Real Estate Developers Regulatory Framework, & Cytonn Weekly #08/2023

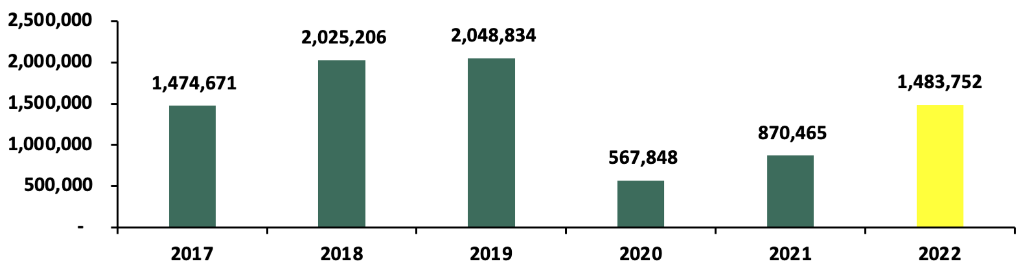
Real Estate

I. **Industry Report**

During the week, the Ministry of Tourism through the Kenya Tourism Research Institute released the Annual Tourism Sector Performance Report - 2022, highlighting the performance in the number of international visitor arrivals, inbound tourism earnings, bed and room occupancies, and the Meetings Incentives Conferences and Exhibition (MICE) subsector in local and international conferences in 2022 as discussed below;

i. Kenya registered a 70.5% increase in the number of international arrivals to 1,483,752 persons in 2022 compared to 870,465 persons in 2021. The performance in 2022, represented a 72.4% recovery level compared to pre COVID-19 levels of 2,048,834 persons in 2019, 7.4% points higher than the average global recovery rate compared against the same period. The impressive performance was attributed to; i) continuous easing of COVID-19 containment restrictions and flight travel advisories by many international markets and those imposed in the country, ii) the election season which attracted more regional and international expatriates and election observers, iii) peaceful post-electioneering period after the August general elections, with the subsequent months illustrating sustained improved performance fueled by the festive holidays, iv) resumption of the cruise tourism, v) intensive marketing of Kenya's tourism market through platforms such as the Magical Kenya, Kenya Tourism Board, and implementation of key government initiatives such as the New Tourism Strategic for Kenya 2021-2025, and, vi) increased conferences and meetings from private sector businesses and companies. The graph below shows the number of international arrivals from 2017 to 2022;

Cytonn Report: Number of International Visitor Arrivals (2017-2022)



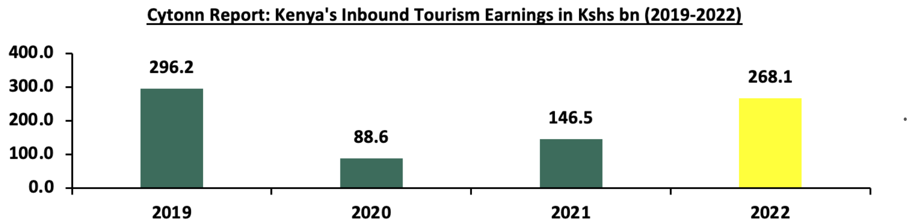
Source: Kenya Tourism Research Institute (KTRI)

ii. The highest number of visitor arrivals were from the United States of America (USA) and Uganda, which registered total number of tourists at 209,360 and 151,121, respectively, attributed to the total lifting of air travel advisories and pandemic related lockdowns into the country. Australia recorded the highest recovery rate in the market, illustrating 253.0% growth to 11,931 persons in 2022 from 3,376 in 2021 in spite of the little efforts made towards marketing of Kenyan tourism to the source market,

iii. In terms of purpose of visit, 543,458 tourists entered the country for leisure, representing 36.6%, while 413,180 came in to visit friends or family members representing 27.8%, and

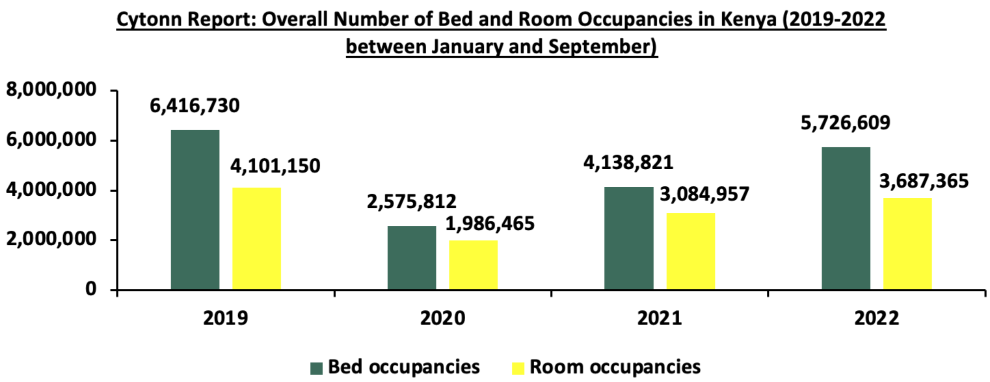
404,183 came in for business and MICE purposes. This was attributed to; i) lifting of all travel restrictions and lockdowns owing to reopening of the global economy which boosted recovery of the hospitality and tourism sectors, ii) increased leisure activities during the festive season and sporting activities with the hosting of 2022 Annual Safari Rally competition, and, iii) increased conferences and meetings from private sector businesses and companies with the peaceful election period attracting more expatriates,

iv. In terms of inbound receipts, inbound tourism earnings increased by 82.9% to Kshs 268.1 bn in 2022 compared to Kshs 146.51 bn in 2021, achieving a 90.5% recovery rate compared to 2019 pre-COVID levels which raked in Kshs 296.2 bn. The rate of growth in revenues was majorly attributable to the 70.5% growth in number of international arrivals, as well as the continued weakening of the Kenyan shilling against other major currencies such as the United States Dollar, Sterling Pound and Euro. The graph below shows Kenya's Inbound Tourism Earnings from 2019 to 2022;



Source: Kenya Tourism Research Institute (KTRI)

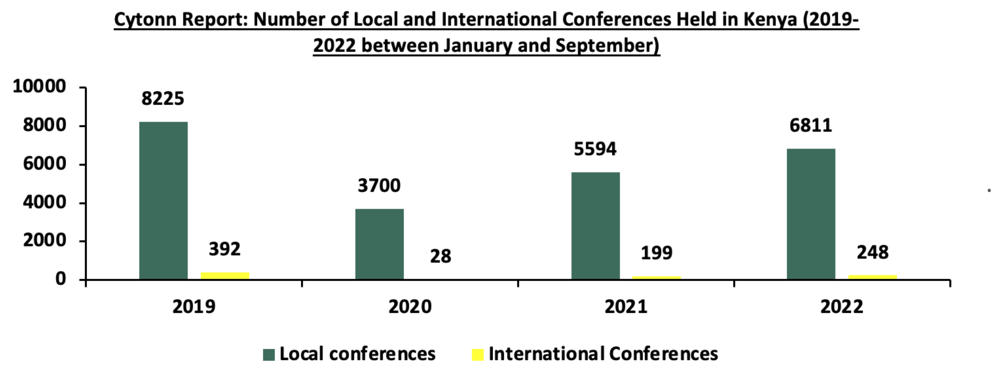
v. In regard to number of both international and domestic bed and room occupancies, the bed occupancy grew by 38.4% to 5,726,609 beds in the period January to September 2022 from 4,138,821 beds the same period in 2021. This represented an 89.2% recovery a rate against 2019 which recorded 6,416,730 occupied beds. On the other hand, rooms occupancy increased by 19.5% to 3,687,365 in 2022 from January to September from 3,084,957 in the same period in 2021, achieving a recovery rate of 89.9% against 2019 pre-COVID levels which recorded 4,101,150 rooms occupied. The growth in occupancies were attributed to; i) reopening of the economy owing to relaxation of COVID-19 pandemic related protocols that resulted to full revamp of accommodation facilities which were temporarily shut down, ii) the rise in the number of international visitors arriving, and, iii) significant growth in the domestic tourism activity occasioned by aggressive marketing strategies such as the '*Kenya Inanitosha Campaign*'. The graph below shows the overall number of bed and room occupancies in Kenya between January and September, from 2019 to 2022;



Source: Kenya Tourism Research Institute (KTRI)

vi. The number of international conferences held in the country increased by 24.6% to 248 in the period between January and September 2022, from 199 within the same period in 2021, achieving a 63.2% recovery rate compared to 2019 pre-COVID levels of 392 conferences. This also led to an increase of 114.6% in number of international delegates to a total of 18,658 in the period between January and September 2022, from 8,693 within the same period in 2021. Both performances were attributed to; i) relaxation of travel advisories with increased health and safety measures in containing COVID-19 among the delegates, ii) peaceful electioneering period that also attracted election observers and expatriates, and, iii) increased marketing strategies put in place by the Government such as bidding for major international conferences like United Nations Environment Assembly, World Travels Award, Africities Summit, among others, and,

vii. On the other hand, the number of local conferences rose by 21.8% to 6,811 in the period between January and September 2022 from 5,594 within the same period in 2021, achieving recovery rate of 82.8% compared to 2019 pre-COVID levels of 8,225 conferences. This led to an increase of 91.2% in number of local delegates to a total of 203,363 in the period between January and September 2022, from 87,444 within the same period in 2021. The upward trajectory in performance was attributed to; i) lifting of the ban on physical gatherings, ii) government drive on the COVID-19 vaccination of citizens, iii) increased public and private expos, trainings, seminars, and, workshops organized by corporate organizations, County and national governments, iv) a return to normalcy in businesses, and, v) peaceful electioneering period. The graph below shows the overall number of local and international conferences held in Kenya between January and September, from 2019 to 2022;



Source: Kenya Tourism Research Institute (KTRI)

The graph below shows the number of local and international delegates in Kenya between January and September, from 2019 to 2022;

Source: Kenya Tourism Research Institute (KTRI)

Moving forward, we expect improved performance with increased activities in the tourism and hospitality sectors, supported by; i) continuous recovery of the economy in the post-COVID-19 and electioneering periods, increased business events, conferences, and meetings from the public and private sectors, ii) increased leisure and sporting activities such as the 2023 Annual World Safari Rally, iii) continued recognition of Kenya's hospitality industry through positive accolades awarded to several local and foreign hotel brands based in Kenya which have boosted investors' confidence in the sector such as the World Travel Awards 2022, MICE Awards, Fodor Finest Hotels, among others, and, iv) intensive marketing of Kenya's tourism market through platforms such as the Magical Kenya and Kenya Tourism Board to local and international tourists. However, due to increased insecurity cases within the country and its neighbouring states such as Ethiopia, South Sudan, Democratic Republic of Congo (DRC) and Somalia, we anticipate factors such as the recently issued travel advisories regarding certain regions of the country by the United Kingdom (UK), United States of America (USA), Irish, and Canadian governments in February 2023 to have a negative impact on international arrivals in 2023. This is in consideration that the aforementioned countries are among top tourist markets for Kenya. Additionally, as part of the current government's austerity measures, we expect the decision to indefinitely suspend hotel meetings, conferences and trainings by Ministries, Agencies and State Departments (MADs) will further weigh down the optimum performance of the conferencing, food and accommodation sub-sectors.

II. **Residential Sector**

During the week, the County Government of Nairobi began the second phase of its plan of redeveloping old County estates through construction of 33,000 new low-cost units. The plan, which is under the Urban Renewal and Housing Program was formulated in FY'2015/2016 and is part of the general Nairobi Integrated Urban Development Master Plan (NIUPLAN) of 2013. The Housing and Urban Renewal program of Nairobi County is an initiative aimed at improving the living conditions of the low-income residents of Nairobi by addressing the challenges faced in the housing and urban development sector. The program seeks to achieve this goal by implementing various strategies such as; i) slum upgrading and improving the existing housing infrastructure, ii) developing new affordable and social housing units, iv) creating sustainable urban development solutions by encouraging the use of eco-friendly materials in housing construction, and, iv) developing the necessary infrastructure to support urban housing development such as roads, water supply systems, and sewage systems.

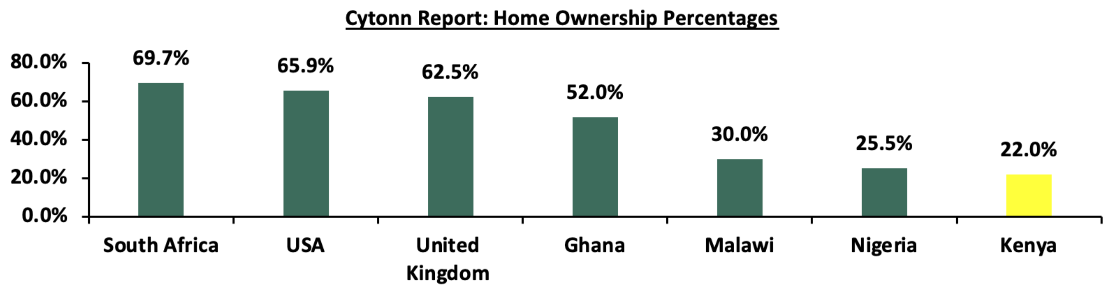
The County government, through its first and second phases of the plan, targets specific estates for redevelopment of housing infrastructure, focus on social housing, and upgrade of slums through joint venture, with the County government providing land as equity contribution and private investors funding it and providing technical expertise. The County Government has so far partnered with Japanese International Cooperation Agency (JICA) and the JICA Study Team (JST) for the technical support in preparing NIUPLAN. The programme will focus on increasing the general supply of affordable housing units for both rent and purchase purposes to residents within the targeted estates by taking advantage of large, public open land spaces that are underutilized to develop the new low-cost houses. Tenants residing in dilapidated structures where the redevelopments will take place will vacate to the new units on priority basis after completion of construction. Demolitions of the old vacated housing units will then be undertaken to create more space for the construction of more housing units. However, for full utilization of the land, some areas will experience minimal displacement of residents before the redevelopment. Developers will cater for the accommodation of those displaced until completion of construction. The table below shows targeted estates for redevelopment in Phase One and Two:

Cytonn Report: Targeted Estates for Housing and Urban Renewal Programme of Nairobi County

Phase	Estates	Estimated Number of New Housing Units
One	Ngong' Road Phase I and II, Uhuru Estate, New Ngara, Old Ngara, Suna Road, Pangani Jeevanjee/Bachelor Quarters	17,000
Two	Bahati, Maringo, Jericho, Lumumba, Ziwani, Bondeni, Embakasi, Kariobangi North, Woodley	33,000

Source: Cytonn Research

However, access to affordable financial resources still poses a major challenge to developers and County governments in undertaking development projects. This is coupled with an underdeveloped capital markets regime, and increasing construction costs on the back of elevated global and domestic inflation, which continue to hamper optimum development activities in the sector. For instance, according to Nairobi County Intergrated Development Plan (CIDP 2018-2022), the Nairobi County government managed to redevelop only 150 housing units and complete repair works of 1,000 units in the first phase of the programme, out of its target of 17,000 units, citing limited financial resources available to the County's housing sector. Other factors that rendered the project unfeasible were; misappropriation of funds at County administration level due to increased corruption, lack of adequate planning and consultation with the affected communities which led to resistance and reluctance to vacation of residents in some parts of the County, poor urban planning which led to insufficient infrastructural development that would support the developments such as roads, water supply, electricity and sewerage systems. We therefore expect these challenges to continue weighing down on the progress towards curbing the low urban homeownership rate, which currently stands at 22.0% compared to other Sub-Saharan African countries such as South Africa and Ghana with urban homeownership rates of 69.7% and 52.0%, respectively, as shown below;



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

Therefore, with the existence of comprehensive laid down plans for readjustment of the city, there is need for the County government to first address the key impediments hindering viability and success rates of affordable housing projects being executed by; i) increasing its partnership with private investors and international organizations with expertise in affordable housing and secure necessary funding for the projects, ii) instituting strict financial controls at County's housing sector such as regular audits and financial reporting done publicly to ensure funds are utilized efficiently and transparently, iii) tough penalties to those found engaging in corrupt practices in the implementation of the projects, iv) increasing community engagement and consultations with affected residents to ensure their cooperation and support throughout the projects, implementation, and, v) prioritizing developments of necessary infrastructure to support the housing units and ensure the availability of basic services for the residents.

III. **Office Sector**

a. **JPMorgan announced plans through State House Nairobi to open regional office in Nairobi, Kenya**

During the week, JP Morgan Chase & Co, an American-based international investment bank, through State House Nairobi, announced plans to open its regional office in Nairobi, Kenya, serving as a central hub for its operations in the East African region with existing footprints in Nigeria and South Africa. The plan comes after an indication in 2018 by the CEO, Jamie Dimon, who expressed interests in opening representative offices in Kenya and Ghana. This is as the investment bank had sought to expand activity and conduct operations in the two countries, but faced regulatory challenges. The expansion of the investment bank into the Kenyan market is supported by; i) the brand's need to increase its geographical and financial dominance across all regions in Africa, ii) step up its competitiveness against other multinational investment banks that have interests in Africa like

Export-Import Bank (EXIM) of China, and, iii) Nairobi's rise as a regional hub for multinational organizations such as United Nations, Microsoft, Google, Deloitte, Price Water Coopers (PwC), Ernst & Young (EY), and many more in serving their financial interest of handling large transactions where the local investment banking firms are not well furnished with the expertise.

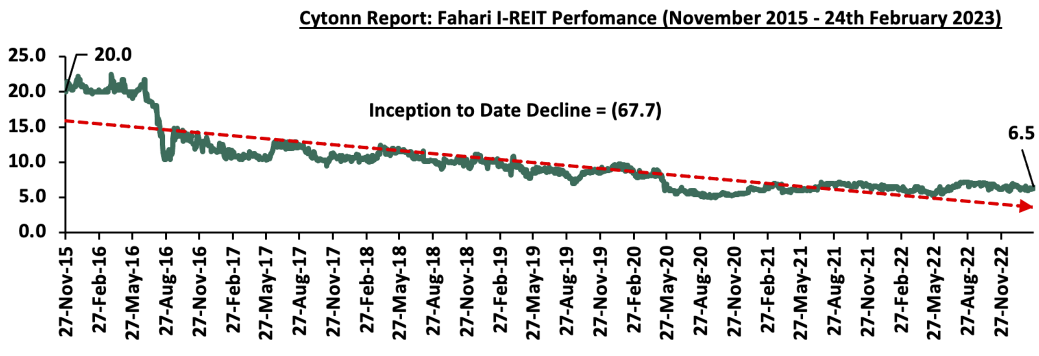
b. **Commonwealth Enterprise and Investment Council opened its regional office in Nairobi, Kenya**

Additionally, Commonwealth Enterprise and Investment Council (CWEIC), Commonwealth's official business networking organization, opened its regional office in Nairobi, Kenya. The office will serve as East Africa's business hub for the organization which will help grow trade and investments by offering opportunities such as; i) supporting businesses in the region seeking export markets for their goods and services in Europe and across the globe, and, ii) providing legal advice for firms eyeing cross-border deals. With a footprint of 56 country members across the world, the move by Commonwealth will create an enhanced business opportunity for firms in East Africa coupled with existing multilateral trade initiatives such as the East African Community Regional Trade Area and African Continental Free Trade Area (AfCFTA). Nairobi becomes the fourth hub for CWEIC in the African continent after Accra Ghana, Lagos Nigeria, and Douala Cameroon thus increasing its trade and investment dominance in Western and Eastern Africa.

In terms of performance, the Kenyan commercial office sector is expected to continue being supported by; i) the continuous drive of regional expansion by multi-national organizations such as JP Morgan and CWIEC which is geared to attract more organizations into the Kenyan market, ii) the rise of co-working spaces designed to accommodate freelancers, small businesses, and niche-centric spaces which are tailored according to a specific gender, profession, need or shared interests of clients, and, iii) full resumption of operations by most local firms and businesses amidst the improved economy in the post-COVID and peaceful post-electioneering period. However, the existing oversupply of office spaces currently at approximately 6.7 mn SQFT in the Nairobi Metropolitan Area (NMA) is expected to continue weighing down the overall occupancy rates and yields, thereby subduing optimum performance of the sector.

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

In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.5 per share. The performance represented a 4.5% gain from Kshs 6.2 per share recorded the previous week, taking it to a 4.7% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3rd January 2023. In addition, the performance represented a 67.7% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 7.7%. The graph below shows Fahari I-REIT's performance from November 2015 to 24th 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 24th February 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 29.1 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 600.4 mn, respectively, since inception in February 2021.

REITs provide numerous advantages, including consistent and prolonged profits, tax exemptions, and diversified portfolios, among others. Despite these benefits, the performance of the Kenyan REITs market remains limited by several factors which include; i) insufficient investor understanding of the investment instrument, ii) time-consuming approval procedures, iii) high minimum capital requirements of Kshs 100.0 mn for trustees, and, iv) high minimum investment amounts set at Kshs 5.0 mn discouraging investments.

We expect the performance of Kenya's Real Estate sector to continue on an upward trajectory, supported by factors such as; i) improved performance of the hospitality sector with increased tourist activities ii) efforts by County governments to rehabilitate housing assets, and, iii) expansion drive by multi-national organizations in the office sector. However, the presence of financial constraints amid the prevailing tough economic environment, the existing oversupply of physical space in selected sectors, and low investor appetite for REITs are expected to continue subduing the performance of the sector.
