Alternative Financing for Real Estate Developments, & Cytonn Weekly #06/2022

Real Estate

I. **Industry Reports**

During the week, Knight Frank Kenya, a Real Estate management and consultancy firm, released their Kenya Market Update H2'2021, a report which highlights the performance of key Real Estate sectors. The following were the key take outs from the report:

- In the Residential Sector, the average selling price of prime spaces in Nairobi improved by 1.2% in H2'2021, compared to a 1.1% decline in the same period in 2020, attributed to the reopening of the economy as investment activities resumed and boosted property prices. Between July 2021 and December 2021, Knight Frank noted that the prime residential rents remained unchanged. This was a better performance as compared to H2'2020 whereby the prices had declined by 4.2% driven by the reopening of the economy, and landlords maintaining low rental rates to retain clients,
- The average prime commercial office rents recorded a 9.0% increase to Kshs 136.3 per SQFT in H2'2021, from Kshs 125.0 per SQFT in H1'2021, partly attributed to the completion of several grade A office blocks in Nairobi which attracted high rental rates. The average occupancies increased by 5.0% points to 78.0% in H2'2021, from 73.0% in H1'2021 attributed to co-working and financial service sectors taking up space. Absorption of Grade A and B office spaces increased by approximately 60.0% in H2'2021, from 13.0% in H2'2020, attributable to; i) the reopening of the economy, ii) increased roll-out of vaccines thus enabling employees to resume working from the offices, and, iii) pent-up demand from 2020, which was mainly in the grade A stock with quality finishes, and,
- The average prime retail rental rates increased by 2.6% to Kshs 466.0 per SQFT in H2'2021, from Kshs 454.0 per SQFT in H1'2021 attributed to increased activities by retailers prompting the acquisition of spaces. However, retail rental yield may be affected negatively by the shift to shorter, more flexible lease structures and turnover rents in a trend retail chains are adopting.

The findings of this report are in line with the Hass Consult's House Price Index Q4'2021 which highlighted that 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. It is also in line with our Cytonn Annual Markets Review-2021 report, which highlighted that the selling prices in all residential segments appreciated at an average of 1.3% in FY'2021, from a 0.2% price correction in FY'2020. Average rental rates in the commercial office sector remained flat at Kshs 93.0 per SQFT in FY'2021, with the average occupancy rates increasing marginally by 0.2% points to 77.9%, from 77.7% in FY'2020. Additionally, the asking rents in the retail sector registered a 0.6% increase to Kshs 170.0 per SQFT in FY'2021, from Kshs 169.0 per SQFT in FY'2020, while the average occupancy registered a 1.6% points increase to 76.8% in FY'2021 from 75.2% in FY'2020. We expect these sectors to record more activities attributed to the improving demand for housing, aggressive uptake of retail space previously occupied by troubled retailers, improved business environment following the lifting of the COVID-19 containment measures and roll-out of vaccines supporting resumption of businesses' full operations.

II. **Residential Sector**

a. **Property Developer Acorn Group Begins Construction of 2 Student Hostels**

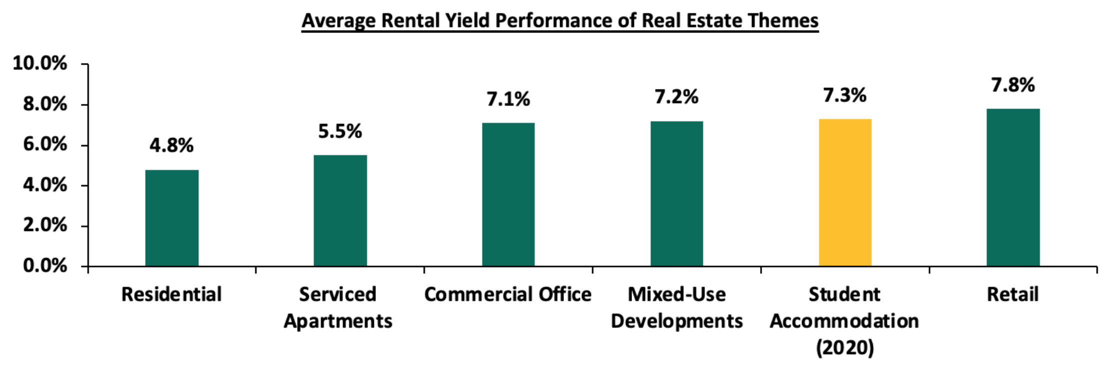
During the week, property developer Acorn Group, began construction of two new hostels worth Kshs 2.5 bn next to the University of Nairobi Chiromo Campus along Science Crescent Road, off Riverside Road, following an announcement they made in November 2020. The project which will be run by Acorn D-REIT, the unit which specialises in developing the hostels brands, Qwetu, which is the premium offering, and, Qejani for the mass market, is set for completion by March 2023. It will consist of 1,950 beds under the Qejani hostel brand while the Qwetu hostel will have 850 beds, bringing the total student accommodation capacity to 2,800.

The developer has continued to focus on student housing having developed other hostels under the Qwetu brand in Ruaraka, Parklands and Jogoo Road, United States International University, Nairobi West and Hurlingham. Moreover, the firm has another project in Karen that is underway and set for completion by the end of 2022. Additionally, the firm plans to develop three other hostels worth a total of Kshs 3.6 bn by March 2024 namely; i) phase II Hurlingham Qejani at a cost of Kshs 959.6 mn with 504 units to accommodate 1,440 students, ii) Qwetu and Qejani residences opposite Kenyatta University at a cost of Kshs 1.9 bn with 924 units to accommodate 2,348 students, and, iii) Qejani brand of hostel in Juja targeting students of Jomo Kenyatta University of Agriculture and Technology (JKUAT) at a cost of Kshs 712.1 mn with 378 units to accommodate approximately 1,054 students.

The focus on modern student housing continues to gain traction supported by;

i. Student housing deficit which is driven by continued increase in student numbers with Kenya National Bureau of Statistics data indicating a university enrolment of 546,699 in 2021, with the exclusion of technical colleges, against an available stock of 300,000 units,
ii. The need to accommodate and attract international students seeking higher education thus creating a ready market for student housing, and,
iii. Attractive returns evidenced by relatively high yields of 7.3% as per the Cytonn Student Housing Market Kenya Researchcompared to other Real Estate sectors like the residential and mixed-use developments which have an average rental yield of 4.8% and 7.2%, respectively.

The graph below shows the performance of rental yields in student housing compared to the different Real Estate themes in FY'2021;



Source: Cytonn Research

We expect investments in student housing to continue gaining momentum and attracting more investment opportunities further boosting their returns.

b. **Bondeni Affordable Housing Projects Sells a Third of its 605 Housing Units**

Royal Group Industries, a fully Kenyan-owned company, through its Director Yusuf Hassanali, announced that approximately 202 of the 605 units at the Bondeni Affordable Housing Project in Nakuru City, were sold to clients. The construction of the Kshs 2.0 bn project, which is a public-private partnership (PPP) agreement between the State Department for Housing and Urban Development and Kings Sapphire LTD (a subsidiary of Roya Group Industries), started in May 2021 and is set for completion by December 2023. It will consist of one, two and three bedrooms with the following unit sizes;

Bondeni Affordable Housing Project

Typology	No. of Units	Unit Size	Price (Kshs)	Price per SQM
1 Bed	45	33.3	1.6 mn	46,547
2 Bed	180	64.1	3.2 mn	49,142
3 Bed	380	85.2	4.4 mn	52,727
Average				**49,472**

Source: Boma Yangu

In terms of allocation, approximately 121 of the units will be purchased by civil servants, 100 units will be reserved for people living around the upcoming estate which shall be purchased on the tenancy purchase scheme through the National Housing Corporation (NHC) and, the rest shall be left to potential clients. The affordable housing initiative continues to take shape in Kenya, and other key PPP projects which are underway include:

i. River Estate in Ngara by National Government and Edderman Property Limited,
ii. Nairobi Expressway by National Government and China Roads and Bridges Corporation, and,
iii. Pangani Housing Project by National Government and Tecnofin Kenya Limited which are still underway.

Despite the growing demand for affordable housing units, evidenced by the relatively high number of individuals who have registered through the Boma Yangu portal currently at 326,346; the implementation of affordable housing projects has been sluggish and the government is expected to fall short of its target of delivering 500,000 housing units by the end of 2022, having only delivered 1,832 affordable and social housing units so far. PPPs have proven to be a strategic way of delivering projects with benefits such as:

i. Access to finance for projects,
ii. Ability to share project risks between the government and the private sectors,
iii. Access to private sector efficiencies such as new and improved technologies and skilled labour by the government,
iv. Enhancing ease of doing business, and,
v. The delivery of large scale projects in a cost effective way that would otherwise cause constrains to tax payers if they are implemented by the government.

Despite the benefits of PPPs, these strategies have fallen short of achieving their developmental targets due to;

i. Inadequate planning for PPP projects,
ii. Insufficient regulatory framework to handle complex PPP transactions,
iii. Irregularities in the procurement processes,

iv. Differing goals between the private entities and the government since the government's main interest is to protect the interests of its citizens while the private sectors interest is to capitalize on returns,
v. Bureaucracy and lengthy approval processes, and,
vi. High transaction costs involved in execution of projects.

However, with the new Public-Private Partnership Law that was signed in November 2021, we expect PPPs in Kenya to perform better as the law seeks to streamline project processes with clear delivery timelines, expand procurement options, and, create robust processes for privately initiated investment proposals. We expect this to promote more public-private partnership through boosting investor confidence in the projects. In our view, if the project is successfully delivered within the target timelines, it will help enhance the confidence of Kenyans in the affordable housing programmes particularly projects that involve partnership between the government and other agencies.

III. **Retail Sector**

a. **Chicken Cottage, a UK fast-food food chain Enters Kenya**

During the week, Chicken Cottage, a UK fast-food chain announced a partnership deal with Express Kitchen, a subsidiary of AAH Limited to open 50 outlets at Hass Petroleum's service stations in Kenya, Rwanda, Tanzania and Uganda this year. The first outlet is scheduled to be opened in Nairobi in April 2022. The partnership with Chicken Cottage follows a similar deal announced in November 2021 by Hass with US pizza chain Papa John's. AAH Limited is the majority shareholder of Hass Petroleum Group which operates 150 petrol stations in ten African countries.

Chicken Cottage which runs 75 restaurants across Europe, Africa, Asia, and Middle East, will compete locally with fast-food chains such as Kentucky Fried Chicken (KFC) which has 22 outlets. The entry of the fast-food retail chain into the Kenyan market is supported by; i) the brand's need to increase its geographical footprint, ii) the strategic market approach by Hass to attract customers who fuel for Chicken Cottage which will boost their revenues, iii) the vibrant youthful population in the country who are expected to form a large part of the firms targeted clientele particularly through e-commerce, and, iv) Nairobi's rise as a hub for international corporations supported by the developing infrastructure.

The Kenyan retail sector performance is expected to be supported by the opening of new franchises such as Chicken Cottage and the rise of e-commerce through online payments and deliveries complementing sales in physical outlets.

b. **Naivas Supermarket to Open 2 New Outlets while Chandarana is set to open 4 New Outlets**

Naivas supermarket, a local retail chain, announced plans to open 2 new outlets by the end of February 2021. The two outlets will be located at Nairobi's Greenspan Mall in Donholm and Imara Shopping Mall in Imara Daima. Currently, Naivas operates 79 outlets, having opened 10 outlets in 2021, compared to other retailers such as Quickmart and Carrefour which opened 9 and 5 branches, respectively.

The retailer's decision to expand in Mombasa Road and Eastlands is supported by presence of a good transport network e.g the Nairobi Expressway and Airport North Road which will enhance client and supplier accessibility, presence of the prime space left by troubled retailers such as Tuskys, and high footfall from the residents of the surrounding estates. In terms of performance, according to the Cytonn Annual Markets Review-2021, Eastlands where Donholm is classified, recorded average rent per SQFT of Kshs 133, which is 21.8% lower than the market average of Kshs 170 per SQFT. On the other hand, Mombasa Road where Imara Daima is classified recorded average rent per SQFT of Kshs 148, which is 12.9% lower than the market average of Kshs 170 per SQFT. This signifies that the retailer's decision to invest in the area is mainly due affordability of the retail spaces.

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

Chadarana Foodplus Supermarket, a local retail chain, announced plans to open 4 outlets over the next four months leading to June 2022. Three of these will be large size convenience stores which will be located in Riverside, Thigiri, and General Mathenge in Westlands, and 1 will be located in an undisclosed mall outside Nairobi. The retail chain plans to focus its expansion in residential areas, eyeing heavy footfall in the estates and thus offering convenience to residents, as opposed to its strategy that favoured expansion in malls. This move will see Chandarana expand its footprint in the country and increase its market share having opened its 24^{th} outlet in Westlands' Rhapta Road early this year. It faces competition from other retail chains such as Naivas, Quickmart and Carrefour who are taking up space left by troubled retailers such as Nakumatt and Tuskys.

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 in 2022	Projected number of branches FY'2022
Naivas	Local	46	61	69	79	0	0	79	2	81
QuickMart	Local	10	29	37	47	2	0	49	0	49
Chandarana	Local	14	19	20	23	1	1	24	4	28
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

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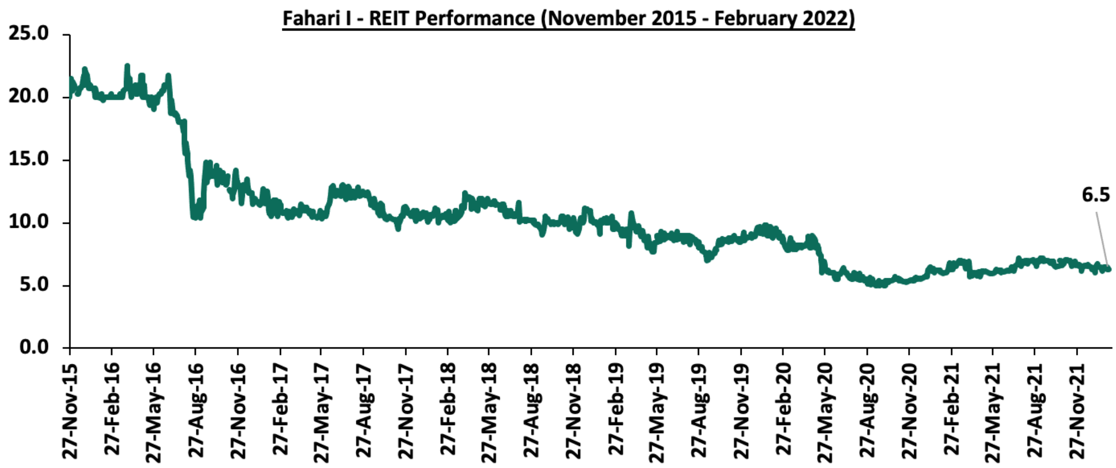
Uchumi	Local	37	37	37	2	0	35	2	0	2
Choppies	International	13	15	15	0	0	13	0	0	0
Shoprite	International	2	4	4	0	0	4	0	0	0
Nakumatt	Local	65	65	65	0	0	65	0	0	0
Total		**257**	**313**	**334**	**185**	**3**	**179**	**188**	**6**	**194**

Source: Online Research

We expect the Retail Sector to continue witnessing expansion activities by local and international retailers driven by factors such as; i) positive demographics, ii) infrastructure developments opening up areas for accessibility and investments, and, iii) the improved business environment promoting transactions and activities. However, rise of e-commerce has also led to reduced need for physical retail space hence the oversupply of 1.7mn SQFT of space in the Kenya retail market and 3.0 mn SQFT in the Nairobi Metropolitan Area is expected to weigh down performance of the Retail Sector.

IV. Listed Real Estate

In the Nairobi Stock Exchange, the ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.5 per share. This represented a 3.2% and 1.6% Week-to-Date (WTD) and Year-to-Date (YTD) increase, respectively, from Kshs 6.3 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 67.5% decline from the inception price of Kshs 20.0. In the Unquoted Securities Platform, the Acorn D-REIT 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 D-REIT and I-REIT, respectively, from the Kshs 20.0 Inception price. The Kenyan REIT market performance continues to be weighed down by factors such as; 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;



The Real Estate sector is expected to record increased activities supported by focus on the affordable housing initiative, student housing, and, expansion by local retailers aiming to increase their market share in the Retail Sector. However, business uncertainties brought about by the upcoming elections and the low of investor appetite in REITs is expected to

weigh down the performance of the sector.

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