Real Estate Investment Trusts (REITs) Performance in Kenya, & Cytonn Weekly #14/2022

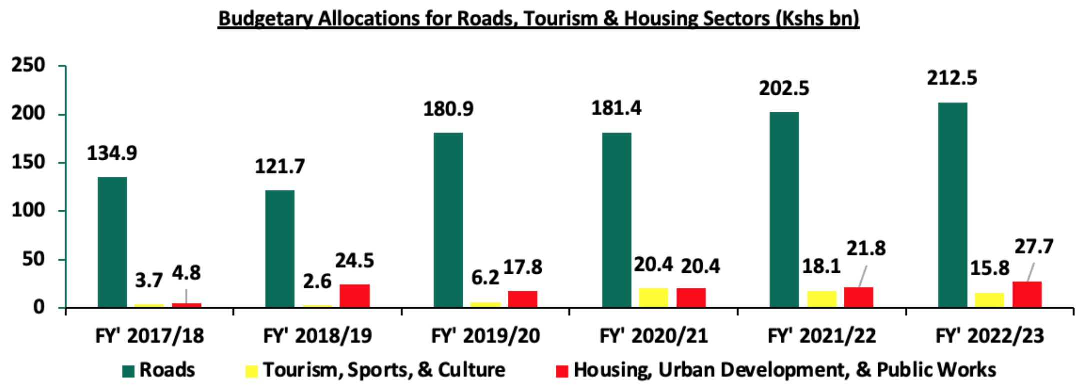
Real Estate

I. **Industry Report**

In the proposed FY'2022/23 Budget Statement there was an allocation of Kshs 256.0 bn for key themes in the Real Estate and related sectors as highlighted below;

i. Infrastructure sector was allocated a total of Kshs 212.5 bn in the FY'2022/23 to support construction of roads and bridges as well as the rehabilitation and maintenance of roads, which is a 4.9% increase from Kshs 202.5 bn allocated in FY'2021/22,
ii. Housing, Urban Development and Public Works were allocated a total of Kshs 27.7 bn, a 27.1% increase from Kshs 21.8 bn in FY'2021/22, with Kenya Mortgage Refinance Company (KMRC) receiving Kshs 4.6 bn to enhance its lending capacity to primary mortgage lenders. Other key areas in the residential sector including construction of affordable housing units, urban housing units and Kenya Informal Settlement Improvement Phase II, received an allocation of Kshs 8.7 bn, Kshs 1.2 bn, and Kshs 5.9 bn, respectively, and,
iii. The tourism sector was allocated a total of Kshs 15.8 bn, with the Tourism Promotion Fund (TPF) receiving Kshs 1.8 bn, and Tourism Fund receiving Kshs 3.2 bn. The allocation to the tourism sector is a 12.7% decrease from the Kshs 18.1 bn allocated in FY'2021/22, due to the recovery of the sector amidst the reopening of the economy and easing of the COVID-19 pandemic containment measures, which in turn led to increased visitor arrivals into the country as well as improved operations in the hospitality sector.

The graph below shows comparison among road, tourism and housing budgetary allocations in the last six fiscal years;



Source: National Treasury of Kenya

With the increased budget allocations in the infrastructure and housing sectors, as well as the reopening of the economy boosting performance of the hospitality sector, we expect increased development activities in the aforementioned sectors, thus in turn boost the overall performance of the Kenyan Real Estate sector.

II. Commercial Office Sector

During the week, Jubilee Holdings, an international insurance company, purchased Coca-Cola East Africa's former head office located in Upper Hill, Nairobi, at a cost of Kshs 1.1 bn. The insurance firm is expected to begin its operations in the Grade A Commercial Office building totaling 116,350 SQFT and sitting on a 3.2 acre piece of land, in September 2022, upon completion of the renovations being done. Currently, the insurer's offices are located at the Jubilee Insurance House along Wabera Street in Nairobi's CBD, where they will lease out part of it, whilst also continue to house its agents and customer service operations. Additionally, Jubilee Holdings also has interest in purchasing other office buildings including; Nairobi's IPS Building, Nation Centre, and Courtyard, among others, which in turn will increase its investment magnitude in the real estate market.

The decision by Jubilee to take up the office building in Upper Hill as its head office is driven by;

i. The need to acquire better quality office spaces due to limited supply of Grade A offices in Nairobi's CBD currently at 5.9%,
ii. Preference for Green Buildings thereby posing the Coca Cola East Africa Green building as a good match,
iii. Favorable prices with the building having been sold to the insurer at Kshs 1.1 bn, 45.0% lower than the original listing price of Kshs 2.0 bn in June 2019, and,
iv. Availability of funds with the insurer having realized a strong growth in its FY'2021 earnings, evidenced by a 67.0% net profit growth to Kshs 6.8 bn in the review period.

In terms of performance, according to the Cytonn Q1'2022 Markets Review, Upper Hill office spaces recorded relatively high selling prices at Kshs 12,409 per SQFT compared to the market average of Kshs 12,113 per SQFT. The insurer bought the 116,350 SQFT office building at Kshs 1.1 bn thereby realizing a Kshs 9,454 per SQFT buying price, which is 21.9% lower than Upper Hill's average selling prices for office spaces. This signifies a good deal for the insurer, as it was able to leverage on the affordability of the office space as basis of purchasing the building. The table below shows summary of Nairobi Metropolitan Area commercial office sub market performance;

All Values in Ksh Unless Stated Otherwise

Nairobi Metropolitan Area Commercial Office Submarket Performance Q1'2022

Area	Price (Kshs) /SQFT Q1'2022	Rent Kshs/ SQFT Q1'2022	Occupancy (%) Q1'2022	Rental Yield (%) Q1'2022
Gigiri	13,500	118	83.3%	**8.8%**
Westlands	11,846	105	74.5%	**8.1%**
Karen	13,325	107	82.8%	**7.8%**
Parklands	11,562	91	82.8%	**7.7%**
Kilimani	12,440	91	80.2%	**7.1%**
Upperhill	12,409	94	76.1%	**6.9%**
Nairobi CBD	11,863	82	83.8%	**6.9%**
Thika Road	12,571	78	77.6%	**5.7%**
Mombasa Road	11,250	73	64.6%	**5.1%**

Nairobi Metropolitan Area Commercial Office Submarket Performance Q1'2022

Area	Price (Kshs) /SQFT Q1'2022	Rent Kshs/ SQFT Q1'2022	Occupancy (%) Q1'2022	Rental Yield (%) Q1'2022
Average	**12,113**	**94**	**77.9%**	**7.3%**

Source; Cytonn Research

The commercial office sector continues to show signs of recovery evidenced by the various expansion activities witnessed in the sector, hence we expect this to continue driving performance of the sector. However, the existing oversupply of office spaces currently at 6.7 mn SQFT coupled with other firms still embracing the remote working strategy is expected to hinder the performance of the sector.

III. **Retail Sector**

During the week, Eat'N'Go Limited, an international fast food chain, opened a new outlet in Westlands Square, Nairobi, bringing its total operating outlets in Nairobi to 9. This comes barely a week after the master franchisee for the Domino's Pizza, Cold Stone Creamery, and Pinkberry Gourmet Frozen Yoghurt brands announced plans to open 100 new stores in Kenya. The retailer's decision to open the new store in Westlands was driven by;

i. Strategic location of the shopping mall along Waiyaki way thus promoting accessibility,
ii. Stiff market competition from close rivals such as Galitos and Pizza Inn,
iii. Positive demographics, evidenced by Kenya's high urbanization and growth rates currently at 4.0% and 2.3%, respectively, compared to the world's 1.8% and 1.0%, respectively, according to the World Bank and,
iv. Nairobi's recognition as a regional hub hence attracting foreign investments.

In terms of performance, Cytonn Q1'2022 Markets Review report highlights that Westlands recorded average rental yields of 9.5%, 1.6% points higher than the market average of 7.9% in the period under review, hence the retailer is leveraging on the remarkable performance of the area as basis of investments.

Nairobi Metropolitan Area Retail Market Performance Q1'2022

Area	Rent Kshs/ SQFT Q1'2022	Occupancy (%) Q1'2022	Rental Yield (%) Q1'2022
Karen	200	85.0%	**10.0%**
Kilimani	183	86.8%	**9.9%**
Westlands	214	72.9%	**9.5%**
Ngong Road	164	81.0%	**8.3%**
Kiambu road	179	77.6%	**8.1%**
Mombasa road	146	78.6%	**7.0%**
Thika Road	156	74.2%	**6.6%**
Satellite towns	145	70.8%	**6.2%**
Eastlands	131	73.0%	**5.8%**
Average	**170**	**77.2%**	**7.9%**

Source: Cytonn Research 2022

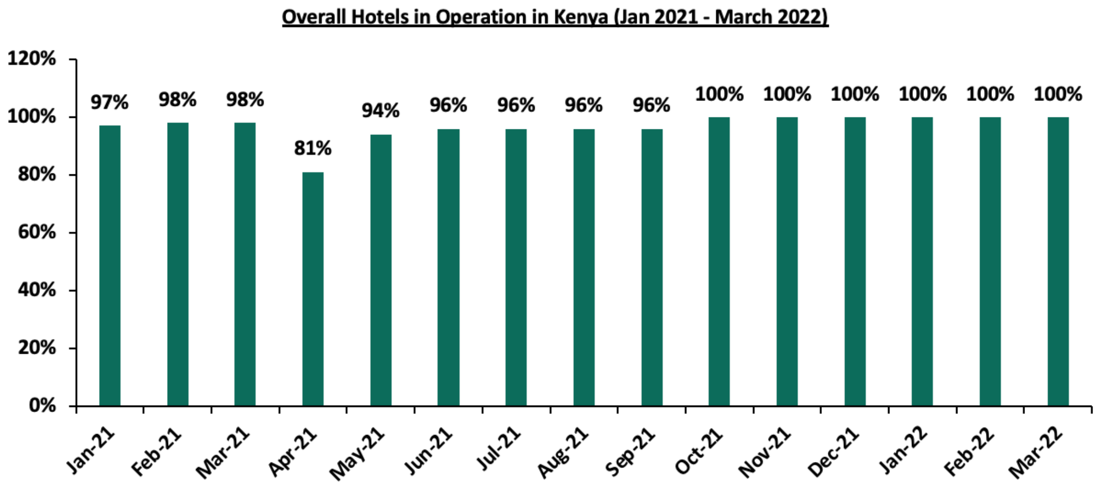
We expect the retail sector to continue realizing aggressive expansion activities from local and international retailers such as Naivas, Eat'N'Go, and QuickMart, among others, due to; i) positive demographics, ii) Nairobi's recognition as a regional hub hence driving foreign investments, and, iii) availability of infrastructure enhancing accessibility to retail stores. Conversely, the existing retail space oversupply in the Nairobi Metropolitan Area currently at 3.0 mn SQFT, coupled with the online shopping strategy still being adopted by some retailers hence derailing occupancy rates, is expected to weigh down performance of the sector.

IV. **Hospitality Sector**

During the week, French's Fairmont Norfolk Hotel located in Nairobi's Central Business District (CBD), resumed operations after having been shut down for nearly two years. The five star hotel seized its operations in July 2020 amidst the onset of the COVID-19 pandemic which caused a slowdown of business activities. The move by Norfolk comes barely two weeks after global five-star hotel Radisson Blu located in Nairobi Upper Hill announced plans to resume operations as well on 9th May 2022. This is a sign that the hospitality sector performance is regaining normalcy, after having been one of the worst hit sectors at the onset of the pandemic. Some of the factors driving increased activities in the sector and the reopening of various hotels such as Norfolk include;

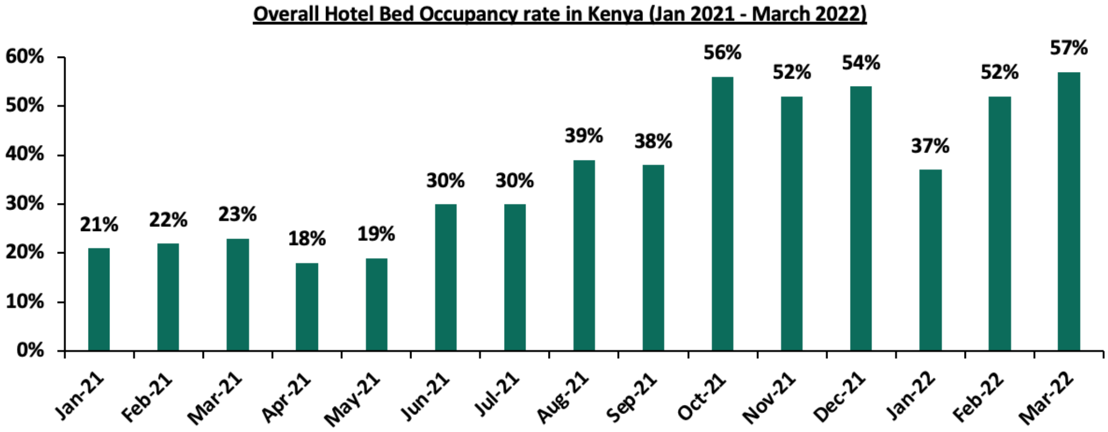
i. Lowered pandemic restrictions i.e. social distancing and lockdowns,
ii. Roll out of COVID-19 vaccines thereby boosting confidence of visitors in the sector, and,
iii. Increased events, conferences, and tourism activities leading to increased booking and operation of hotels.

According to Central Bank of Kenya's Monetary Policy Committee Hotels Survey March 2022 report, the hospitality sector realized an overall improvement in activities and performance evidenced by the increased number of hotels in operations, bed occupancy levels, and share of foreign clientele. The graph below shows the overall percentage of the number of operating hotels in Kenya as of January 2021– March 2022;



Source: Central Bank of Kenya (CBK)

The graph below highlights the hotel bed occupancy rates in Kenya between January - March 2022;



Source: Central Bank of Kenya (CBK)

We expect the hospitality sector to continue recording remarkable performance and activities mainly as a result of the relaxation of COVID-19 containment measures, increased visitor arrivals thereby boosting performance of hotels and serviced apartments, and, the roll out of vaccines in various parts of the country. However, uncertainties around the upcoming general elections are expected to weigh down performance of the sector, especially with regards to visitor arrivals.

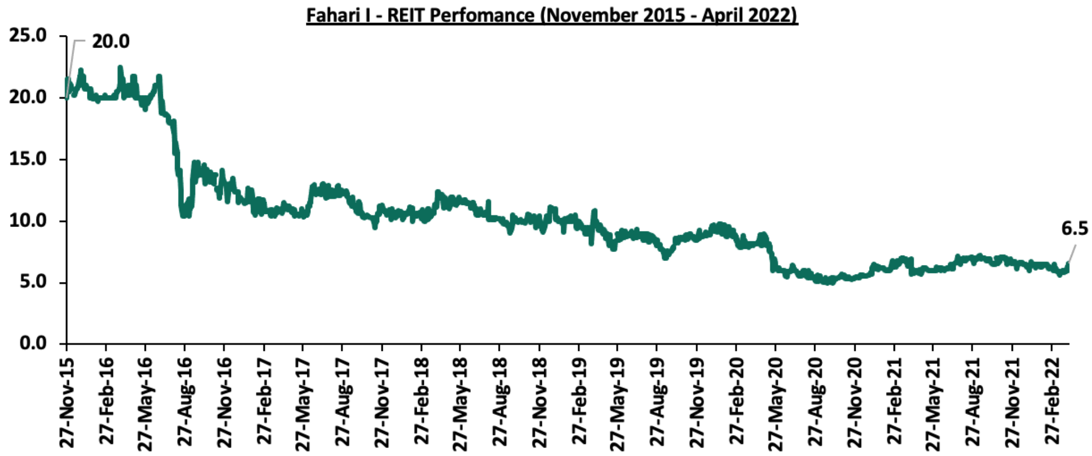
V. **Infrastructure**

During the week, the Kenya Urban Roads Authority (KURA) announced that it was seeking Kshs 1.0 bn from an undisclosed party to complete the upgrade of roads in Nairobi's informal settlement areas. The two-year project worth Kshs 5.4 bn began in 2021 and was expected to be completed by December 2022, however has been stalling for the past three months due to financial constraints. Currently, the project is approximately 90.6% done, with 370.0 Km roads done out of the total planned 408.4 Km. The breakdown of the roads are as follows, 70.0 Kms in Githurai, Githurai 57.5 Kms, Roysambu 50.8 Kms, Mwiki 42.0 Kms, Kangemi 41 kms, Dandora, Utawala, Mihango and Ruai 40.0 Kms cumulatively, and Kawangare 22.6 Kms. Upon its completion, the roads will; i) Ease transport services by promoting seamless transport of goods, people, and services, to various surrounding areas such as Kawangware, Kibera, Mathare, and ii) Boost Real Estate investments in the surrounding areas by promoting accessibility.

Infrastructure development has proven to be a top priority for the Government of Kenya evidenced by the numerous ongoing and completed projects in the country such as; i) the Nairobi Expressway, ii) Nairobi Commuter Rail project, and, iii) the Western Bypass project, among others. We therefore expect a similar trend to continue being witnessed in the sector as a result of government's aggressiveness to implement projects through various strategies including; i) issuing of infrastructure bonds to raise funds for construction, ii) initiating project partnerships such as Public Private Partnerships, and, iii) priority in the YoY budget allocations, with the sector having been allocated Kshs 212.5 bn in the proposed FY'2022/23 Budget Statement, a 4.9% increase from Kshs 202.5 bn in FY'2021/22.

VI. **Real Estate Investment Trusts (REITS)**

In the Nairobi Stock Exchange, ILAM Fahari I-Reit closed the week trading at an average price of Kshs 6.5 per share. This represented a 10.2% and 1.6% Week-to-Date (WTD) and Year-to-Date (YTD) increase respectively, from Kshs 5.9 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 Kshs 20.0. Overall, the 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 April 2022:



We expect Kenya's property market to be on an upward trajectory driven by an improved budget allocation in Real Estate and related sectors, increased uptake of office spaces as most tenants resume full operations, aggressive expansion in the retail sector, and increased activities in the hospitality thereby boosting performance of hotels and serviced apartments. However, investor's minimal appetite for the REIT instrument is expected to continue weighing down the overall performance of the property sector.