureau of Statistics

The real estate sector continues to make remarkable improvements supported by; i) improved mortgage availability, ii) continued focus on infrastructure and affordable housing projects, iii) an expected improvement in the number of development plans for construction within Nairobi, and, iv) aggressive retail space uptake by local and international retailers. However, factors such as the low consumer spending patterns, high development costs, low tourist arrivals from top source markets such as the UK, are expected to continue hindering performance of the sector.