Cytonn Monthly - May 2023

Real Estate

I. **Industry Reports**

During the month, the following industry reports were released and the key take-outs were as follows:

Cytonn Report: Notable Industry Reports During the Month of May 2023

#	Theme	Report	Key Take-outs
1	Real Estate Mortgage	Bank Supervision Annual Report 2022 by the Central Bank of Kenya (CBK)	· The number of mortgage accounts increased by 4.0% to 27,786 in 2022, from 26,723 in 2021, which also represented a 10-year Compounded Annual Growth Rate (CAGR) of 4.1%, from 18,587 recorded in 2012, · The average mortgage loan size decreased by 2.2% to Kshs 9.0 mn in 2022, from 9.2 mn in 2021, attributable to lower values of mortgage loans advanced in 2022 by financial institutions, · The value of mortgage loans outstanding increased by Kshs 16.7 bn, representing a 6.8% increase to Kshs 261.8 bn in 2022, from Kshs 245.1 bn in 2021, · The average interest rate charged on mortgages increased by 1.0% points to 12.3% in 2022, from 11.3% in 2021. The interest rates majorly ranged from 8.2% to 17.0% in 2022 compared to a range of from 7.1% to 15.0% recorded in 2021, · The outstanding value of Non-Performing Mortgage Loans (NPMLs) increased by 33.6% to Kshs 37.8 bn in 2022, from Kshs 28.3 bn in 2021, and, · The Loan to Value Ratio, which is the maximum loan as a percentage of the property value, stabilized at 90.0% in 2022 since 2014, leaving mortgage customers to cover for their own incidental costs such as legal and registration costs. For more information, please see our Cytonn Weekly #20/2023.
2	General Real Estate	Economic Survey 2023 Report reports by the Kenya National Bureau of Statistics (KNBS)	· Declined Growth in the Real Estate Sector – According to the report, the Real Estate Sector grew by 4.5% in FY'2022. This was however 2.2% points lower than the 6.7% growth recorded in FY'2021, · Slower Growth in the Construction Sector - The construction sector grew by 4.1% in FY'2022, 2.6% point lower than the 6.7% growth recorded in FY'2021, and, · Sustained Recovery in Accommodation and Food Service Sector - The Accommodation and Restaurant services grew by 26.2% in FY'2022, from the 52.6% growth recorded in FY'2021 demonstrating sustained recovery of the sector toward pre-COVID levels. For more information, see Cytonn Weekly #18/2023.

Cytonn Report: Notable Industry Reports During the Month of May 2023

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3	Residential and Land Sectors	House Price Index Q1'2023 , and, Land Price Index Q1'2023 Reports by Hass Consult	· The average q/q selling prices for residential houses registered a 0.02% increase in Q1'2023, compared to a 2.2% decline recorded in Q4'2022, while on a y/y basis the average selling prices for residential houses appreciated by 2.0%, compared to a 6.8% increase that was recorded in Q1'2022, and, · Average q/q and y/y selling prices for land in the Nairobi suburbs slightly increased by 0.3% and 1.4% respectively, compared to 0.1% and 1.1% recorded in Q1'2022, and, · Consequently, q/q and y/y land prices in satellite towns of Nairobi increased by 1.3% and 8.1% respectively, compared to a 2.2% and 7.4%, respectively in Q1'2022. For more information please see Cytonn Weekly #18/2023

We expect Kenya's Real Estate sector to continue registering growth in terms of activity, driven by; i) positive performance in land and residential sectors on the back of increased focus by the government on affordable housing, ii) sustained recovery in the accommodation and food sectors post COVID-19, iii) positive demographics above the global averages thus driving the demand for Real Estate upwards, and iv) increased activities in the mortgage industry. However, we expect that the optimal performance of the sector will be hindered by factors such as high construction costs, worsened by inflationary pressures resulting from both local and global economic shocks. Additionally, the continued depreciation of the Kenyan shilling against major international trading currencies, could potentially increase the import bill of building materials and raw materials for local production of crucial construction materials such as cement, paint and steel among others, further slowing down the growth of the construction sector.

II. **Residential Sector**

Notable highlights during the month include;

i. President Ruto presided over ground breaking of the Lapfund Bellevue Park Residences housing project consisting of 2,356 residential units worth Kshs 16.0 bn, located in South C, Nairobi. The project targeting middle-income earners will comprise of studio, 1, 2 and 3-bedroom residential units, a commercial area with offices, and amenities including a strip retail center and recreational facilities. The development of the project will be undertaken by the Local Authorities Provident Fund (LAPFund), and, will be delivered under a contractor-financed model basis, by CRJE (East Africa) Limited, a subsidiary of the Chinese CREC Group. For more information, please see our Cytonn Weekly #19/2023.

We anticipate that the sector's performance will be driven by; i) the initiation and completion of various housing projects across the country under the affordable housing programme, and, ii) continuous launch of projects by developers in the private sector. This we expect will aid in addressing the existing housing deficit, currently standing at 2.0 mn units, as well as increase urban home-ownership rates in the country which have remained relatively low at 22.0% compared to other African countries such as South Africa at 69.7% and Ghana with 52.0% respectively. However, we expect the rising constructions costs to hinder performance of the sector by increasing development costs for developers.

III. **Commercial Office Sector**

Notable highlights in the sector include;

i. Actis Limited, a global private equity firm, announced that it had shut down two offices located in Nairobi, Kenya and Cape Town, South Africa. However, Actis has maintained that the closure of these branches does not imply an exit from the respective markets. For more information, please see our Cytonn Weekly #21/2023, and,

ii. The United Nations (UN) announced plans to relocate the United Nations Office for Project Services (UNOPS) Africa regional office to Nairobi, Kenya. Previously, the UNOPS Africa regional headquarters had its base in Denmark, while maintaining country offices in Liberia, Tunisia, Sudan, South Sudan, Kenya, the Democratic Republic of Congo (DRC), Nigeria, Ethiopia, Cote d'Ivoire, and Tunisia. For more information please see Cytonn Weekly #18/2023.

We expect to witness continued improvement in performance in the commercial office sector supported by; i) Kenya’s recognition as a regional hub for businesses and diplomacy in the Eastern and Central Africa regions which has attracted more global organizations and agencies to the Kenyan commercial market, ii) gaining traction of co-working spaces and niche centric office spaces that cater to a diverse clientele, and, iii) resumption of operations by most local firms and businesses resulting from the post-COVID-19 and peaceful post-electioneering periods thereby boosting occupancy rates. However, we expect the sector's overall performance to be subdued by the existing oversupply of approximately 5.8 mn SQFT in the Nairobi Metropolitan Area (NMA) as at 2022.

IV. Retail Sector

During the week, French retailer Carrefour Supermarket, opened a new outlet at the Business Bay Square (BBS) mall located in Eastleigh, Nairobi, bringing the retailer’s number of operating outlets countrywide to 20. The recently launched mall, with phase 1 currently at about 90.0% complete, comprises of retail facilities, banks and micro-finance institutions, food courts and restaurants, medical facilities, a mosque, commercial offices, entertainment and recreation facilities, and a kid’s playground. Phase 2 of the project, comprising of a hotel and residential serviced apartments will begin once the first phase is wrapped up, totaling to 130,000 SQM with both phases fully complete. The move is part of the retailer’s strategic plan to expand its footprint in the Kenyan market. Moreover, the retailer’s decision to open up a new branch at the mall was influenced by the desire to capitalize on high footfall in the mall, and serve customers living adjacent estates. In support of this, the mall will host key retail brands including Simbisa brands, Artcaffe, Java House, L’Oreal, LC Waikiki, Optica, Goodlife among others. Notably, this comes at a time when formal retail penetration in Kenya is still low, standing at 30.0% as at 2018, coupled with existing gaps left by other retailers such as Nakumatt, Uchumi, Shoprite and Choppies Supermarkets which exited the market.

The table below shows the number of stores operated by key local and international retail supermarket chains in Kenya;

Cytonn Report: Main Local and International Retail Supermarket Chains

Name of retailer	Category	Branches as at FY’2018	Branches as at FY’2019	Branches as at FY’2020	Branches as at FY’2021	Branches as at FY’2022	Branches opened in 2023	Closed branches	Current branches	Branches expected to be opened	Projected branches FY’2023
Naivas	Hybrid*	46	61	69	79	91	2	0	93	0	93
Quick Mart	Hybrid**	10	29	37	48	55	3	0	58	0	58
Chandarana	Local	14	19	20	23	26	0	0	26	0	26
Carrefour	International	6	7	9	16	19	1	0	20	0	20
Cleanshelf	Local	9	10	11	12	12	1	0	13	0	13
Tuskys	Local	53	64	64	6	4	0	59	5	0	5
Game Stores	International	2	2	3	3	0	0	3	0	0	0
Uchumi	Local	37	37	37	2	2	0	35	2	0	2
Choppies	International	13	15	15	0	0	0	15	0	0	0
Shoprite	International	2	4	4	0	0	0	4	0	0	0
Nakumatt	Local	65	65	65	0	0	0	65	0	0	0
Total		**257**	**313**	**334**	**189**	**209**	**7**	**181**	**217**	**0**	**217**

***40% owned by IBL Group (Mauritius), Proparco (France), and DEG (Germany), while 60% owned by Gakiwawa Family (Kenya)**

****More than 50% owned by Adenia Partners (Mauritius), while Less than 50% owned by Kinuthia Family (Kenya)**

Source: Cytonn Research

Additionally, during the month;

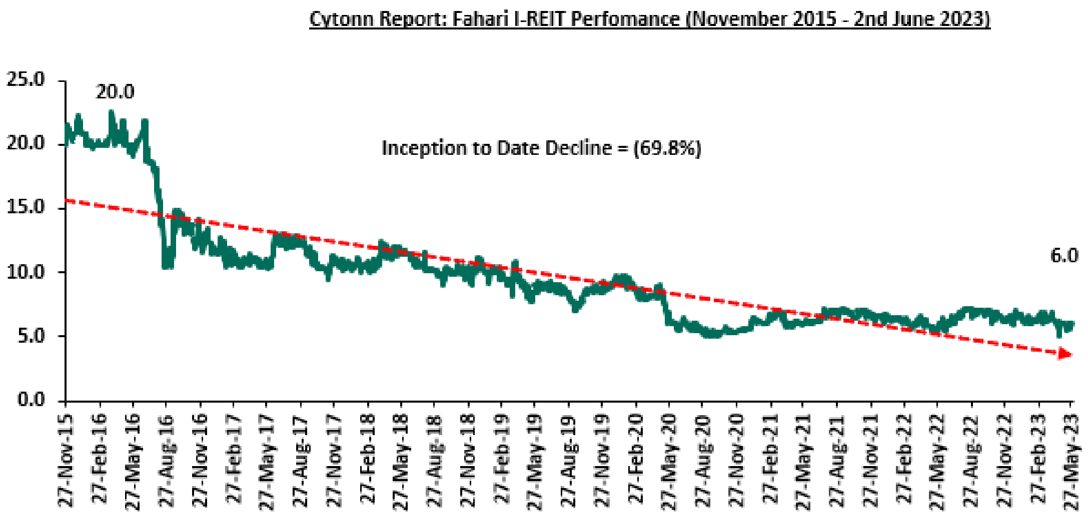
i. Chain store Naivas Supermarket opened a new outlet located at Shell petrol station along Haile Selassie Avenue, Nairobi, bringing the retailer's number of operating outlets countrywide to 93. For more information, please see our Cytonn Weekly #19/2023.

We continue to expect increased activities in the Kenyan retail industry attributed to; i) sustained expansion efforts by both domestic and foreign retailers who are aggressively competing for a bigger share of the market and increased capital investments by foreign entities in the retail market, ii) the growing demand for goods, services, and retail space driven by favorable demographics both within and beyond the Nairobi Metropolitan Area (NMA), and, iii) increased infrastructural development enhancing accessibility in regions offering new opportunities for retail investment. Nevertheless, the rampant proliferation of e-commerce which is quickly changing how consumers shop and purchase goods, and the oversupply of retail spaces, currently estimated at 3.0 mn SQFT in the Nairobi Metropolitan Area (NMA) and 1.7 mn SQFT in the larger Kenyan retail sector (excluding NMA), remain significant obstacles that continue to impede the sector's growth and overall performance.

V. **Regulated Real Estate Funds**

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

In the Nairobi Securities Platform, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.0 per share. The performance represented a 4.9% increase from Kshs 5.8 per share recorded the previous week, taking it to an 10.9% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3 January 2023. In addition, the performance represented a 69.8% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 10.8%. The graph below shows Fahari I-REIT's performance from November 2015 to 2 June 2023;



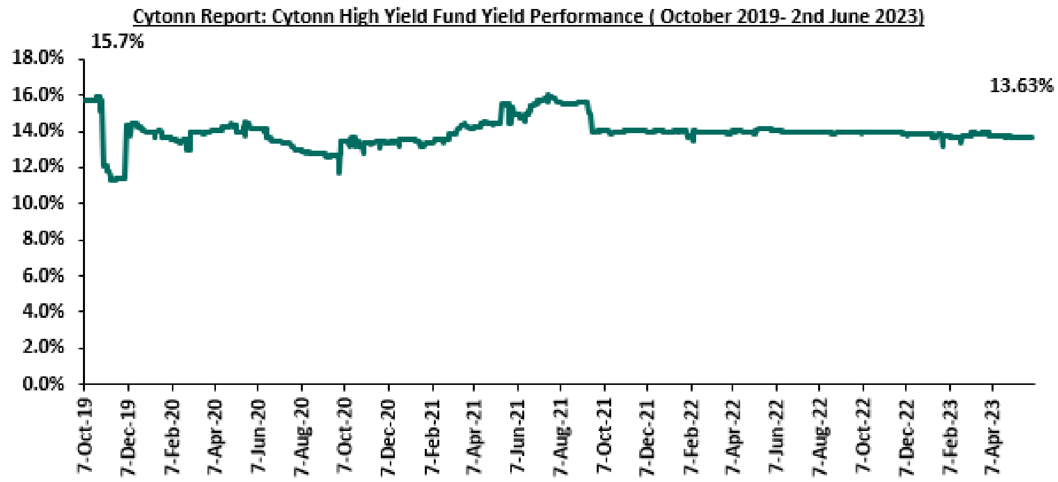
In the Unquoted Securities Platform Acorn D-REIT and I-REIT traded at Kshs 23.9 and Kshs 21.6 per unit, respectively, as at 26 May 2023. The performance represented a 19.4% and 7.9% gain for the D-REIT and IREIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and 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)

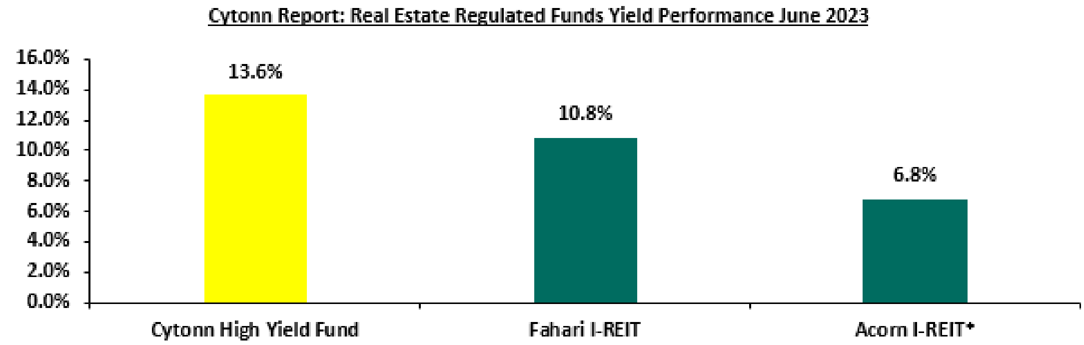
high minimum capital requirements of Kshs 100.0 mn for trustees, and, iv) high minimum investment amounts set at Kshs 5.0 mn discouraging investments.

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

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 13.6%, remaining relatively unchanged from the previous week. The performance also represented 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 2 June 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 10.8%, 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:



**FY'2022*

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) ongoing efforts by both the government and private sector to prioritize affordable housing, ii) infrastructural advancements supporting investments, iii) aggressive expansion strategies pursued by both local and international retailers, and, iv) relatively positive demographics in the country increasing demand for housing. 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 hindering optimal the performance of the sector.

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