Kenya's Cost of Credit, & Cytonn Monthly – January 2022

Real Estate

I. **Industry Reports**

During the week, Hass Consult, a Real Estate development and consulting firm, released the House Price Index Q4'2021, a report highlighting the residential market performance of various nodes in the Nairobi Metropolitan Area (NMA). The following were the key take outs from the report;

i. The average selling prices for properties within the NMA recorded a q/q increase of 3.0% and a y/y increase of 3.1%, respectively, mainly driven by the improved performance of the detached units which realized a 4.9% q/q and 5.9% y/y increase in their selling prices,
ii. Westlands was the best performing node in the Nairobi suburbs recording a q/q capital appreciation of 3.0%, mainly attributed to adequate infrastructure and amenities, presence of high end income earners with the capability to purchase the properties, and its nearness to the Nairobi CBD. On the other hand, Runda recorded the highest price correction of 0.9% due to declined demand emanating from high prices which prompted people to look for affordable alternatives. For satellite towns, Ngong recorded the highest q/q price appreciation at 3.5% as a result of affordability and increased infrastructure developments such as Ngong Road, whereas Tigoni realized the highest price correction of 1.9% as a result of a declined demand for housing units, and,
iii. Average asking rents recorded a 0.2% q/q growth, with Ridgeways being the best performing node within the Nairobi suburbs with a 2.5% q/q rent increase attributed to its serene location and availability of good infrastructure, whereas the rental rates in Gigiri recorded a 1.9% decline as more focus is on buying of properties. The selling prices in Gigiri increased by 5.5% on a q/q basis. For satellite towns, Ruiru realized the highest q/q increase in rents at 3.1%, attributed to increased demand resulting from improving infrastructure developments, coupled with the presence of growing middle income earners in the area, whereas Kitengela realized a 2.2% q/q rent decline as a result of declined demand for rental units.

The findings of the report are in line with our Cytonn Annual Markets Review 2021 which highlighted that the average selling prices for houses within the Nairobi Metropolitan Area appreciated by 1.6% to Kshs 119,494 per SQM in 2021, from Kshs 116,774 per SQM in 2020. Average total return to investors came in at 6.1%, an increase from the 4.7% recorded in FY'2020. On a q/q basis, the average total returns improved by 0.6% points from the 5.5% recorded in Q3'2021. The overall improvement in performance was attributed to a general improvement in Real Estate transactions fueled by increased demand, coupled with improved investor confidence in the residential market.

Hass Consult also released the Land Price Index Q4'2021, a report highlighting the performance of the Land Sector in the Nairobi Metropolitan Area. Key take outs from the report include;

i. Overall asking prices for land within the NMA increased by 0.9% on a q/q basis and 3.9% on a y/y basis as result of increased demand fueled by increased infrastructure developments opening up areas for investments, as well as positive demographic with Kenya's urbanization and population growth rates currently being at 4.0% p.a and 2.3% p.a, respectively, against the global average of 1.8% p.a and 1.0% p.a, respectively according to the World Bank,

ii. Satellite towns recorded the highest capital appreciation on both q/q and y/y basis at 1.4% and 6.7%, respectively, mainly attributed to their affordability thus driving demand. Kiserian was the best performing node with a q/q price appreciation of 5.2% and a 19.0% y/y increase, as a result of its low entry point compared to its peers such as Rongai, and in turn making it more attractive to speculators, and,
iii. Land prices of Nairobi suburbs recorded capital appreciations of 0.3% on a q/q basis and 1.2% on a y/y basis. Spring Valley was the best performing node with a price increase of 5.6% over the quarter and 10.0% over the year, mainly attributed to its good infrastructure driving demand such as Shanzu road.

The findings of the report are in line with our Cytonn Annual Markets Review 2021 which highlighted that the Nairobi Metropolitan Area land sector recorded an average annualized capital appreciation of 2.8% in FY'2021, due to; i) the implementation and conclusion of vast infrastructure projects promoting accessibility and opening up areas for Real Estate investments, ii) efforts by the government to improve land transactions facilitated by the launching of the National Land Information Management System (NLIMS), and, iii) Kenya's relatively high urbanization and population growth rates of 4.0% p.a and 2.3% p.a, respectively, against the global average of 1.8% p.a and 1.0% p.a, respectively, thus driving increased demand for development land. Satellite towns recorded the highest appreciations at 4.8% over the year as a result of their affordability thus driving demand.

Other notable reports were released during the month were as follows:

#	Theme	Report	Key Take-outs
1	General Real Estate	Leading Economic Indicators November 2021 by the Kenya National Bureau of Statistics (KNBS)	• Overall international arrivals through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) increased by 5.1% to 76,706 in November 2021, from 72,809 realized in October 2021. On a YoY basis, this was a 59.3% increase from the 31,211 visitors recorded in November 2020, and, • Cement consumption increased by 4.0% to 7.5 mn metric tonnes between January and October 2021, from 7.2 mn metric tonnes realized in 2020. For more information, see Cytonn Weekly #04/2022.
		Quarterly Economic Review July-September 2021 by the Central Bank of Kenya (CBK)	• The gross loans advanced to the Real Estate sector increased by 3.2% to Kshs 463.0 bn in Q3'2021, from Kshs 448.0 bn in H1'2021. On a YoY basis, this was an increase of 6.5% from the Kshs 433.0 bn realized in Q3'2020. Additionally, gross loans advanced to the Tourism sector also increased to Kshs 106.0 bn in Q3'2021, from Kshs 105.0 bn in H1'2021, • Gross loans advanced to the Building and Construction sector slightly declined by 1.6% to Kshs 123.0 bn in Q3'2021, from Kshs 125.0 bn in H1'2021, and, • The Gross Non Performing Loans in the Real Estate sector increased by 1.4% to Kshs 69.2 bn in Q3'2021, from Kshs 68.2 bn recorded in H1'2021. On a YoY basis, the performance represented a 16.6% increase from Kshs 57.7 bn realized in Q3'2020. For more information, see Cytonn Weekly #04/2022.
		Q3'2021 GDP Report by the Kenya National Bureau of Statistics (KNBS)	• The Real Estate Sector grew by 5.2%, 0.3% points higher than the 4.9% growth recorded in Q2'2021, • The Construction sector recorded a growth of 6.4% in Q3'2021, 6.1% points lower than the 12.5% growth in Q3'2020. This performance represented a 0.1% points q/q drop from 6.5% growth recorded in Q2'2021, and, • The Accommodation and Restaurant sector grew by 24.8% in Q3'2021 from a contraction of 63.4% in Q3'2020. This performance represented a 15.4% points q/q increase from the 9.4% growth recorded in Q2'2021. For more information, see Cytonn Weekly #1/2022.

The overall Real Estate sector performance continues to record improved performance supported by; i) increased development activities thereby supporting the overall growth of the sector, ii) increased demand for residential units, iii) increased tourism arrivals thereby boosting performance of hotels and serviced apartments, and, iv) investor confidence in the land sector which has continued to show resilience despite the pandemic. However, we expect financial constraints to continue hindering construction activities in the sector as banks might limit lending capacities to developers as result of the increasing loan default rates, evidenced by the growth in NPLs in the Real Estate sector which recorded a 5-year CAGR of 26.5% to Kshs 69.2 bn in Q3'2021, from Kshs 21.4 bn in Q3'2016.

II. **Residential Sector**

Following the recent approval granted by the Capital Markets Authority (CMA) to Kenya Mortgage Refinance Company (KMRC) to float a Kshs 10.5 bn Medium Term Note (MTN) programme, during the week, KMRC released the Information Memorandum of the MTN. As highlighted in our Cytonn Weekly #02/2022, KMRC aims at raising a total of Kshs 1.4 bn during the first tranche of issuance, which will be disbursed to participating primary mortgage lenders (PMLs), such as banks, microfinance institutions and Savings and Credit Cooperatives (SACCOs) at a 5.0% rate, for onward lending to homebuyers at single digit rates.

The table below shows the particulars of the MTN;

Description of Note	
Issuer	Kenya Mortgage Refinance Company (KMRC)
Trustee	Ropat Trust Company Ltd
Aggregate Nominal Amount	Kshs 10.5 bn
Issue Date	4th March 2022
Listing Date	14th March 2022
Tranche 1	Kshs 1.4 bn
Interest Rates	12.5% p.a payable semi-annually in arrears
Placing Agent	NCBA Investment Bank Ltd.
Receiving Bank	KCB Bank Kenya Ltd.
Specified Denomination	Kshs 100,000 with integral multiples of Kshs 100,000 thereof
Tenor	7 years amortizing, with a Weighted Average Life of 4.5 years
Interest on Late Payments	Initial Interest Rate plus a margin of 2.0% p.a to trade creditors
Credit Rating	GCR-AA+AA- (Highest certainty of timely payment of obligations)
Default	In case of default, issuer commences negotiations with any one or more of its creditors with a view to the general readjustment or rescheduling of its indebtedness. *N/B; Trade creditors not mentioned*

Source; Kenya Mortgage Refinance Company (KMRC)

Based on the updated information memorandum, KMRC updated their financial statements as at Q3'2021 highlighting that their total operating income came in at Kshs 466.9 mn in Q3'2021, representing a 52.6% increase from the Kshs 221.1 mn realized in FY'2020. Total operating profits came in at Kshs 107.9 mn in Q3'2021, a 28.5% increase from the Kshs 77.2 mn profit recorded in FY'2020 as a result of increased revenues realized in the period of focus, from avenues such as bonds. KMRC is likely to record an increase in the overall borrowings evidenced by the additional draw down that it made in January 2022 worth Kshs 2.3 bn on a national treasury loan facility, and the Kshs 12.3 bn medium term note. As at Q3'2021, total borrowings increased by 79.8% to Kshs 6.7 bn, from Kshs 3.7 bn in 2020. With KMRC offering an interest rate of 12.5% from the MTN and lending at 5.0% rate, this will lead to a negative spread of (7.5%). Despite KMRC indicating that the mix of the concessional loans from the World Bank and the funds from the capital market will sustain their lending model, we doubt that is sustainable and` KMRC will be able to issue bonds at 12.5% and lend at 5.0% for the foreseeable future.

Notable highlights in the sector during the month include;

i. The Kenya Mortgage Refinance Company (KMRC), a treasury backed lender, announced that it had made an additional drawdown worth Kshs 2.8 bn on a national treasury loan facility, for onward lending to primary mortgage lenders. For more information, see Cytonn Weekly #04/2022,
ii. The Country Government of Mombasa announced plan to construct 3,200 housing units in Likoni. This is after 348 residents of Likoni Flats Estate agreed to move out of their dilapidated houses which were constructed in 1973 to allow for the construction of new units. For more information, see Cytonn Weekly #04/2022,
iii. Mr Charles Hinga, the Principal Secretary for the State Department of Housing and Urban Development, signed a Memorandum of Understanding (MoU) with Seascan Development Limited, a Real Estate developer, to construct 4900 affordable housing units in the project dubbed Mowlem Estate in Nairobi's Dandora area, at a cost of Kshs 18.0 bn. For more information, see Cytonn 2022 Markets Outlook,
iv. The Kenya Mortgage Refinance Company, a treasury backed lender, got approval from the Capital Markets Authority (CMA) to roll out a Kshs 10.5 bn medium-term bond programme. The firm aims at raising a total of Kshs 1.4 bn during the first tranche of issuance, which will be disbursed to participating primary mortgage lenders (PMLs), such as banks, microfinance institutions and Savings and Credit Cooperatives (SACCOs) at a 5.0% rate, for onward lending to homebuyers at single digit rates. For more information, see Cytonn Weekly #02/2022,
v. The United States Embassy announced plans to lease a 90-unit gated estate in Rosslyn comprising of both apartments and town houses dubbed *'OBO Kenya Diplomatic Housing'* for its staff. The US Embassy will lease the development for a period of eight years at a cost of Kshs 4.3 bn with the estimated first year's rental income being Kshs 533.8 mn. For more information, see Cytonn Weekly #1/2022, and,
vi. The National Environmental Management Authority (NEMA), gazetted the proposed development of three hostel buildings with a capacity to accommodate 4,842 students valued at Kshs 3.6 bn. The project will be overseen by Acorn Holdings, a student housing developer, who incorporated three limited liability partnerships to develop the student accommodation facilities. For more information, see Cytonn Weekly #1/2022.

We expect the residential sector to continue recording more development activities driven by; i) improved investor confidence in the sector, ii) positive demographics driving demand for housing units, iii) efforts by the government to make mortgages available through KMRC, and, iv) increased infrastructure developments opening various areas for investments and accessibility.

III. **Retail Sector**

During the week, QuickMart Supermarket, a local retail chain opened a new outlet at OBC Kitengela Mall, bringing its total operational stores to 48. This also marks the retailer's first store to be opened this year, and also the first store to be opened in the town which was being served by other retailers such as Naivas and Eastmatt. The move to open the new store in Kitengela is driven by; i) positive demographics, with Kajiado County where Kitengela lies currently having a population growth rate of 4.6% against Kenya's 2.3%, and, ii) strategic location of the mall along the Nairobi-Namanga road which enhances easy accessibility to the store. In terms of performance, according to our Cytonn Annual Markets Review 2021, satellite towns where Kitengela lies recorded average rents per SQFT of Kshs 142 compared to the market average of Kshs 170 per SQFT, hence supporting the retailer's decision to open the new store in the area due to affordability.

The table below shows the submarket performance of nodes in the Nairobi Metropolitan Area (NMA):

Nairobi Metropolitan Area Retail Market Performance FY'2021

Area	Rent Kshs /SQFT FY'2021	Occupancy% FY'2021	Rental Yield FY'2021
Westlands	213	78.8%	10.0%
Karen	202	84.0%	9.8%
Kilimani	183	86.0%	9.8%
Ngong Road	171	79.0%	7.7%
Kiambu road	180	74.2%	7.7%
Mombasa road	148	75.0%	6.8%
Thika Road	161	74.0%	6.7%
Satellite towns	142	69.0%	6.2%
Eastlands	133	71.6%	5.6%
Average	**170**	**76.8%**	**7.8%**

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	Highest number of branches that have ever existed as at FY'2021	Number of branches opened in 2022	Closed branches	Current number of Branches	Number of branches expected to be opened	Projected number of branches FY'2022
Naivas	Local	46	61	69	79	0	0	79	1	80
QuickMart	Local	10	29	37	47	1	0	48	0	48
Chandarana	Local	14	19	20	22	0	0	22	1	23
Carrefour	International	6	7	9	16	0	0	16	0	16
Cleanshelf	Local	9	10	11	12	0	0	12	0	12
Tuskys	Local	53	64	64	3	0	61	3	0	3
Game Stores	International	2	2	3	3	0	0	3	0	3
Uchumi	Local	37	37	37	2	0	35	2	0	2
Choppies	International	13	15	15	2	0	13	2	0	2
Shoprite	International	2	4	4	0	0	4	0	0	0
Nakumatt	Local	65	65	65	0	0	65	0	0	0
Total		**257**	**313**	**334**	**186**	**1**	**178**	**187**	**2**	**189**

Source: Online Search

Additionally, Optica Limited, a local eye-wear retailer opened a new outlet at Viashla center in Ruiru Kamakis. This brings the retailer's total outlets to 54, in its expansion strategy to reach out its products and services to target customers. The move to open the new outlet in Ruiru is driven by; i) strategic location of the store along the greater Eastern Bypass, ii) availability of prime retail space for uptake, and, iii) demand of eye wear as the public is also adopting prescription sunglasses for vision correction and protection from UV rays. In terms of performance, Thika Road where Ruiru lies recorded average rents per SQFT of Kshs 161 compared to the market average of Kshs 170 per SQFT, according to our Cytonn Annual Markets Review 2021, thus, the retailer is leveraging on affordability of the area.

We expect the retail sector to continue witnessing expansion activities by local and international retailers such as Naivas, QuickMart, Optica, and Carrefour. This will be driven by factors such as; i) positive demographics, ii) infrastructure developments opening up areas for accessibility and investments, as well as, iii) the improved business environment promoting transactions and activities. However, the existing oversupply at 1.7 mn SQFT in the Kenyan retail sector and 3.0 mn SQFT in the NMA retail sector, the growing popularity of e-commerce, and, business uncertainties brought about by the incoming elections, is expected to weigh down the performance of the sector.

IV. **Mixed Use Developments**

Notable highlight during the month include;

i. CCI Group of companies, a business process outsourcing (BPO) provider, and, nutrition supplements distributor Max International took up approximately 60.0% of the 270,000 SQFT space at Garden City Business Park along Thika Road. CCI and Max International are taking up six-and-a-half floors, and, half-a-floor, respectively, at the business park with East Africa Breweries limited having being the other corporate giant that took up space at the development in November 2019. For more information, see Cytonn Weekly #02/2022.

V. **Hospitality Sector**

Notable highlights during the month include;

i. The United Arab Emirate (UAE) retained Kenya in its 'Red List' of countries barred from visiting UAE, with other countries such as Ghana, Angola, Uganda, Guinea and Cote d'Ivoire allowed admission to the middle-eastern state in its latest review. For more information, see Cytonn 2022 Markets Outlook. However, key to note is that Kenya is currently not on the red list after having been removed by UAE on 27th January, and,
ii. The Kenyan government suspended all inbound and transit passenger flights from the United Arabs Emirates (UAE) for seven days effective 10th January. Additionally, the United States of America (USA), raised Kenya's travel advisory alert from Level One to Level Three, amidst concerns of the increasing COVID-19 infections following the emergence of the Omicron variant. For more information, see Cytonn Weekly #02/2022.

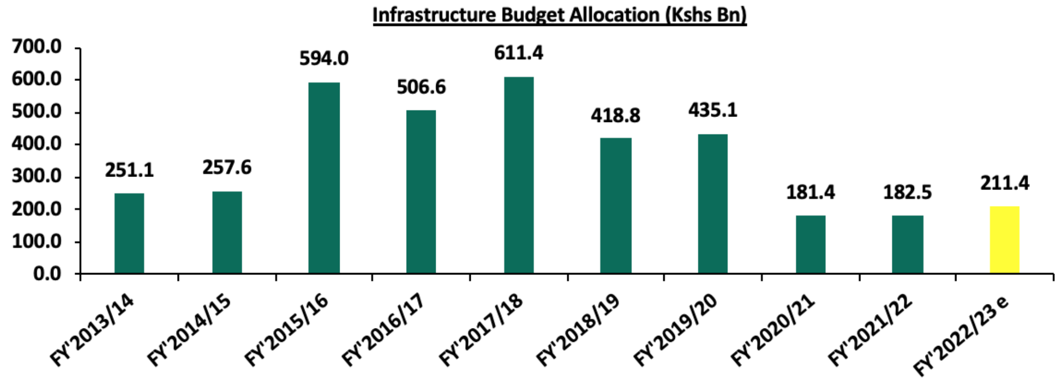
VI. **Infrastructure**

During the week, the national government through the Kenya Railways Corporation announced plans to revamp select dilapidated railway lines in the country namely; i) 217.0Km Nakuru-Kisumu Meter Gauge Railway (MGR), ii) 77.8Km Gilgil-Nyahururu MGR line, and, iii) 69.1Km Kisumu-Butere railway line, at a cost of Kshs 4.5 bn. According to Kenya Railways, a total of Kshs 3.0 bn has been set aside to rehabilitate the Nakuru –Kisumu MGR, whereas Kshs 1.0 bn and Kshs 0.5 bn have been set aside to rehabilitate the Gilgil-Nyahuru and Kisumu-Butere lines, respectively. Upon completion of the projects, the three railway lines will;

a. Act as main transport shipment points between the Standard Gauge Railway Line, and road for freight traffic destined for areas beyond Naivasha,
b. Increase trade activities in the surrounding regions, and,
c. Increase property investments in the surrounding regions through eased accessibility, as well as boosting prices for existing properties.

The government through its various entities such as the Kenya National Highways Authority and

Kenya Railways Corporation, among others, continue to realize and implement various infrastructure projects in order to better the performance of the economy. Some of the ongoing projects include; i) Nairobi Commuter Rail Project, ii) Nairobi Expressway, and, iii) The Western Bypass, among many others. To achieve this, the government has implemented various measures in order to ensure the continuity and completion of projects such as; i) Public Private Partnerships, ii) issuing of infrastructure bonds, and, iii) priority of projects through budget allocations. In light of this, we expect an increase in the budget allocation for the infrastructure sector to Kshs 211.4 bn in FY'2022/23, 15.8% higher than the Kshs 182.5 bn allocation in FY'2021/22 according to the 2022 Draft Budget Policy Statement. The graph below shows the budget allocation to the infrastructure sector over last nine financial years;



Source: National Treasury of Kenya

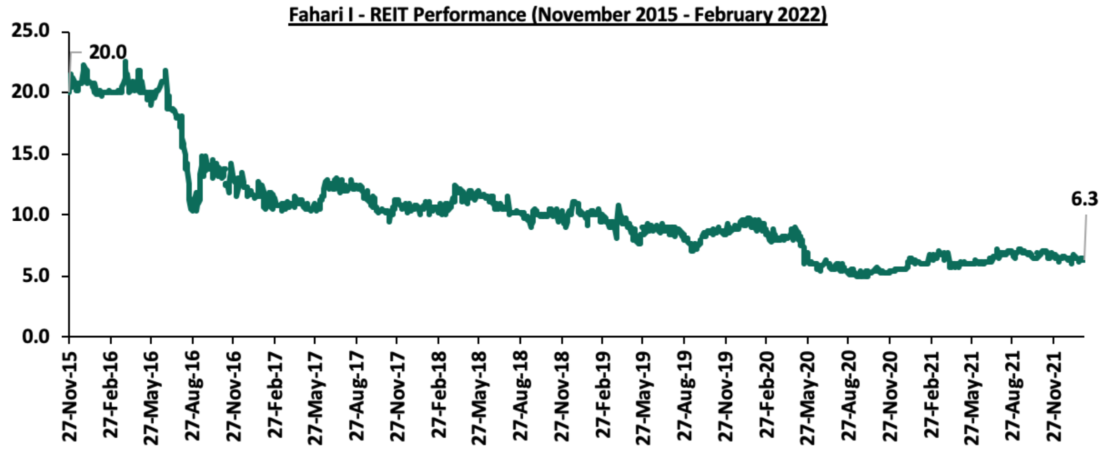
Other notable highlights during the month include;

i. The national government announced that it has begun the documentation processes for dualing of the 40 Km Mtwapa-Kilifi Road. This will be part of the 460 Km Malindi-Tanga-Bagamoyo East African corridor development project, a transnational highway between Kenya and Tanzania. For more information, see Cytonn Weekly #04/2022, and,
ii. The government of Kenya through the Kenya Rural Roads Authority (KERRA) announced that it has begun upgrading to Bitumen Standards the Mago-Mululu - Wangulu (E240) & Lusui - Vokoli (E293) Roads. For more information, see Cytonn 2022 Markets Outlook.

We expect continued construction, revamp, and completion of various projects in the infrastructure sector due to government's aggressive focus to initiate, implement and conclude projects.

VII. **Listed Real Estate**

In the Nairobi Stock Exchange, ILAM Fahari I-Reit closed the week trading at an average price of Kshs 6.3 per share. This represented a 3.1% and 1.6% Week-to-Date (WTD) and Year-to-Date (YTD) decline, respectively, from Kshs 6.5 per share and Kshs 6.4 per share, respectively. On Inception-to-Date (ITD) basis, the REIT's performance continues to be weighed down having realized a 68.5% decline from Kshs 20.0. In the Unquoted Securities Platform, Acorn DREIT closed the week trading at Kshs 20.2 while the I-REIT closed at Kshs 20.6 per unit. This performance represented a 1.0% and 3.0% gain for the DREIT and I-REIT, respectively, from the Kshs 20.0 Inception price. Kenyan REIT market performance continues to be weighed down by; i) a general lack of knowledge on the financing instrument, ii) general lack of interest of the REIT by investors, and, iii) lengthy approval processes to get all the necessary requirements thus discouraging those interested in investing in it. The graph below shows Fahari I-REIT's performance from November 2015 to February 2022:



We expect the Kenyan Real Estate sector to continue recording increased activities driven by; i) improved economic environment promoting growth of the sector, ii) increased residential development activities, iii) aggressive expansion by local and international retail chains, iv) increased tourism arrivals thereby boosting performance of hotels and serviced apartments, v) more development activities and demand for MUD's as a result of their convenience, vi) investor confidence in the land sector which has continued to show resilience despite the pandemic, and vii) government's continued focus on the infrastructure developments that drive property investments. Despite this, the increasing Real Estate NPLs, emergence of new COVID-19 variants, the low of investor appetite in REITs, and, the incoming elections accompanied by uncertainties, is expected to weigh down performance of the sector.