Unit Trust Funds (UTFs) Performance, Q3’2022, & Cytonn Monthly

Real Estate

I. **Industry Reports**

a. **Hass House and Land Price Index Q4’2022 Reports by Hass Consult**

During the week, Hass Consult, a Real Estate Development and Consulting firm based in Kenya, released its House Price Index Q4’2022 Report, which reports the performance of Nairobi Metropolitan Area’s (NMA) Real Estate residential sector. The following were the key take outs:

i. The average q/q selling prices for residential houses declined by 2.2% in Q4’2022 compared to a 0.8% increase in Q3’2022, while on a y/y basis, the average selling prices appreciated by 4.8% compared to a 3.1% increase that was recorded in Q4’2021. The quarterly decrease was mainly driven by drop in the selling prices of all parameters under analysis such as detached units by 1.5%, semi-detached houses by 4.3%, and apartments by 1.5%. The quarter was cited to be affected by the political transition after the August General elections which fueled uncertainty in the market coupled with global inflationary pressures, and rising interest rates following an increase in MPC rates by the Central bank of Kenya (CBK) in September and November hence hiking of mortgage costs. However, the y/y increase in performance was mainly attributed to annual price increase of detached houses by 9.4% as the sector sustained recovery from the COVID-19,

ii. In the Nairobi Suburbs detached and semi-detached houses, Lang’ata was the best performing node having recorded a y/y capital appreciation of 13.0% for its detached units, pointing signs to the rising demand for standalone mansions and townhouses in the region due to the region’s affordability as compared to neighboring nodes such as Karen. On the other hand, houses in Lavington recorded the highest y/y price correction of 4.6%. This was largely due to a drop in demand for townhouses and a shift of trend by clients preferring to buying and renting apartment units. In the recent years, apartments have drastically altered the housing landscape in Lavington where the region was previously dominated by detached and semi-detached homes,

iii. In the Nairobi Suburbs apartments, Lang’ata remained to be the best performing region recording a y/y capital appreciation of 9.0% due to i) its proximity to the city center and prime locations such as Karen, iii) strategic and attractive location near various shopping malls located in Karen such as Galleria, the Hub, Waterfront, and recreational facilities such as Nairobi National Park, iii) adequate infrastructure providing seamless access to Lang’ata via Lang’ata road, Ngong’ Road, Mombasa Road, the Southern Bypass, and the presence of Wilson Airport for air transportation. All the select factors have contributed to increasing demand for those working within and outside the area seeking convenience with regards to shopping, recreation, and logistics. On the other hand, Upperhill realized the highest y/y price correction of 10.3% attributed to; i) its transformation into a business district, leading to a shift in demand from residential to commercial properties., and, ii) city dwellers preferring to live away from the hustle and bustle of the city occasioned by huge traffic snarl-ups in the area and noise pollution leading to reduced demand for the properties,

iv. In the satellite towns, houses in Ngong' recorded the highest y/y price appreciation at 21.1% driven by increased demand resulting from; i) improved infrastructure development such as the Ngong' Road thus enhancing accessibility, ii) growing middle income population in the area enhancing demand, and, iii) proximity to prime locations such as Karen. Conversely, houses in Limuru realized the highest y/y price correction of 5.9% attributed to reduced demand owing to the region's unfavorable location far from Nairobi CBD, other major urban business nodes, and main transportation hubs like the Jomo Kenyatta International Airport (JKIA), Standard Gauge Railway (SGR), among others,

v. In satellite towns' apartments, Mlolongo recorded the highest y/y price appreciation of 1.2% attributed to increased demand for apartments in the region with the newly constructed Nairobi Expressway enhancing proximity to the City centre increasing accessibility to the satellite town. On the other hand, Ruaka realized the highest y/y price correction of 9.4% attributed to property developments that had priced their apartments in United States Dollars revise them to Kenyan Shillings. This is on the back of the continuous devaluation of the Kenyan Shilling against the Dollar, making the properties more expensive in the local market and thereby reducing their competitiveness against other property developments priced in Kenyan Shillings and,

vi. The overall asking rents of housing units in the NMA slightly declined by 1.5% q/q and slightly increased by 0.3% y/y, compared to a 0.2% q/q decline recorded in Q3'2022 and 2.7% y/y growth recorded in 2021, attributed to slow growth in the general demand for rental units. Apartments recorded the highest y/y increase in asking rents of 4.5% with detached and semi-detached units realizing price corrections of 0.6% and 2.4% respectively, signaling rising demand of tenants in the low-middle and middle income earning brackets who continue to prefer renting apartments due to their affordability,

vii. In the Nairobi suburbs, houses in Loresho realized the highest y/y rent appreciation of 6.9%. This was attributed to; i) the affordability it presents to most tenants who want to live in areas around leafy suburbs like Spring Valley, ii) presence of sufficient amenities and infrastructure enhancing investments, and, iii) its serene environment and strategic location which is in part of Westlands. On the other hand, houses in Kileleshwa realized the highest y/y rental rates decline of 9.0% attributed to reduced demand for detached and semi-detached houses owing to new tenants shifting preference to renting apartments in the region,

viii. In the Nairobi Suburbs apartments, Lang'ata remained to be the best performing region recording a y/y rent appreciation of 10.3%, attributed to increased demand for the units in the region due to better amenities and the accessibility it offers. On the other hand, Upperhill continued to realize the highest y/y rent correction of 8.3% attributable to reduced demand for residential properties by city dwellers and the region attracting more commercial office investments as compared to residential,

ix. In the satellite towns, houses in Ngong' recorded the highest y/y rent appreciation at 16.2%, driven by increased demand resulting from; i) improved infrastructure development such as the Ngong' Road thus enhancing accessibility, ii) a growing middle income population in the area enhancing demand, and, iii) proximity to prime locations such as Karen. Conversely, houses in Kiambu realized the highest y/y rent correction of 6.1% attributed to reduced demand for detached and semi-detached houses owing to competition from neighboring nodes like Juja and Ruiru that offer; i) affordable rental rates, ii) better institutions, shopping and recreational amenities such as Kenyatta University, Jomo Kenyatta University of Agriculture and Technology, Zetech University, Spur Mall, Juja City Mall, Thika Road Mall, and Garden City, iii) closeness to prime locations like the upcoming Northlands City and Tatu City, and, iv) improved accessibility as they are located along Thika Superhighway, and the Eastern and Northern Bypasses, and,

x. For the satellite towns' apartments, Rongai realized the highest y/y rental rate increase by 15.3% mainly due to better accessibility facilitated by improved infrastructure development like Nairobi Expressway. On the contrary, apartments in Athi River recorded the highest y/y rental rates declines of 1.7% due to reduced demand at the back of competition from neighboring nodes such as Kitengela, Rongai, Mlolongo and Syokimau which are all located along Mombasa road but are closer to the City centre and major transportation hubs like Jomo Kenyatta International Airport (JKIA) and the SGR via the Nairobi Expressway which has significantly improved accessibility to the regions.

The findings of the report are in line with our Cytonn Q4'2022 Markets Review, highlighting that the residential market in NMA recorded improvement in performance with the average total returns to investors coming at 6.2%, a 0.1%-points increase from the 6.1% recorded in FY'2021, attributable to average rental yield of 5.1% and y/y appreciation of 1.1%. The y/y improvement in performance was majorly driven by improved selling prices and rents which came in at Kshs 119,609 and Kshs 540, respectively, from Kshs 119,494 and Kshs 508, respectively, recorded in FY'2021. The improvement in price and rental charges was mainly driven by; i) increased major infrastructural developments like the Nairobi Expressway, and Eastern, Northern and Western Bypasses that have improved accessibility of areas along the development hence higher demand, ii) an increase in property transaction volumes, and, iii) a gradual economic recovery from the COVID-19 period which saw landlords collect higher rents. However, the performance is expected to be weighed down by; i) the continuous inflationary pressures in the economy, ii) devaluation of the Kenyan currency, and, iii) increased credit risk on accessing finances for development and buying of residential properties due to rising interest rates on loans and mortgages by commercial banks.

Hass Consult also released the Land Price Index Q4'2022 Report which highlights the performance of Real Estate land sector in the Nairobi Metropolitan Area (NMA). The following were the key take outs from the report:

i. The average q/q and y/y selling prices for land in the Nairobi suburbs slightly increased by 0.2% and 1.2% respectively compared to 0.4% and 1.2% growth recorded in Q4'2021. The decrease in performance was attributable to continuous reduced activities on the Real Estate market and the general economy from the previous quarter due to August General elections and political transitions creating uncertainty among investors. Consequently, the average q/q and y/y selling prices for land in the satellite towns of Nairobi increased by 1.0% and 9.0%, respectively compared to 1.4% and 6.7%, fueled by their affordability,
ii. Spring Valley was the best performing node in the Nairobi suburbs with a y/y price appreciation of 14.6%. This was attributed to increase in demand for land in the region owing to; i) adequate infrastructure, ii) adequate amenities such as Global Trade Centre (GTC), Sarit Centre, and Westgate Shopping Malls, and, iii) proximity to prime and rising urban nodes such as Westlands which was cited as the city's premium entertainment and commercial hub, creating value to its neighborhoods that ease access to the region's working zones, recreational and shopping centres. On the other hand, Upperhill recording the highest y/y price correction of 3.3%. This was due to continuous decline in demand for development land resulting from; i) the existing high oversupply of commercial spaces hence developers pausing their construction plans, ii) land in the area being the most expensive in the NMA thus hindering uptake, and, iii) general drastic shift of developers to satellite towns due to scarcity of affordable land for development in Nairobi, and,
iii. For satellite towns, Syokimau was the best performing node with a y/y capital appreciation of 17.5%, attributed to rising demand for development land due to increased improved infrastructure and accessibility following the launch of the Nairobi Expressway in May 2022. On the other hand, Limuru was the worst performing node with a y/y price correction of 3.0% driven by low demand for land in the area, resulting from relatively farther distance from Nairobi CBD and other business nodes.

The findings of the report are also in line with our Cytonn Q4'2022 Markets Review, which highlighted that the overall average selling prices for land in the NMA appreciated by 4.3% to Kshs 131.0 mn per acre in Q4'2022 from Kshs 130.8 mn per acre recorded in Q4'2021. This was mainly attributed to; i) better accessibility through improved infrastructure which has increased areas attractiveness to investors and developers thereby fueling demand for land, ii) proximity to amenities such as shopping malls, organizations and learning institutions, iii) improved development of infrastructure such as roads, railways, water and sewer lines, and, iv) increased construction activities particularly in the residential and infrastructural sector hence fueling demand for land development.

b. **Kenya Market Update H2’2022 Report by Knight Frank**

During the week, Knight Frank, an international Real Estate consultancy and management firm, released the Kenya Market Update H2’2022 Report highlighting the performance of key Real Estate sectors in the country. The following were the key take outs from the report:

i. In the residential sector, the average selling prices for prime housing units increased by 0.9% points to 3.8% in Q4’2022 from 2.9% recorded in Q3’2022, mainly driven by; i) rising demand for high-quality homes for high-net worth individuals, ii) growth of multinationals in the country with preference for prime residential properties, iii) entry of new high quality projects in the market such as Rosslyn Grove which has been leased by the United States Embassy in Kenya and 221-unit Mi-Vida residential development in Garden City, and, iv) peaceful electioneering period which improved the economy and the purchasing power of buyers,
ii. The average asking rents for prime commercial office spaces stagnated at USD 1.2 per SQFT in H2’2022 from H1’2022. However, in terms of Kenyan Shillings, the performance represented a 4.7% increase to Kshs 148.2 per SQFT in H2’2022, from Kshs 141.5 per SQFT recorded in H1’2022. The increase was mainly driven by; i) the completion of grade A office spaces which fetch prime rents, ii) continued depreciation of the Kenyan Shilling against the Dollar, iii) increased demand at the back of continued preference for quality office spaces by Internet and Communication Technology (ICT) companies, Multinational Corporations (MNCs), and Non-Governmental Organizations (NGOs). The rise in demand was evidenced by a 1.2% points increase in occupancy rates to 74.0% from 72.8% in H1’2022 with increase in absorption of the existing office spaces and further decline in release of major incoming office spaces,
iii. In the retail sector, the average asking rents for prime retail spaces came in at Kshs 617.5 (USD 5.0) per SQFT in H2’2022. The report highlights that most established malls had attracted an occupancy rate of above 90.0% attributed to continuous expansion of local and foreign retailers like Naivas, Quickmart, Chandarana, and Carrefour who continue to occupy vacant spaces left by retailers such as Uchumi, Nakumatt, Tuskys, Game, Shoprite, and Choppies who exited the market. New major malls were opened towards the festive season such as Broadwalk in Nairobi County, Greenwood Mall in Meru County, Kilele Mall in Murang’a County, with major upcoming malls include Business Bay Square in Nairobi County, and Promenade Mall in Mombasa County. However, there was a decline in the general supply of malls in the country with more focus on convenience centres that serve residential neighborhoods in most parts of Nairobi Metropolitan Area (NMA), and,
iv. The average prime industrial rents recorded a 5.0% increase to Kshs 70 per SQFT from Kshs 68 per SQFT in H1’2022 mainly attributed to; i) rapid infrastructure developments driving growth of the sector, ii) the growth of e-commerce that continue to drive the demand for storage facilities, and, iii) the easing of logistic restrictions and improved business environment in post-election period which increased investor confidence in Kenya’s industrial market.

The findings of this report are in tandem with our Annual Markets Review 2022 Report which highlighted an increase in the average selling price for residential units and an increase in the average rent per SQFT of office spaces within the Nairobi Metropolitan Area (NMA). We still maintain our view that the Real Estate sector performance will be supported mainly by; i) the positive demographic driving demand and construction for housing units, ii) increased infrastructural developments boosting accessibility, iii) the continuous aggressive growth and expansion by both local and international retailers, iv) continuous absorption of existing office spaces coupled with the expansion of various firms, and, v) rising trend of co-working office space strategy. However, rising construction of costs of housing units, limited access to finances for Real Estate projects, fast-evolving e-commerce in retail sector, and existing oversupply of approximately 6.7 mn SQFT and 3.0 mn SQFT in the NMA commercial office and retail sectors respectively, are expected to hamper the optimum performance of the Real Estate sector.

II. Residential Sector

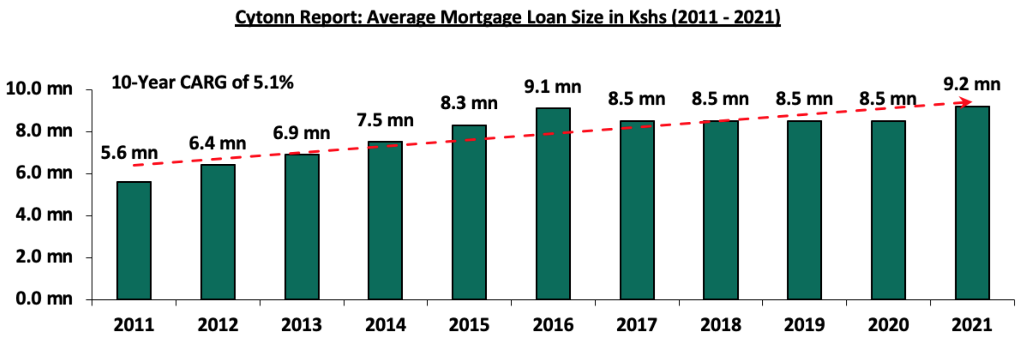
During the week, Kenya Mortgage Refinancing Company (KMRC), a state-backed mortgage refinancing company increased the limit of maximum mortgage to be issued to its clients. The table below shows the adjustments made in the size of maximum mortgage in Kenya;

Cytonn Report: Kenya Mortgage Refinancing Company (KMRC) limit of maximum mortgage in Kshs

Region	Previous limit of maximum mortgage in Kshs	New limit of maximum mortgage in Kshs
Nairobi Metropolitan Area- Nairobi County - Kiambu County - Kajiado County - Machakos County	4.0 mn	8.0 mn
The rest of the 43 counties	3.0 mn	6.0 mn

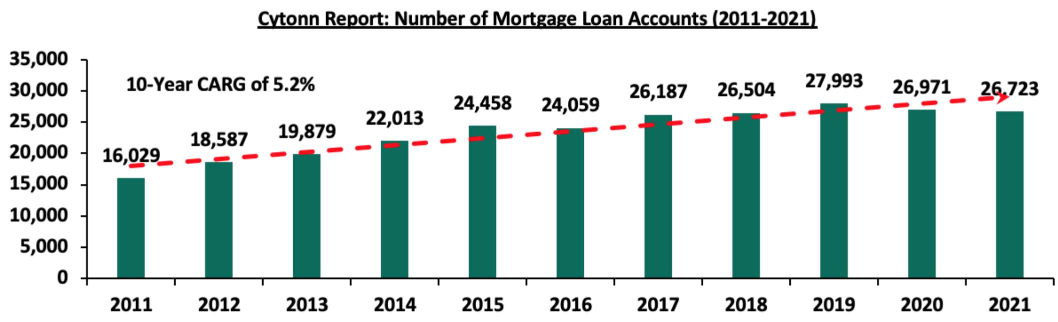
Source: Kenya Mortgage Refinancing Company (KMRC)

The move to double up the limits was attributed by rising prices of residential units amid; i) renewed demand from buyers who had slowed down acquisitions at the peak of COVID-19 economic hardship, ii) elevated price growth of key construction inputs such as steel, paint, and cement due to persistent supply chain disruptions occasioned by the Russia-Ukraine war, and, iii) the global and domestic inflationary pressures on general cost of goods and services on the back of high fuel prices, acute scarcity of the United States Dollar in the global economy, and the continuous devaluation of the Kenyan currency against the Dollar. Banks and SACCOs which are in partnership with KMRC will lend the mortgages at a rate of 9.5% which is lower than the market rate of between 11.5% and 18.8% according to the Central Bank of Kenya's Bank Supervision Annual Report 2021. However, the Kshs 8.0 mn KMRC backed mortgage is still lower than the average maximum home loan size which stands at Kshs 9.2 mn, as at 2021. The trend of average mortgage loan size has been upward in the recent past, realizing an 10-year Compounded Annual Growth Rate (CAGR) of 5.1% to Kshs 9.2 mn from Kshs 5.6 mn as shown in the graph below;



Source: Central Bank of Kenya

This growth can be attributed to the joint efforts of the government and private financial institutions in enhancing financial accessibility and providing more reasonable and flexible mortgage options. In line with the growth of mortgage loan size, the average number of loan accounts has also seen an increase, recording an 10-year CARG of 5.2%. These developments showcase a commitment towards making the mortgage process more accessible and accommodating for the general public. The graph below shows the average mortgage loan accounts from 2011 to 2021;

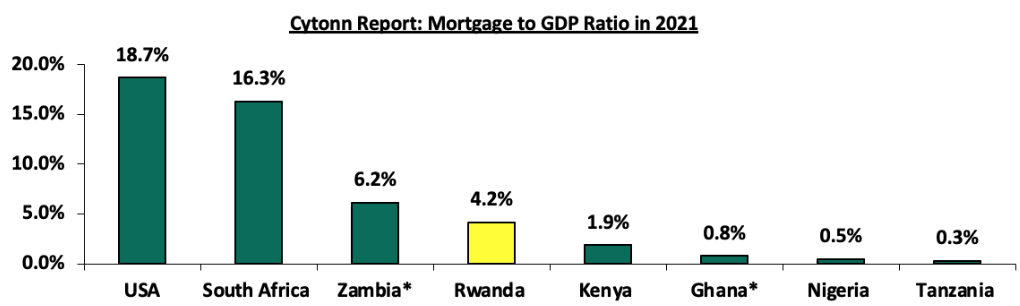


Source: Central Bank of Kenya

Additionally, KMRC increased the Loan to Value Ratio (LTV) to 105.0% from 90.0%, eliminating the previous 10.0% deposit required to be paid by a home-buyer before accessing the mortgage. KMRC noted that the 5.0% above the value of house under purchase will be used to cater for incidental costs such as legal fees and valuation. The decision will significantly reduce barriers buyers face to own houses there-by making the state-backed mortgage more affordable and lucrative in the market especially for the first time buyers within the low and middle-income class bracket.

We expect that the policy changes made by KMRC will improve its competitiveness in offering affordable mortgages in the market, thereby attracting more partners from the financial sector to widen the opportunity of offering the loans. We also expect the mortgage refinancing company to continuously modify its regulations in accordance with the fast-evolving Real Estate industry, specifically by raising its allocation to align with the average mortgage loan size of Kshs 9.2 mn and above. Consequently, the move is expected to boost homeownership for more Kenyans especially in urban centres, spark growth of mortgage uptake, and help address some of the critical challenges that have counteracted mortgage uptake in the country such as; i) increasing property prices making it difficult for low-income earners to access mortgages, ii) high interest rates and high deposit requirements, iii) low-income earning levels that cannot sustain servicing of loans, and, iv) lack of credit information for those in the informal sector hence facing exclusion from mortgage programs offered by financial institutions, and, v) high Incidental costs such as legal fee, valuation fee, and stamp duty.

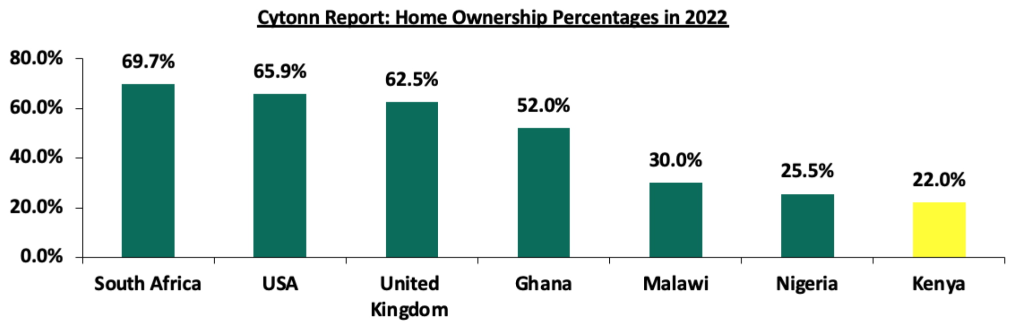
Subsequently, Kenya's mortgage to GDP continues to underperform at approximately 1.9%, compared to countries such as South Africa and Rwanda which are at approximately 16.3% and 4.2% as at 2021, respectively, as shown below;



**(2020)*

Source: Centre for Affordable Housing Africa

In addition, the percentage of Kenyan urban residents who own homes is relatively low at 22.0%, with the majority of the population, 78.0%, being property renters. This is in contrast to other Sub-Saharan African countries such as South Africa, Ghana, Malawi, and Nigeria where home-ownership rates are much higher at 69.7%, 52.0%, 30.0% and 25.5%, respectively as at 2022. The low home ownership rate in Kenya is majorly attributed to the high cost of purchasing residential properties and lack of affordable financing options and a standardized mechanism of accessing the finances for potential homeowners. The graph below shows homeownership percentages for different countries in comparison to Kenya in 2022;



Source: US Census Bureau, UK Office for National Statistics, Centre for Affordable Housing Africa

Notable highlights during the month include;

i. President William Ruto presided over the ground breaking ceremony of the Kshs 10.0 bn Shauri Moyo-A Affordable Housing Project which sits on an 8.0-acre piece of land in Shauri Moyo, Nairobi County. For more information, see Cytonn 2023 Markets Outlook,
ii. President Ruto oversaw the ground breaking of the Kings Boma Estate affordable housing project consisting 1,050 residential units, worth Kshs 2.8 bn, located along the Ruiru-Kiambu road in Kiambu County, nearing Kenya Prisons Staff Training College. For more information, see Cytonn Weekly #03/2023, and,
iii. Mwalimu National Sacco, a teachers-owned Sacco signed a partnership deal with state-owned financier, Kenya Mortgage Refinancing Company (KMRC) to provide low-cost mortgages capped at an interest rate of 9.0% to its members, 2.3% points lower than the market average of 11.3% in 2021. Additionally, Tatu City, a mixed-use satellite city development, launched a luxurious lakeside-living project dubbed 'Kofinaf Tatu Residences', sitting on a 200-acre piece of land within Kofinaf Estate, located in Tatu City, Kiambu County. For more information, see Cytonn Weekly #02/2023.

III. **Industrial Sector**

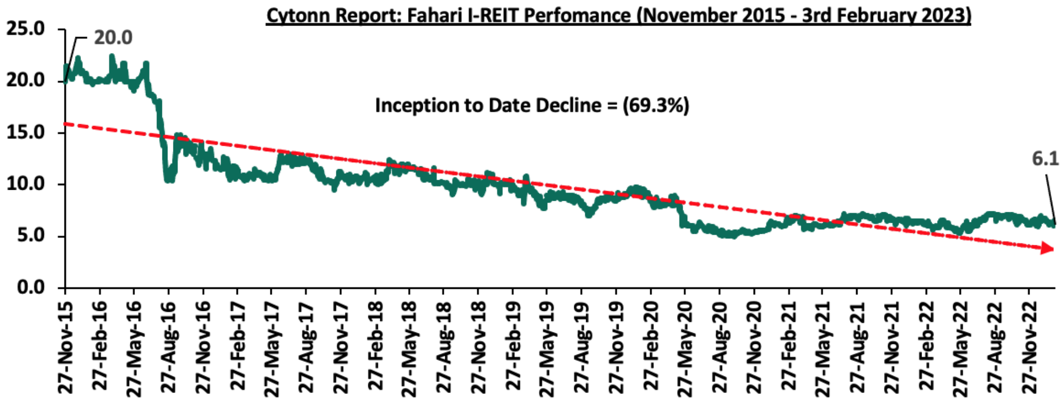
During the month, Logistics firm Mitchell Cotts Freights Kenya Limited, in partnership with two other logistics firms; Perishable Movements Kenya Limited and Fresh Handing Kenya Limited, unveiled a dry cargo and cold storage facility worth Kshs 30.0 mn, within Jomo Kenyatta International Airport (JKIA). For more information, see Cytonn Weekly #02/2023.

IV. **Statutory Reviews**

During the month, the Finance Act 2022, became effective as of 1st January 2023, with the Capital Gains Tax (CGT) chargeable on net gains upon transfer of property tripling to 15.0% from the 5.0% previously chargeable. For more information, see Cytonn Weekly #01/2023.

V. **Real Estate Investment Trusts (REITs)**

In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.1 per share. The performance represented a 2.5% decline from Kshs 6.3 per share recorded the previous week, taking it to a 9.4% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3rd January 2023. In addition, the performance represented a 69.3% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 8.1%. The graph below shows Fahari I-REIT’s performance from November 2015 to 3rd February 2023;



In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 23.9 and Kshs 20.9 per unit, respectively, as at 27th January 2023. The performance represented a 19.4% and 4.4% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 12.3 mn and 29.0 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 598.9 mn, respectively, since inception in February 2021.

We expect the performance of the Real Estate sector to remain on an upward trend, supported by factors such as; i) continued efforts geared to the adjustment of regulations on mortgage financing through the KMRC to align with the evolving Real Estate market, ii) the positive demographic profile of the country driving housing demand, iii) continuous partnership of the government with the private sector to focus on affordable housing, iv) progressive infrastructural development thereby opening up areas for investment, and, v) aggressive expansion by both local and international retailers in a bid to maintain market dominance. However, factors such as; i) increased construction costs on the back of high global and domestic inflation, ii) constrained financing to developers on the back of rising lending rates, coupled with underdeveloped capital markets, iii) prevailing oversupply of physical space in select sectors, and, iv) low investor appetite in Real Estate Investments Trusts (REITs) are expected to continue subduing the performance of the sector.
