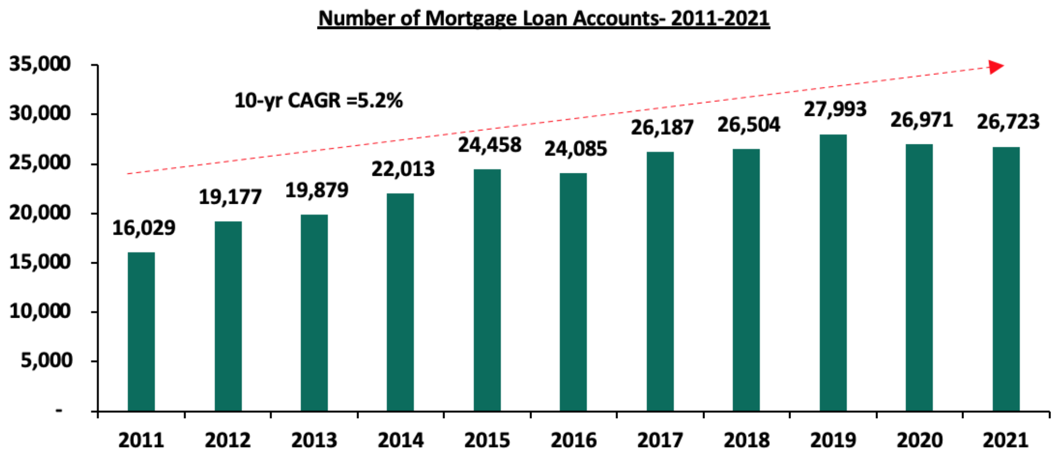
Effects of Elections on Investments Environment in Kenya, & Cytonn Weekly #21.2022

Real Estate

I. **Industry Reports**

During the week, the Central Bank of Kenya (CBK), released the Bank Supervision Annual Report 2021, and the key take-outs were as follows;

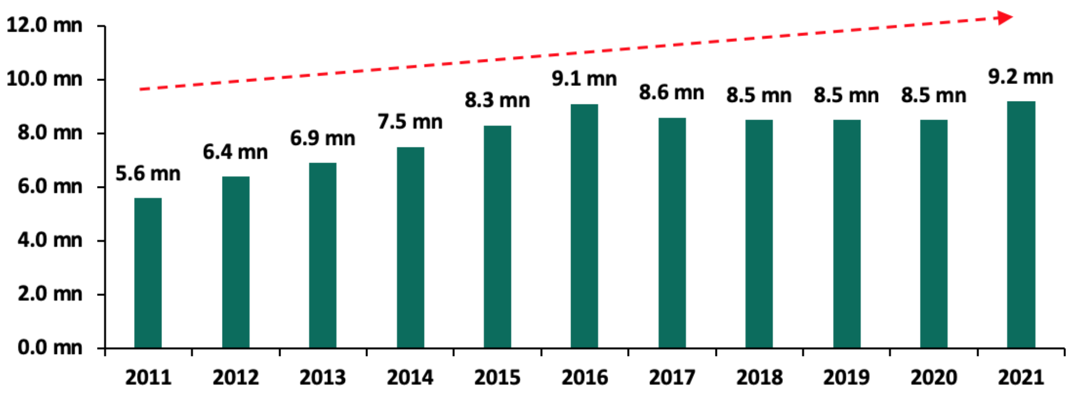
i. The residential mortgage market recorded a 0.9% decline in the number of mortgage loans accounts in the market, to 26,723 in December 2021 from 26,971 in December 2020. The decline was mainly attributed to a higher number of existing mortgage loan repayments outpacing the number of new loans issued. The fewer mortgage loans advanced by banks is on the other hand partly due to the effect of the Covid-19 depressed economy. The graph below shows the number of mortgage loan accounts in Kenya over the last 11 years;



Source: Central Bank of Kenya (CBK)

ii. The overall value of mortgage loans outstanding to registered a 5.3% increase to Kshs 245.1 bn in December 2021 from Kshs 232.7 bn in December 2020. Additionally, the average mortgage loan size increased to Kshs 9.2 mn in 2021 from Kshs 8.6 mn in 2020, attributed to higher value of mortgage loans advanced in the year. The graph below shows the average mortgage loan size from 2011 to 2021;

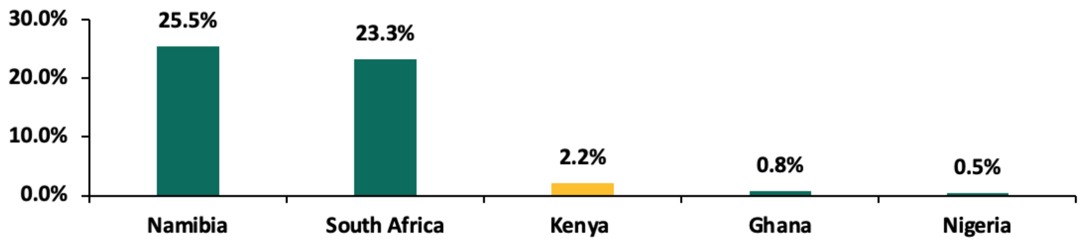
Average Mortgage Loan Size- 2012-2020



Source: Central Bank of Kenya (CBK)

iii. The average interest rate charged on mortgages in 2021, was 11.3% and it ranged between 7.1% and 15.0% compared to an average of 10.9% with a range of 7.0% to 15.0% in 2020. With an average mortgage size of Kshs 9.2 mn, an average interest rate of 11.3% and a maximum tenor of 20 years, one is required to make monthly repayments of approximately Kshs 96,847 per month which is unaffordable assuming a gross salary of Kshs 50,000 per month, which is the median household income in Kenya. Given the above, the Kenya mortgage to GDP ratio has continued to lag behind at 2.2% as of 2021 compared to countries such as Namibia and South Africa at 25.5% and 23.3%, respectively as shown in the graph below;

Mortgage to GDP Ratio as of 2021



Source: Online Research

iv. Key to note, the mortgage Non-Performing Loans (NPLs) to gross mortgage loans ratio was 11.6% in December 2021, 0.4% points lower compared to 12.0% in December 2020. The ratios were below the industry gross NPLs to gross loans ratio of 14.1% in December 2021, and 14.5% in December 2020. This was attributed to the higher number of mortgage loans that were repaid as compared to the number of new mortgage loans granted in the year.

Development of the mortgage market in Kenya continues to face impediments such as i) high interest rates currently at 11.3%, ii) low income levels leading to low mortgage affordability, iii) high initial costs when taking mortgages, iv) inability of borrowers to meet the strict eligibility criteria, and, v) high property and development costs. We expect continued subdued performance of the mortgage market, however activities in the mortgage market will be boosted by the government’s efforts through operationalization of the Kenya Mortgage Refinance Company (KMRC), having been allocated Kshs 8.7 bn in the FY’2022/23 Budget Statement to finance the Affordable Housing Program aimed at increasing home ownership in Kenya.

II. **Mixed-Use Developments (MUDs)**

a. **Heri Homes in Partnership with Finsco Africa to Construct 384 Apartments in Ruiru Town**

During the week, Heri Homes, a property developer in Kenya, in partnership with Finsco Africa, a Real Estate consultancy firm, announced plans to construct 384 affordable apartments in Ruiru Town, as part of its 200- acre mixed-use development project dubbed Legacy Ridges. The affordable housing development consisting of 2 and 3 bedroom units, will sit on 10 acres of the land while the remaining land will incorporate bungalows and maisonettes, a hotel resort, and commercial office buildings. The table below shows a breakdown of units at the project;

Legacy Ridges Project

Typology	Unit size (SQM)	Unit Price (Kshs)	Price per SQM(Kshs)
2	75	3.5 mn	46,667
3	95	4.3 mn	45,263
Averages			**45,965**
3br + DSQ (Semi-detached)	135	8.5 mn	62,963
4br +DSQ (Semi-detached)	160	9.7 mn	60,625
Averages			**61,794**

Source: Online Research

The aforementioned plan comes after the company broke ground for the semi-detached units within the same property in February 2022, signifying effort in delivering housing units to different classes of potential clientele. Upon the completion of the Legacy Ridge project, it will;

i. Cater to the growing middle class and the increasing Ruiru population of 371,111 as at 2019 according to KNBS,
ii. Provide a live, work play environment for its residents, and,
iii. Attract a working population with the growing commercial activities.

Moreover, Heri Home's decision to develop the affordable homes for Kenyans further complements the government's Affordable Housing Initiative, which aims at eradicating the 2.0 mn units housing deficit that grows annually by 200,000 units. The demand for housing is evident in the current number of registered applicants in the Boma Yangu Portal at 328,979. Some of the ongoing projects include; i) Park Road Project in Ngara, ii) Buxton Housing Project in Mombasa, and, iii) King's Sapphire Bondeni project in Nakuru, among others.

In terms of performance, according to our Nairobi Metropolitan Area (NMA) Mixed-Use Developments Report 2021, Thika Road where Ruiru is categorized recorded a residential average price per SQM of Kshs 128,545, which is 9.5% lower than the market average of Kshs 142,055 per SQM with a relatively high rental yield of 7.0%. The developer is therefore leveraging on the affordability of housing units with its average price per SQM for the affordable housing units at Kshs 45,965. The table below shows the market performance by nodes of Mix-Use Developments in Nairobi Metropolitan Area;

(All Values in Kshs Unless Stated Otherwise)

Nairobi's Mixed-Use Developments Market Performance by Nodes 2021

	Retail Performance				Commercial Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occup. %)**	**Rental Yield (%)**	**Price/ SQM**	**Rent/ SQM**	**Annual Uptake %**	**Rental Yield %**	**Average MUD yield**
Karen	23,333	196	86.7%	**8.8%**	13,233	117	85.0%	**9.0%**					**8.7%**
Westlands	15,833	173	70.8%	**9.5%**	12,892	110	71.7%	**7.3%**	211,525	1,226	15.6%	**7.0%**	**7.8%**
Kilimani	18,500	162	79.0%	**8.3%**	13,713	106	79.0%	**6.7%**					**7.4%**

Nairobi's Mixed-Use Developments Market Performance by Nodes 2021

	Retail Performance				Commercial Office Performance				Residential Performance				
Location	**Price/SQFT**	**Rent/SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price/ SQFT**	**Rent/SQFT**	**Occup. %)**	**Rental Yield (%)**	**Price/ SQM**	**Rent/ SQM**	**Annual Uptake %**	**Rental Yield %**	**Average MUD yield**
Mombasa Rd	20,000	185	70.0%	**8.4%**	13,000	100	60.0%	**5.5%**	156,079	853	13.3%	**6.6%**	**7.4%**
Thika Rd	23,750	215	82.5%	**9.2%**	13,250	105	72.5%	**6.9%**	128,545	612	17.9%	**6.1%**	**7.0%**
Upper Hill	15,485	130	62.5%	**6.4%**	12,000	102	70.0%	**7.0%**					**6.8%**
Eastlands	20,000	124	75.0%	**5.5%**	12,000	80	62.5%	**5.0%**	72,072	360	10.0%	**4.2%**	**5.1%**
Average	**18,759**	**170**	**75.9%**	**8.4%**	**12,924**	**106**	**73.6%**	**7.1%**	**142,055**	**763**	**15.0%**	**6.0%**	**7.2%**

The average MUDs performance is based on areas where sampled projects exist

Source: Cytonn Research

b. **Purple Dot Limited Launches Construction of a Kshs 2.5 bn mixed-use commercial complex project along Mombasa Road**

During the week, Purple Dot International Limited, launched the construction of a Kshs 2.5 bn mixed-use commercial project along Mombasa Road dubbed Purple Tower. The 14-floor project which will sit on a 1.15-acre piece of land along Mombasa Road, will comprise of office and retail spaces. The first three floors will be for retail spaces while the remaining floor spaces will comprise offices. This comes a week after the development firm announced plans to develop a warehousing hub worth Kshs 600.0 mn at the Harvest Industrial Park in Athi River, Machakos County, a sign of its increasing appetite for the Kenyan property market. The decision by the firm to make investments along Mombasa Road is driven by;

i. Improved infrastructure enhancing accessibility, due to rehabilitation of Mombasa road and construction of Nairobi Expressway,
ii. Relatively good average rental yield for commercial and retail spaces at 5.5% and 8.4% respectively, and,
iii. The growing number of Small and Medium-sized Enterprises (SMEs) seeking commercial office and retail spaces.

In terms of performance, according to our Nairobi Metropolitan Area (NMA) Mixed-Use Developments Report 2021, Mombasa Road recorded high average rental yield of 7.4%, 0.2% points higher than the market average of 7.2%, hence the developer is leveraging on the remarkable performance as its basis of investments in the area. We expect the mixed-use development sector to continue recording gradual expansion activities and improved performance attributed to overall improved performance the different Real Estate themes when incorporated together. Furthermore, we expect an increase in Mixed-Use Development investments due to the integration benefits such as easier access to amenities and services, a live, work and play environment all in one location and risk diversification. The developments also offer better returns compared to single use themes.

III. Industrial Sector

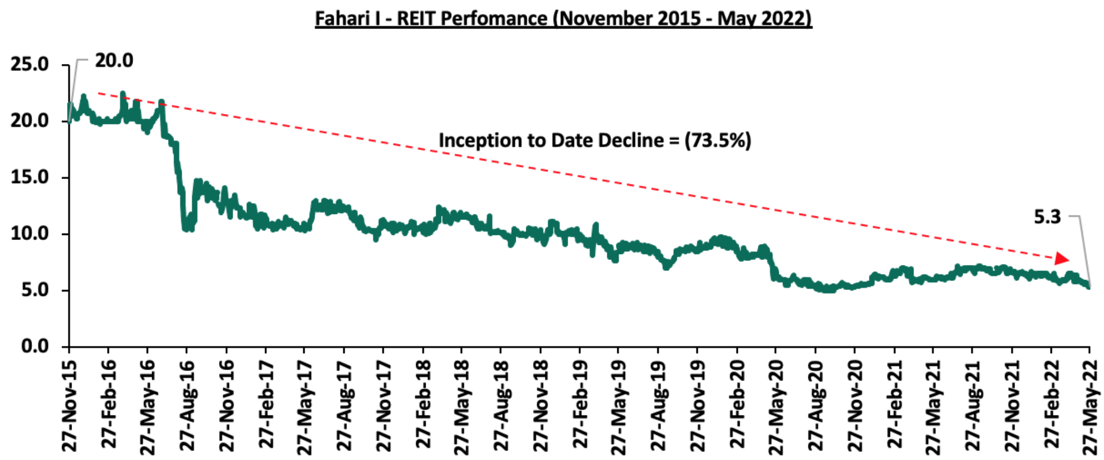
During the week, Botswana's listed real estate firm Letlole La Rona Limited (LLR) signed a deal with Mauritius-based Grit Real Estate Income Group, to buy a 30.0% stake, in Orbit Products Africa's manufacturing facilities in Mlolongo, at an initial cost of Kshs 842.0 mn. This comes after Grit had invested Kshs 6.2 bn to acquire Orbit's warehousing complex in March 2022 and announced plans for its redevelopment and expansion by the end of 2023. Orbit will remain a tenant on the existing factory and warehouses for an initial 25-year lease, and be let on a 20-year lease on the additional space once redevelopment and expansion is complete. The move by Orbit of selling property then leasing it back is a strategy to raise capital and inject it back to its business. On the other hand, the decision by LLR and Grit to invest along Mombasa Road is driven by:

i. Strategic location of the industrial park promoting accessibility to and from the place,
ii. Completion of the Mombasa Inland Container Depot in Syokimau thus enabling ease of access to warehousing facilities, and,
iii. Increased investment in warehouse facilities offering relatively good returns, because of the popularity of e-commerce in the country driving demand for storage facilities.

We expect the sector to continue recording a boom in activities and performance mainly as a result of the rapid infrastructural developments such as the Standard Gauge Railway and the Nairobi Mombasa Highway, that enhance transport of goods and cargo, coupled with increased demand for warehouse and storage facilities resulting from the rise in e-commerce.

IV. **Listed Real Estate**

In the Nairobi Stock Exchange, ILAM Fahari I-REIT closed the week trading at an average price of 5.3 per share. This represented a 3.6% and 17.2% Week-to-Date (WTD) and Year-to-Date (YTD) decline, from Kshs 5.5 per share and Kshs 6.4 per share, respectively. On Inception-to-Date (ITD) basis, the REIT has recorded a 73.5% decline from Kshs 20.0 in November 2015. The graph below shows Fahari I-REIT's performance from November 2015 to May 2022:



The performance of the Real Estate sector is expected to be supported by investor interest in mixed-use developments which continues to gain traction due to their relatively high returns, compared to the single-use counterparts.