Off-Plan Real Estate, & Cytonn Weekly #21/2023

Real Estate

I. **Commercial Office Sector**

During the week, Actis Limited, a global private equity firm, announced that it had shut down two offices located in Nairobi, Kenya and Cape Town, South Africa. This comes at a time when Actis is actively exploring alternative working solutions, which consequently resulted in the decision to not renew the commercial leases for the two offices. However, Actis has maintained that the closure of these branches does not imply an exit from the respective markets. Following the closure Actis currently maintains a total of 17 physical offices worldwide, with four of them strategically located in Africa which include; Lagos in Nigeria, Johannesburg in South Africa, Port Louis in Mauritius, and Cairo in Egypt. Within Kenya, Actis has invested in the residential sector in Garden City Mall and Mi Vida homes, the retail sector in Junction Mall, and in the hospitality sector with an ownership of Java House.

The decision by Actis to review its office footprint in Africa aligns with the prevailing trend of hybrid and remote working strategies that have significantly influenced the commercial office market. This is as many companies have embraced these strategies to reduce costs and introduce greater flexibility in their working environments alongside their recovery from the COVID-19 pandemic. Consequently, this shift has resulted in a slowdown in occupancy rates in the commercial market, with the closure of their office located at Courtyard, along General Mathenge Road in Westlands, Nairobi prolonging the vacancy rates within the sector.

The table below shows the Nairobi Metropolitan Area (NMA) commercial office sub-market performance;

All values in Kshs unless stated otherwise

Cytonn Report: Nairobi Metropolitan Area Commercial Office Market Performance Q1'2022/Q1'2023

Area	Price Kshs/ SQFT Q1'2023	Rent Kshs/ SQFT Q1'2023	Occupancy Q1' 2023	Rental Yields Q1 2023(%)	Price Kshs/ SQFT Q1'2022	Rent Kshs/ SQFT Q1'2022	Occupancy Q1'2022 (%)	Rental Yields Q1 2022(%)	Δ in Rent	Δ in Occupancy (% points)	Δ in Rental Yields (% points)
Gigiri	13,500	118	81.6%	8.7%	13,500	118	83.3%	8.8%	0.4%	(1.7%)	(0.1%)
Westlands	12,032	108	77.2%	8.4%	11,846	105	74.5%	8.1%	2.8%	2.7%	0.2%
Karen	13,431	111	82.9%	8.3%	13,325	107	82.8%	7.8%	3.8%	0.1%	0.5%
Kilimani	12,260	93	84.1%	7.8%	12,440	91	80.2%	7.1%	2.9%	3.9%	0.7%
Parklands	11,662	91	82.2%	7.8%	11,562	91	82.8%	7.7%	0.0%	(0.6%)	0.0%
Nairobi CBD	11,971	83	85.3%	7.2%	11,863	82	83.8%	6.9%	1.4%	1.4%	0.3%
Upperhill	12,605	97	76.6%	7.0%	12,409	94	76.1%	6.9%	2.7%	0.4%	0.1%
Thika Road	12,571	79	80.3%	6.0%	12,571	78	77.6%	5.7%	1.4%	2.7%	0.3%
Mombasa Road	11,325	71	67.0%	5.2%	11,250	73	64.6%	5.1%	(2.5%)	2.4%	0.1%
Average	**12,238**	**97**	**79.8%**	**7.6%**	**12,113**	**94**	**77.9%**	**7.3%**	**2.2%**	**1.9%**	**0.4%**

Source: Cytonn Research

Going forward, we expect the sizing down of physical operations by companies which has resulted in an oversupply of approximately 5.8 mn SQFT of space in the NMA market, to continue subduing the performance of the commercial office sector. On the other hand, the vacancy rates will further prompt investors to withhold new developments in order to allow occupation of the existing space. As a result, we expect this will in the long term boost the sector by increasing the uptake rates of commercial space.

II. **Regulated Real Estate Funds**

a. Real Estate Investment Trusts (REITs)

In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 5.8 per share. The performance represented a 4.0% decline from Kshs 6.0 per share recorded the previous week, taking it to an 15.0% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3 January 2023. In addition, the performance represented a 71.2% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 11.3%. The graph below shows Fahari I-REIT’s performance from November 2015 to 26 May 2023;

In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 23.9 and Kshs 21.6 per unit, respectively, as at 26 May 2023. The performance represented a 19.4% and 7.9% gain for the D-REIT and IREIT, 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 30.1 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 620.7 mn, respectively, since inception in February 2021.

REITs provide numerous advantages, including; access to more capital pools, consistent and prolonged profits, tax exemptions, diversified portfolios, transparency, liquidity and flexibility as an asset class. Despite these benefits, the performance of the Kenyan REITs market remains limited by several factors such as; i) insufficient investor understanding of the investment instrument, ii) time-consuming approval procedures for REIT creation, 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.

b. **Cytonn High Yield Fund (CHYF)**

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 13.6%, representing a 0.1% points decline from the 13.7% yield recorded the previous week. The performance also represented a 0.3% points Year-to-Date (YTD) decline from 13.9% yield recorded on 1 January 2023, and 2.1% points Inception-to-Date (ITD) loss from the 15.7% yield. The graph below shows Cytonn High Yield Fund’s performance from October 2019 to 26 May 2023;

Notably, the CHYF has outperformed other regulated Real Estate funds with an annualized yield of 13.6%, as compared to Fahari I-REIT and Acorn I-REIT with yields of 11.3%, and 6.8% respectively. As such, the higher yields offered by CHYF makes the fund one of the best alternative investment resource in the Real Estate sector. The graph below shows the yield performance of the Regulated Real Estate Funds:

Source: Cytonn Research

We expect the performance of Kenya’s Real Estate sector to remain on an upward trajectory, supported by factors such as; i) the ongoing push by both the government and

private sector to focus on affordable housing, ii) improvement in infrastructure, ii) aggressive expansion drive by both local and international retailers, and, iv) the relatively positive demographics in the country that are driving demand for housing upwards. However, the shift by companies to scale down physical operations in favour of hybrid and remote work policies, existing oversupply of physical space in select sectors, rising costs of construction on the back of rising inflation, and low investor appetite for REITs are expected to continue subduing the performance of the sector.
