Off Plan Investment in Real Estate, & Cytonn Weekly #15/2017

Cytonn Weekly

Executive Summary

Fixed Income: T-bills were oversubscribed for the 11th consecutive week, with overall subscription coming in at 117.3%, compared to 149.5% recorded the previous week. The 182-day paper was not on offer for the 6th week in a row, as the government aims to spread maturity concentration risk across the three papers. Meanwhile, the National Treasury has ordered the tax and duty-related provisions of the Finance Bill 2017 into effect even before the Bill passes into Law;

Equities: During the week, the equities market recorded mixed trends with NASI and NSE 25 gaining 1.6% and 0.4%, respectively, while NSE 20 lost 0.1%. The High Court withdrew the Motor Insurance Underwriting Guidelines of 2009 issued by the Insurance Regulatory Authority (IRA), thus stopping IRA from setting the industry premium rate for motor segment;

Private Equity: Activity in the private equity space continues to gain traction based on investments, fund raising and exits registered during the week as, (i) Synergy Private Equity Fund achieved its 9th investment by completing its investment in Northstar Finance Services Limited, (ii) Frontier Investments Management raised USD 116.0 mn in the first close in its second fund, Frontier Energy II, and (iii) Mediterrania Capital and AfricInvest successfully exited Grupo San Jose & Lopez (SJL);

Real Estate: Kenya ranked as the third most preferred travel destination by the high net worth individuals (HNWI) in Africa in 2016, surpassing world famous Mauritius and Seychelles. The World Bank has pointed to low or informal incomes, combined with high financing costs as the key factors limiting supply of affordable housing in Kenya. Two Rivers Development Limited (TRDL), is set to issue a one -year note at a yield of 14.5%, seeking to raise Kshs 2.0 bn for its real estate projects;

Focus of the Week: Following increased incidences of claims of fraud associated with off-plan purchases in the real estate market, this week we look at off plan investments in real estate ? the processes involved, the advantages and disadvantages and the key things to look out for before purchasing real estate off plan.

Company Updates

- Our Investments Manager, Maurice Oduor, discussed the banking report released by Cytonn Investments. Watch Maurice Oduor on Citizen TV here
- Our Investment Analyst, John Ndua, discussed the decline in the private sector credit uptake, which has dragged down the private sector growth. Watch John Ndua on CNBC here
- Our Investment Analyst John Ndua, discussed the banking report by Cytonn Investments that ranked KCB as the most attractive bank in Kenya. Watch John Ndua on KTN here
- We continually showcase real estate developments by our real estate development affiliate, Cytonn Real Estate, through weekly site visits. The site visits target both investors looking to

invest in real estate directly, and also those interested in high yield investment products to familiarize themselves with how we support the high yield returns. If interested in attending the site visits, kindly register here

- We continue to see very strong interest in our Private Wealth Management training, which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. To register for the training kindly use this link
- For recent news about the company, see our news section here
- We have 12 investment-ready projects, offering attractive development and buyer targeted returns of around 25.0% p.a. See further details here: Summary of investment-ready projects
- To invest in any of our current or upcoming real estate projects, please visit Cytonn Real Estate
  - The Alma, which is over 55.0% sold, has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. See The Alma.
  - Amara Ridge is currently 100.0% sold and has delivered 33.0% p.a. returns to investors. See Amara Ridge
  - The Ridge Phase One is currently 20.0% sold. See The Ridge
  - Taraji Heights is currently 10.0% sold. See Taraji Heights
- Following the completion of sales for Amara Ridge, we are currently looking for land in Karen for our next development. We are also looking for 3-10 acres of land in Garden Estate, Muthaiga North, South C and Lang?ata. Contact us at rdo@cytonn.comif you have any land for sale or joint ventures in the above areas
- We continue to beef up the team with the ongoing hires: Careers at Cytonn

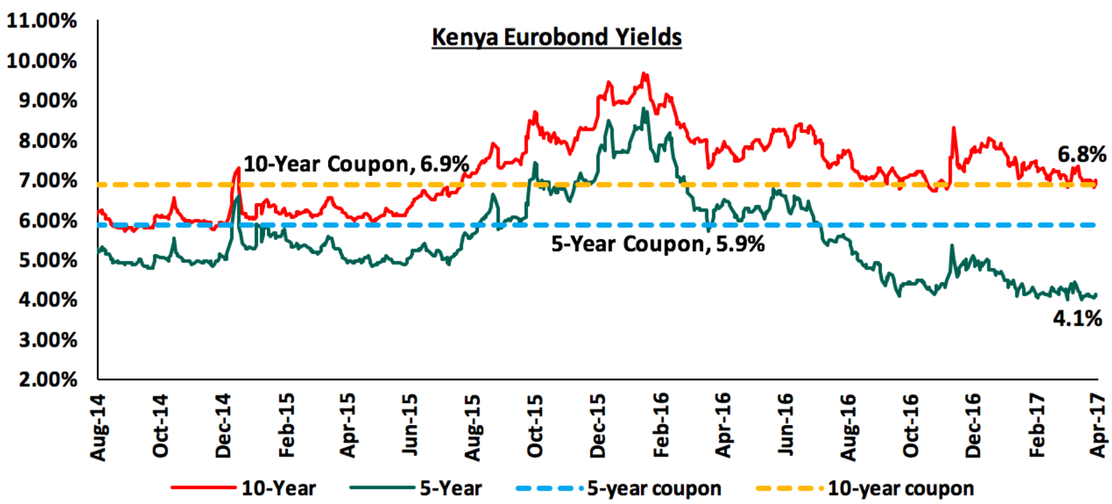
Fixed Income

T-bills were oversubscribed for the 11th consecutive week, with the overall subscription rate coming in at 117.3%, compared to 149.5% the previous week. The 182-day paper was not on auction for the 6th week in a row, a move aimed at managing maturity concentration by spreading risk across the three papers. Subscription rates for the 91 and 364-day papers came in at 127.5% and 107.1%, compared to 125.1% and 173.9% the previous week, respectively. Yields on the 91 and 364-day papers remained unchanged at 8.8% and 10.9%, respectively.

Recently, there has been upward pressure on interest rates as investors continue to demand higher yields, given the high inflation rate, currently at 10.3%. The 91-day T-bill has been the main focus, as it currently offers a negative real return of 1.5%. Despite this, the government has remained disciplined by rejecting bids that are above market. The market responded to this positively by bidding less aggressively as indicated by the high total overall acceptance rate of 81.0% compared to 78.0% at the start of February, an indication that investors are bidding within the ranges that are deemed acceptable by the Central Bank of Kenya.

This week, the Kenyan Government re-opened two bonds, FXD 3/2008/10 and FXD 1/2009/10, with effective tenors of 1.4 and 2.0 years, respectively, in a bid to raise Kshs 30.0 bn for budgetary support. In the last 3 auctions, the government has rejected expensive bids from investors, given that the domestic borrowing program is ahead of target and hence the government is under no pressure to borrow at yields above market. However, it is important to note that (i) the government has only borrowed Kshs 205.8 bn from the foreign market, which is just 44.5% of its foreign borrowing target of Kshs 462.3 bn, and (ii) the Kenya Revenue Authority (KRA) has already missed its first half of 2016/17 fiscal year revenue collection target by 3.2%, and is also expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year due to depressed earnings growth by corporates. Given that (i) these bonds traded on the secondary market at yields of 12.1% and 12.6% as at 7th April, 2017 for the 1.4 year and 2.0 year bonds, respectively, and (ii) market liquidity distribution remains skewed towards the larger banks, we expect investors to bid for the bonds at yields above the secondary market yield, and we therefore recommend a bidding range of between 12.1% - 12.6% for the FXD 3/2008/10 and 12.6% - 13.1% for the FXD 1/2009/10.

According to Bloomberg, the yields on the 5-year and 10-year Eurobonds, with 2.2 years and 7.2 years to maturity, remained relatively flat closing the week at 4.1% and 6.8%, respectively. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 2.8% points and 4.7% points, respectively, for the 5-year and 10-year bonds due to improving macroeconomic conditions. The declining Eurobond yields and Standard & Poor?s (S&P) having maintained Kenya?s foreign and local currency sovereign credit ratings for the short and long term at ?B+/B?, respectively, are an indication that Kenya remains a stable and hence attractive investment destination.



The Kenya Shilling remained relatively stable against the dollar to close the week at Kshs 103.4 as was recorded the previous week, on account of increased currency inflows as the Easter holiday weekend drew nearer. On a year to date basis, the shilling has depreciated against the dollar by 0.9%. The forex reserve level currently stands at USD 8.0 bn (equivalent to 5.3 months import cover) from USD 7.0 bn (equivalent to 4.6 months import cover) recorded on 17th March 2017, largely as a result of the receipt of the Kshs 82.3 bn syndicated loan. Going forward, we expect the shilling to come under pressure from (i) global strengthening of the dollar due to the expected series of rate hikes during the year, and (ii) recovery of global oil prices. However, with the current forex reserve level, we believe the CBK will be able to support the shilling in the short term.

The World Bank has revised its outlook on Kenya?s 2017 GDP growth downwards, to 5.5% from 6.0% previously. The basis of their downward revision was (i) the slow-down in private sector credit growth that has been persistent since late 2015 and may worsen as a result of the cap on interest rates resulting in slow growth in SMEs, (ii) the prevailing drought that has affected the agricultural sector, Kenya?s biggest contributor to GDP at 19.3% of GDP as at Q3?2016, with major exports such as tea and horticultural produce being affected, and (iii) spill-over effects of the drought such as a rise in energy prices due to lower Hydro-Electric Power (HEP) production and increases in food prices due to low agricultural production; all building up to rising inflationary pressure in the country. However, the growth is still strong, above the Sub-Saharan Africa projected growth of 2.9%. In our view, we expect GDP growth for 2017 to be between 5.4% - 5.7%, supported by government spending on infrastructure and recovery of the tourism sector.

The National Treasury has ordered the tax and duty-related provisions of the Finance Bill 2017 into effect even before the Bill passes into Law. This order became effective last week and will see excise stamp fees paid on cigarettes and alcoholic beverages with more than 10.0% alcohol content increase to Kshs 2.8 per retail unit from Kshs 1.5 previously. Contrary to this, excise stamp fees on non-alcoholic beverages, mineral water and cosmetics have practically been halved, reducing to Kshs 0.6, Kshs 0.5 and Kshs 0.6 per retail unit, respectively. Keeping in mind that non-alcoholic beverages are consumed by a larger population and at a higher frequency than alcoholic beverages (above 10.0% alcohol content), the net effect of these changes would be a tax cut on beverages in general. The provisions in the Finance Bill are in line with taxation measures outlined in the National Budget for the fiscal year 2017/18 where it was proposed to increase tax on wines and spirits with alcohol content above 10.0% to Kshs 200 per liter from Kshs 175 previously. This move will likely result in alcoholic beverage manufacturers and retailers passing on the extra costs to the consumer, leading to an increase in prices of these wines and spirits. In our view, this move by the Treasury (i) will have minimal effect on inflation as alcoholic beverages, tobacco & narcotics only bear a 2.1% weighting on the Consumer Price Index? (CPI?s) and (ii) will lead to minimal increase in revenue for the exchequer as the bulk of tax collection comes from PAYE and VAT at 43.4% and 22.3%, respectively, whose changes were to increase the tax brackets hence lesser collections.

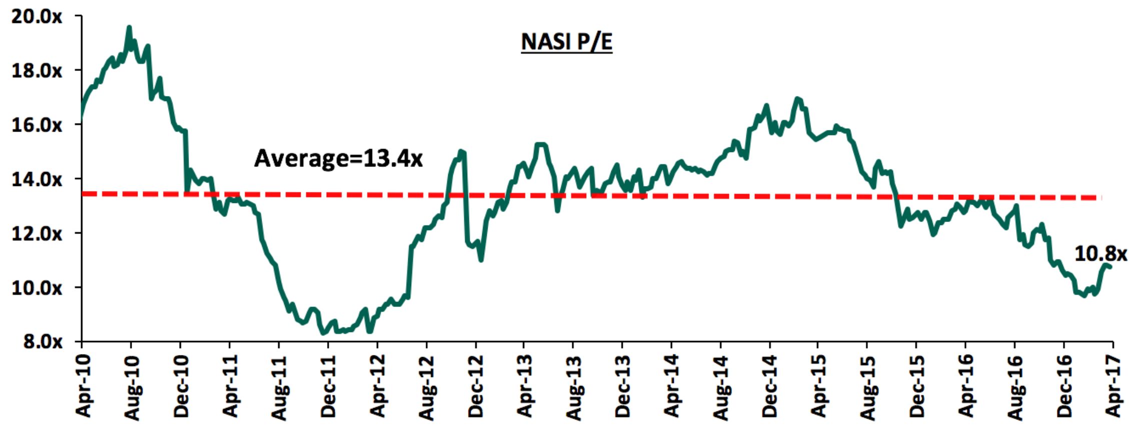
The Government is ahead of its domestic borrowing for the current fiscal year, having borrowed Kshs 235.2 bn against a target of Kshs 177.6 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). The government has only borrowed Kshs 205.8 bn, of the budgeted foreign borrowing, representing 44.5% of its foreign borrowing target of Kshs 462.3 bn, and the Kenya Revenue Authority (KRA) has already missed its first half of 2016/17 fiscal year revenue collection target by 3.2%, and it is expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year. Given that the government has less than 2.5 months to the close of the current fiscal year and the fact that borrowing from the foreign market is a much longer process than borrowing from the domestic market, the government is likely to use the domestic market to plug in the deficit that is likely to arise. This creates uncertainty in the interest rate environment as domestic borrowing may exert upward pressure on interest rates, and result in longer term papers not offering investors the best returns on a risk-adjusted basis. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments.

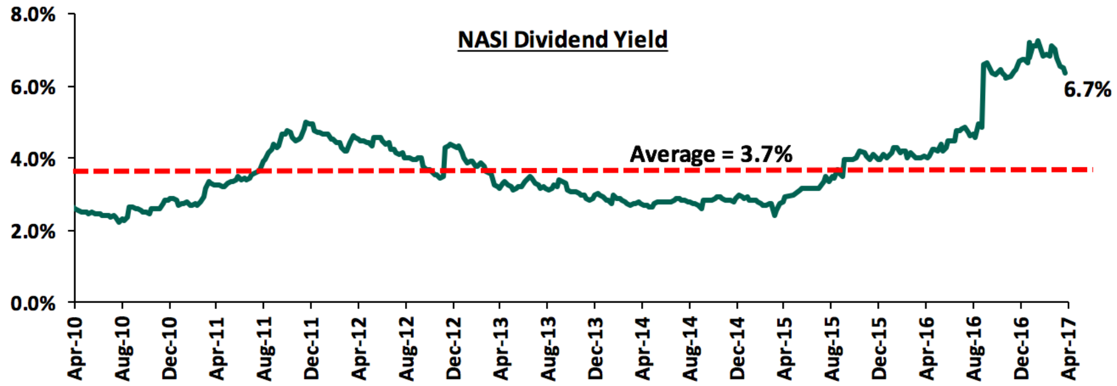
Equities

During the week, the equities market recorded mixed trends with NASI and NSE 25 gaining 1.6% and 0.4%, respectively, while NSE 20 lost 0.1%, taking their YTD performances to 1.3%, (2.4%) and 0.1%, respectively. This week?s performance was supported by gains in large cap stocks such as Safaricom, which gained 8.1%. Since the February 2015 peak, the market has lost 43.5% and 24.2% for NSE 20 and NASI, respectively.

Equities turnover increased by 24.9% to close the week at USD 31.1 mn from USD 24.9 mn, the previous week. Foreign investors remained net buyers with net inflows of USD 1.0 mn, compared to a net inflow of USD 0.7 mn recorded the previous week, with foreign investor participation increasing slightly to 88.1%, from 86.2% recorded the previous week. Safaricom and KCB were the top movers for the week, jointly accounting for 75% of market activity. We expect the Kenyan equities market to be flat in 2017, driven by slower growth in corporate earnings, neutral investor sentiment mainly due to the forthcoming general elections, and the aggressive rate hike cycle in the US, which may reduce the level of foreign investors? participation in the local equities market.

The market is currently trading at a price to earnings ratio of 10.8x, versus a historical average of 13.4x, with a dividend yield of 6.7% versus a historical average of 3.7%. The current 10.8x valuation is 11.3% above the most recent trough valuation of 9.7x experienced in the first week of February of 2017 and 30.1% above the previous trough valuation of 8.3x experienced in December of 2011. The charts below indicate the historical P/E and dividend yields of the market.





The High Court has withdrawn the Motor Insurance Underwriting Guidelines of 2009 issued by the Insurance Regulatory Authority (IRA), thus stopping IRA from setting the industry premium rate for motor segment. The guidelines, which were issued by IRA in 2010 on account of underperformance in the sector, pushed upwards the motor private segment premiums from a blanket-flat rate of 4.0% of the value of the car to a cap of 7.5%, with a discount of 10.0% for each year of no claim to a minimum of 4.5%. Despite the set rate, price undercutting has been ongoing in the insurance industry as a result of cut-throat competition in the business segment leading to losses in the motor class of business. This ruling will allow for insurers to charge premium rates of their own choosing, and with the introduction of the risk-based capital regime, most insurance companies have increased premium rates as they align premiums to be proportionate to the risk being insured. We view this as a good development for the industry as pricing in an open market economy is supposed to be determined by the forces of demand and supply, rather than regulatory intervention; the only exceptions that warrant regulatory intervention are public goods, such as utilities. Anytime there is external interference, such as with quotas, minimum wages or legislations; there is either excess supply or demand, which leads to a deadweight loss in the economy and ineffective allocation of resources. The court ruling comes at a time when the National Transport and Safety Authority (NTSA) is set to roll out digital driving licenses, while the IRA plans to have underwriters share customer information with Credit Reference Bureaus (CRB) to curb fraud. On implementation of these changes, insurance firms will be better placed in developing and pricing products in line with each customer?s risk profile, thus increasing profitability of the segment going forward. We hope that the trend to do away with regulatory or industry set fees will percolate its way into other areas such as legal fees, architectural fees, quantity surveying fees, and other areas that continue to set fee scales.

Marshalls East Africa is set to delist from the Nairobi Securities Exchange (NSE), following years of recording losses. Global Limited, the firm?s top shareholder with a stake of 13.9% has offered to buy out fellow minority shareholders at a 25.0% premium, at Kshs 10.8, to the six-month volume weighted average price of Kshs 8.6 as at 30th March. The buyout will open on 10th May and close on June 7, but is subject to shareholders? approval at the company?s annual general meeting scheduled for 8th May. The plan to remove the company from trading on NSE will give Marshalls greater flexibility in changing its business strategy without prejudicing shareholders, and will also reduce expenses related to maintaining a listing on the NSE, such as additional listing fees as a result of listing additional shares, and annual listing fees.

Following the release of FY?2016 earnings, a number of companies reported depressed earnings with the total number of companies that issued profit warnings in 2016 coming in at 11, compared to 14 companies in 2015, indicating a continually challenging operating environment. As a result of this, cost rationalization measures, such as laying-off of staff and closure of branches by banks continue to gather pace, with KCB Group being the latest to report laying off of 223 employees in 2016. The Group spent Kshs 186.0 mn in the staff restructuring process that brought its total employee number to 7,192 from 7,415 in 2015. This came after KCB Group had indicated that it would lay off staff to cut expenses in a bid to improve efficiency, pointing towards lower staff costs going forward.

This brings to 10 the number of banks that have announced downsizing plans since the implementation of the interest rate cap as shown in the table below.

Kenya Banking Sector Restructuring			
	Bank	**Staff Retrenchment**	**Branches Closed**
1	Sidian Bank	108	-
2	Equity Group	400	-
3	Ecobank	-	9
4	Family Bank	Unspecified	-
5	First Community Bank	106	-
6	Bank of Africa	-	12
7	National Bank	Unspecified	-
8	NIC	32	-
9	Standard Chartered	300	-
10	KCB Group	223	-

BAT Kenya also laid off 40 employees resulting in staff restructuring costs of Kshs 338.0 mn on account of redundancy. The company said it introduced new working practices in the manufacturing process, leading to a 9.0% reduction in cost of operations in 2016. BAT Kenya has seen consistent cost reduction, and with the reduction of number of employees, it may continue to record lower costs in the short term.

Below is our Equities Recommendation table. Key changes from last week include:

- Liberty moved from a ?Buy? recommendation with an upside of 20.9%, to an ?Accumulate? recommendation with an upside of 16.8%, following a 4.4% price increase;
- Stanbic moved from a ?Hold? recommendation with an upside of 8.2%, to an ?Accumulate? recommendation with an upside of 11.6%, following a 7.9% price decrease.

all prices in Kshs unless stated otherwise									
EQUITY RECOMMENDATION									
No.	**Company**	**Price as at 07/04/17**	**Price as at 13/04/17**	**w/w Change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****	**Recommendation**
1.	ARM	20.0	20.0	0.3%	(21.6%)	31.2	0.0%	56.0%	Buy
2.	Bamburi	164.0	163.0	(0.6%)	1.9%	231.7	7.8%	49.9%	Buy
3.	Kenya Re	19.1	19.2	0.3%	(14.9%)	26.9	3.9%	44.4%	Buy
4.	Britam	10.3	10.0	(2.9%)	0.0%	13.5	2.9%	37.9%	Buy
5.	KCB ***	33.8	33.0	(2.2%)	14.8%	40.1	9.1%	30.6%	Buy
6.	Sanlam	24.8	25.0	1.0%	(9.1%)	30.5	0.0%	22.0%	Buy
7.	BAT (K)	830.0	849.0	2.3%	(6.6%)	970.8	6.2%	20.5%	Buy
8.	Liberty	11.5	11.9	3.5%	(9.8%)	13.9	0.0%	16.8%	Accumulate
9.	Stanbic	60.0	58.0	(3.3%)	(17.7%)	60.2	8.1%	11.8%	Accumulate
10.	Barclays	8.0	7.8	(2.5%)	(8.0%)	7.9	10.3%	11.6%	Accumulate

11.	Co-op	14.0	14.0	0.4%	6.1%	14.4	5.7%	8.3%	**Hold**
12.	Safaricom	18.7	19.5	4.3%	1.6%	19.8	4.7%	6.3%	**Hold**
13.	Jubilee	490.0	468.0	(4.5%)	(4.5%)	482.2	1.8%	4.9%	**Lighten**
14.	I&M Holdings	93.0	90.0	(3.2%)	0.0%	88.0	3.9%	1.7%	**Lighten**
15.	Equity Group	35.0	32.8	(6.4%)	9.2%	30.7	6.1%	(0.2%)	**Sell**
16.	SCBK	213.0	209.0	(1.9%)	10.6%	189.5	6.7%	(2.6%)	**Sell**
17.	NIC	30.5	28.8	(5.7%)	10.6%	26.4	3.0%	(5.2%)	**Sell**
18.	HF Group	10.8	10.4	(3.7%)	(25.7%)	9.2	4.8%	(6.6%)	**Sell**
19.	DTBK	120.0	120.0	0.0%	1.7%	104.0	2.2%	(11.1%)	**Sell**
20.	NBK	6.1	6.0	(1.7%)	(17.4%)	1.7	0.0%	(71.4%)	**Sell**
Target Price as per Cytonn Analyst estimates									
*****Upside / (Downside) is adjusted for Dividend Yield***									
******For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group, ranking as the 14th largest shareholder in the group***									
Accumulate ? Buying should be restrained and timed to happen when there are momentary dips in stock prices.									
Lighten ? Investor to consider selling, timed to happen when there are price rallies									

We remain "neutral with a bias to positive" for investors with short to medium-term investments horizon and are "positive" for investors with long-term investments horizon.

Private Equity

Synergy Private Equity Fund (SPEF), a firm that invests in high-growth companies in Nigeria, Ghana, Liberia and Sierra Leone, has achieved its 9th investment by completing its investment in Northstar Finance Services Limited (Northstar), which offers financial services products, predominately in Nigeria and Ghana. This transaction has seen SPEF add Safetrust Nigeria, Northstar Home Finance, Avance Insurance Co. Ltd and Ping Express Inc. to its portfolio. This investment will enable Northstar achieve its growth strategy and establish a leading position as the most preferred personal finance institution in West Africa. The increased investments in the financial services sector in Sub-Saharan Africa is motivated by (i) the increasing demand for credit by SME?s to cater for their business expansion needs, (ii) the growing financial inclusion in the region facilitated through alternative banking channels, (iii) increased innovation and new product development within the sector, and (iv) the growing middle class supporting an inherent increase in consumption expenditure, and an increase in the percentage of the population that will require financial services.

AfricInvest, a private equity wing of the investment financial services Group Integra, and Mediterrania, a private equity firm supporting developments in Morocco, Tunisia and Algeria, have exited Grupo San Jose & Lopez (SJL) by the sale of their 100% stake to Investec Asset Management (IAM). IAM is an asset manager based in South Africa with approximately USD 114.0 bn under its management. SJL, is a logistics and international road freight transport company that has operations in Maghreb and Europe. Mediterrania Capital and AfricInvest jointly acquired an undisclosed minority stake in SJL in June 2013 and eventually acquired the remainder in August 2015 becoming the sole owners. The acquisition of SJL is in line with Investec?s future strategy in terms of geographical expansion, service development and product offering. SJL, currently managing 11 logistics platforms in Morocco, Tunisia and Europe and delivering over 20,000 annual journeys between Europe and Morocco, will act as a link to the European and African market. With the current infrastructural developments in the region, specialized logistics and transportation are needed to transport raw materials and specialized equipment, and drive efficiency within the industry.

Frontier Investments Management, a Danish private equity firm, has raised USD 116.0 mn in the first close of its second fund, Frontier Energy II. The Fund is to finance greenfield renewable energy projects across the Sub-Sahara Africa region. The fund will be implemented in a similar way as its predecessor, a USD 63.8 mn fund, DI Frontier Market Energy and Carbon Fund, which is fully deployed in six different investments with the objective to generate 139.0 MW from the mix of geothermal, solar and hydro power projects in East Africa. Frontier Energy II is meant to achieve an Internal Rate of Return (IRR) of above 20.0% to the investor in the fund by investing between USD

3.0 mn and USD 30.0 mn, in the form of equity, debt or mezzanine, in projects that require capital ranging from USD 5.0 mn up to USD 300.0 mn. The energy market remains bullish in Sub-Saharan African states with (i) increase in energy requirements by the growing population, (ii) investor friendly regulations put in place by the industry regulators including tax exemption and import duty on material used for renewable energy plant development, and (iii) the Feed-in-Tariff that offers investors a guarantee of returns on their investments.

Private equity investments in Africa remain robust as evidenced by the increased deals and deal volumes in the region?s key sectors; financial services, energy, transport and logistics. Given (i) the high number of global investors looking to cash in on the growing middle class of Africa, (ii) the attractive valuations in frontier markets compared to global markets, (iii) better economic projections in Sub Sahara Africa compared to global markets, and (iv) the high number of exits that is evidence of the attractiveness of the region, we remain bullish on PE as an asset class in Sub-Sahara Africa.

Real Estate

During the week, AfrAsia Bank released their Africa Wealth Report that focused on a comprehensive review of the wealth market in Africa, including high net worth individuals (HNWI) trends, luxury trends and wealth management trends from 2006 to 2016, with projections to 2026. According to this report, HNWI are individuals with net assets of USD 1.0 mn and above. The report ranked Kenya as the third most preferred travel destination by the HNWI in Africa in 2016, surpassing world famous Mauritius and Seychelles. South Africa was the most popular African destination for the super-rich, with approximately 15,000 multimillionaires while Morocco accommodated 5,000. Kenya and Botswana were both ranked at position 3 with both hosting 4,000 multi-millionaires each. Maasai Mara and Nairobi remained the most preferred destinations for the HNWI going on holiday in Kenya, due to the safari experiences that both places offer. Mainly Cottar?s 1920s Safari Camp in Maasai Mara was the most popular safari lodge for the HNWI visiting Kenya and fifth in Africa, supported by the fact that Kenya is famous globally for the wildlife safaris and the wildebeest migration. Wildlife safari was the most popular hobby for HNWIs in Africa last year, followed by golf, cycling, art collecting, horse riding, tennis among others.

We expect growth of the tourism sector to continue, hence attracting more tourists due to the following factors;

- Nairobi is strategically positioned to serve the rest of Africa since most of Africa?s cities can be accessed with direct flights from Nairobi,
- Nairobi is the regional hub, hence the increase in the number of international conferences, contributing positively to MICE tourism. As per 2016 KNBS Economic Survey, there was an increase in international conferences, which resulted into an increase in number of local and international delegates over the past five-years by 3.3% and 20.9%, respectively,
- The infrastructural network within the city has improved and eased the accessibility of national parks and game parks, for example, completion of the Northern tourism circuit which connects with the coastal tourism circuit.

This week, World Bank released the Kenya Economic Update 2017 report that highlighted the need for investment in housing, which will create jobs, improve economic growth and strengthen the country?s financial services sector. This is can be achieved by unlocking the residential housing market through the development of the housing finance market that can provide a wide range of employment opportunities through the construction sector and related industries as evidenced in countries such as Colombia, India, and South Africa. For example, in Colombia it is estimated that 5 jobs are added for every USD 10,000 spent on house construction. The key take outs from this report were;

- Currently, there is an estimated accumulated housing deficit of over 2 million units, with 244,000 housing units needed against a supply of approximately 50,000 housing units per annum and an urbanization rate of 4.4%, leading to approximately 61.0% of urban households living in slums,
- Both Government and private sector developments are majorly targeting high and middle income earners hence leaving low income unattended and resulting in an urban sprawl,
- Nairobi ranked as the highest priced city in Africa, with prices beyond the reach of more than 90.0% of Kenyans, and the cheapest homes in the capital Nairobi are now priced at Kshs 4.0 million, up from Kshs 500, 000 in year 2000.

The World Bank report went further into analyzing the key constraints that are limiting supply of affordable houses in Kenya as;

- Low or informal incomes, combined with high financing costs - this makes mortgages unaffordable for most households since they cannot meet the lending standards that suggest households should not allocate more than 33.0% of net monthly income towards their housing costs,
- The prohibitive cost of houses mainly driven by high land costs, construction costs and auxiliary costs associated with putting utilities or access roads and the costs of maintaining property,
- Cumbersome property titling/registration that deter investors from obtaining urban land for housing and households from being able to secure financing from banks,
- The local banks shying away from providing mortgages, which currently stand at approximately 25,000 home loan accounts equivalent to 3.2% of GDP in 2015.

We remain skeptical on achieving affordable housing in Kenya unless the government provides a conducive environment for both financiers and developers by;

- Making financing more available and affordable for home purchases and/or construction,
- Providing incentives for housing construction by fast-tracking approvals for housing construction permits and possible waivers or reduction in fees and taxes associated with housing construction,
- Provide basic infrastructure and services such as water, transport networks, power and sewer on the land.

Two Rivers Development Limited (TRDL) is set to issue a one -year note at a yield of 14.5%, to raise Ksh2.0 bn to fund its real estate projects. The note will be guaranteed by Centum Investments, which owns 58.0% of TRDL. The funds will be channeled towards financing the construction of the remaining piece of land for other developments such as apartments and office suites. At the same time, TRDL announced its plans to sell 11 plots of land during the year at a minimum disposal value of Kshs 5.0 bn to repay the Kshs 2.0 bn short-term debt and build infrastructure on the remaining land. The land set for sale are five residential plots for Kshs 2.5 bn, three mixed use plots at Kshs 1.4 bn, two mixed retail plots at Kshs 1.2 bn and Kshs 57.0 mn from the disposal of a plot meant for construction of the five-star hotel.

Financing has proved to be a key constraint to many developers with many developments stalling due to cash withdrawal by financiers or lack of project financiers. Our view is that developers should have a team focusing on project finance structuring. The financing should be structured in various forms of debts and equity that complement each other to avoid projects from stalling or sale of project assets that lead to concept changes and likely loss of investor money, confidence or both.

Other Real Estate Highlights during the week are;

1. Nakumatt Supermarket?s Katwe branch in Uganda was closed following rent arrears running into millions of shillings. This follows the closure of its Kenyan Branch in Nairobi along Ronald Ngala street. The retailer has been experiencing financial strain and is currently working on a Ksh 7.5 bn deal to sell a 25.0% stake to a strategic investor to be able to reorganize its capital structure,

2. ICDC has entered into a Memorandum of understanding with Standard Chartered Bank to ease purchase of its coast-based homes, Nyali Zamia Heights apartments in Mombasa, which will benefit buyers from an extended loan repayment tenor of up to 25 years from the bank which translates to lower monthly charges on home loans, and
3. Tatu City is set to launch the third phase of its buy and build residential project, Kijani Ridge. The new phase of the project introduces an additional 100 quarter-acre plots to meet demand as early phases sell out.

We expect continued investment in the hospitality sector as the sector attracts increased numbers of tourists driven by improved security, infrastructure and tourism products and remain neutral on focus on affordable housing by developers until government provides incentives to developers to curb high costs translating to high prices.

Focus of the Week: Off Plan Investment in Real Estate - What a Buyer Needs to Know

Over the last couple of weeks, we have witnessed a number of property buyers coming to the fore claiming to have been swindled by developers over off plan real estate purchases. This week we thus seek to demystify off plan investment in real estate. We start by introducing off plan investments in real estate, the processes involved, the potential gains and risks. We then cover briefly the two most recent cases in the dailies of Simple Homes and Gakuyo, and conclude by advising buyers on what they should look out for when purchasing property off plan.

Introduction

Off plan investment refers to the purchase of property before completion, generally driven by the high price of real estate and the long time taken to deliver units, given low supply of real estate units despite the increasing prices. The buyer hence buys the property off the plan or design stage of the development. It has become increasingly popular as the prices of the property sold are much lower than market, and can be up to 50.0% less than the price of a completed house.

Processes Involved

The process of purchasing a property off plan begins with the signing of three documents, (i) the Reservation Form, (ii) the Letter of Offer and, (iii) the Sale Agreement, where a developer promises to deliver a parcel of land, a house or land package to a buyer at an agreed price at a future date, subject to the developer obtaining all necessary approvals in respect of the development from the relevant authorities and satisfying any conditions necessary to finalize the development. In most cases, the buyer must pay the developer a deposit upon signing the contract, with the balance of the purchase price due at the settlement date, or via a specific payment plan.

Advantages of Purchasing Real Estate Off Plan

i. Potential high capital gains - Buying off plan allows investors to acquire a future asset at today?s price and hence in a rising or a peaking market, the buyer achieves capital gains, and on completion they have a significant margin. Developments have delivered over 50.0% price appreciation. For instance, The Alma in Ruaka by Cytonn Real Estate, which is at 55.0% price appreciation 9-months into construction;
ii. Flexible payment plans ? To purchase a property off plan all one needs is a deposit, which is usually 10% to 20% of the purchase price, and the rest of the amount is either paid on completion, or in flexible periodic installments. This allows individuals without the financial muscle to purchase houses immediately to acquire homes they would otherwise not afford, and,
iii. Preference ? The buyer is able to select the best location for his or her house and can also get to

pick the finishes of the house and hence get a house that is in line with their preference as opposed to buying a complete house where he/she has to settle for whatever has been provided for by the developer in the locations that have been left over by early buyers.

Disadvantages/ Risks of Purchasing Property Off Plan

i. Risk of loss of capital ? The buyer can lose the money invested in case the developer was fraudulent,
ii. Poor quality of construction ? Sometimes developers use very attractive brochures to advertise, but deliver substandard products hence the buyers do not get value for money unlike when buying a complete unit where one negotiates the purchase price based on tangible evidence,
iii. Delayed projects ? More often than not, developers aren?t able to complete the houses in the promised time frame and this can affect the buyers? financial plans, and,
iv. Lower returns ? In rare cases, market conditions may change or the developer may over promise returns such as rental yields and capital appreciation and on completion the buyer achieves lower than expected returns and hence doesn?t earn expected gains.

Case Studies

i. Simple Homes ? Formed in October 2015, it started operating as a developer claiming to sell houses off plan via a tenant purchase scheme, in which buyers were first required to join their cooperative and pay a Kshs 2,000 admission fee, then pay a 25.0% deposit for the houses in various locations including Syokimau and Kitengela. After this, they would be paying monthly instalments equivalent to their current rental rates, which could be as low as Kshs 24,000 per month. The prices of the houses were fixed and no interest was charged. The buyers were to assume occupancy immediately after completion and could pay off the 75.0% from 5-40 years. They however did not take members to sites where they were to get their houses and when clients inquired on progress and requested for site visits, they shut down operations as well as the online activities, which was in February 2017. Local dailies have reported that at least Kshs 500 mn has been lost by investors and homebuyers in the scheme;
ii. Gakuyo Real Estate / Ekeza Sacco ? Gakuyo Real Estate / Ekeza Sacco is alleged to have collected in excess of Kshs 100 mn from about 7,000 clients in deposits with each paying Kshs 10,000 with the total sum inclusive of subsequent installments being in excess of Kshs 3.0 bn. The deposits were supposed to accumulate to quantities large enough to purchase either houses or serviced plots in various parts of the country including Embu and Nanyuki. The company was supposed to deliver the first batch of houses in 2016 but they have not been delivered with some disgruntled clients claiming to have been asked for extra money without delivery to the initial promise. The State Department for Co-operatives through the Commissioner for Co-operative Development has hence launched investigations on the company following these allegations.

Things to Look at/Factors to Consider When Purchasing Off Plan

The victims in the above scams would have saved themselves millions of shillings had they done some very basic due diligence, before parting with their money. We recommend the following:

1. Developer Due Diligence

The buyer should ensure that the developer is a registered company in the country of operation. He/she should also know who the directors of the company are, how they have delivered in previous projects if they have any, to gauge their workmanship, delivery to promise, timelines and proof that they are actually developers. This will prevent one from investing with a brief case company run by fraudsters.

2. Project Due Diligence

For the project, the buyer ought to establish the following facts:

a. Visit the site ? The buyer should visit the site to know it is an actual site that exists. This should be done prior to any investment and throughout the development period to ensure the development is running smoothly and he/she is up to date with the progress of the development, so that if any issues arise, they can follow up with the developer or consider exit options before it is too late. Those who lost money in Simple Homes made deposits without visiting the sites; you should never part with even a penny before visiting the actual site or confirming it is a legitimate site for development,
b. Confirm that the developer has land titles for the given site ? The buyer should always insist to be given copies of the title as proof that the developer is the owner of the land and it is not a scam. He /she can also run a search on the title to ensure it has no undisclosed encumbrances and it is genuine,
c. Project plan approvals ? The buyer should also seek to know if the developer has obtained the necessary approvals for the property and hence has the legal right to develop the property to prevent delays in the delivery of the project,
d. Project team and their delivery history and capability ? The buyer should also know who is in the project team, their previous experience and hence gauge if they are able to deliver the given project,
e. Get regular updates from the developer on the progress ? This is a must to ensure that the development is ongoing and will be delivered on time and quality. A developer who doesn?t give regular updates is suspect and he/she could be hiding crucial information or is fraudulent,
f. Research on comparables around the area to gauge possibility of earning potential returns promised by the developer. That is rents, prices, yields, occupancy and uptake. This also helps the buyer know if the development is overvalued and can hence look for better investment opportunities. A good developer should be able to share at least a summary of their research findings with the buyer,
g. Timelines ? The buyer should understand the project timelines and milestones and hold the developer to them,
h. Project design team ? Seek to understand credibility of the project design team including the architects, engineers and the main contractors.

3. Contracts Due Diligence

The buyer should hire a conveyancing lawyer to review all contracts signed and ensure they are all above par and he or she is not defrauded in any way or exposed to unnecessary risk

4. Last but not least if it?s too good to be true? there is no free lunch!

In the current market due to the high land and construction costs as well as interest rates, house prices are generally high. Hence if a developer offers a house at a price that is very low by market standards and not achievable under normal circumstances, and it is the only company offering such, then one should be cautious and evaluate them fully as it is probably a scam to lure unsuspecting buyers desperate to acquire a home.

Purchasing off plan is a great way of investing in real estate and hence the buyers should not be deterred by the few cases of unethical developers as they will miss out on not only a dream home but also a lucrative investment opportunity with the highest returns of up to 25% p.a. He/she needs to understand what they are getting into, conduct a background check on the developer, consult their lawyers and invest.

For more on sharp real estate investments visit Cytonn Solutions.
