Kenya’s FY'2023/2024 Budget Review, & Cytonn Weekly #25/2023

Real Estate

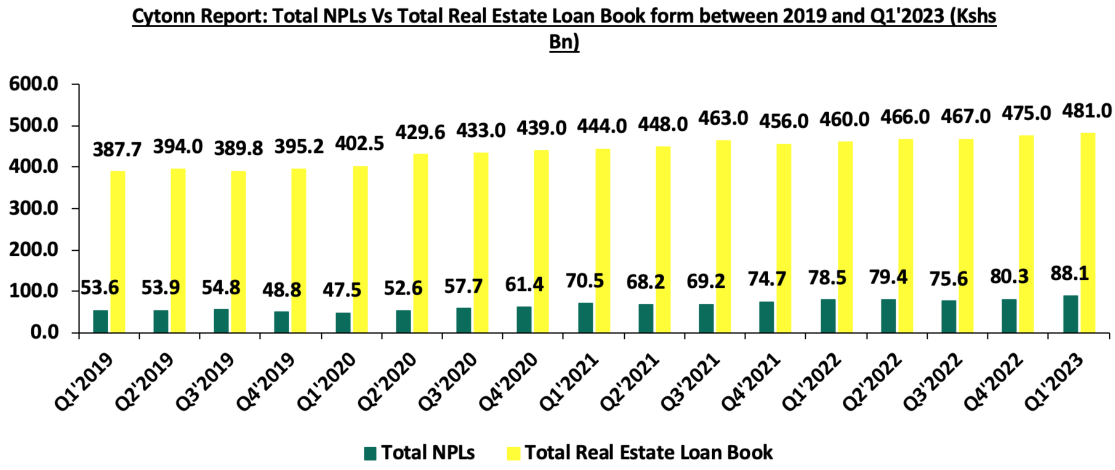
I. **Industry Reports**

a. **Quarterly Economic Report Q1’2023**

During the week, the Central Bank of Kenya (CBK) released the Quarterly Economic Review Q1’2023 Report, which highlighted the status and performance of Kenya’s economy for the period under review. The following were the key takeouts from the report, with regard to the Real Estate and related sectors;

i. The year-on-year (y/y) gross loans advanced to the Real Estate sector increased by 4.6% to Kshs 481.0 bn in Q1’2023, from Kshs 460.0 bn in Q1’2022. The advanced loans also represented a 1.3% quarter-on-quarter (q/q) increase from Kshs 475.0 bn realized in Q4’2022. The increase was mainly on the back of increased construction activities in select Real Estate sectors particularly the residential sector, fuelled by private firms, individuals, and the government’s continuous drive to provide affordable housing to its citizens,
ii. The gross loans advanced to the hospitality sector increased by 0.9% to Kshs 112.0 bn in Q1’2023, from Kshs 111.0 bn in Q1’2022 on a y/y basis. This was attributed to an increased need for operational capital in the sector driven by; i) increased operational expenses due to rising inflation on the back of supply chain disruptions, exacerbated by the Russia-Ukraine war, ii) completion of acquisitions and mergers amid expansionary efforts by players seeking market dominance in the sector, iii) increased costs associated with mergers and acquisitions as a result of increased capital gains tax, iv) aggressive marketing initiatives both locally and internationally by industry players through initiatives such as the annual Magical Kenya Travel Expo, and, v) increased need for financial infusion, following the reopening of hotels and facilities in order to ensure sustain business towards recovery to pre-COVID levels,
iii. Gross loans advanced to the building and construction sector recorded a y/y growth of 8.7% to Kshs 150.0 bn in Q1’2023, from Kshs 138.0 bn in Q1’2022. This also represented a 5.6% q/q increase from Kshs 142.0 bn recorded in Q4’2022. The growth was mainly driven by continuous construction activities, particularly in the housing and infrastructure sectors. Furthermore, construction costs per SQFT increased by 5.0% averaging at Kshs 5,210 in 2022, from Kshs 4,960 in 2021, necessitating the need for more funding, and,
iv. The gross Non-Performing Loans (NPLs) in the Real Estate sector realized a y/y increase of 12.2% to Kshs 88.1 bn in Q1’2023, from Kshs 78.5 bn in Q1’2022 whereas in q/q basis, the performance represented a 9.7% increase from Kshs 80.3 bn realized in Q4’2022. This was majorly attributed to delayed repayments as a result of a challenging operating and business environment occasioned by; i) elevated local and global inflationary pressures, and, ii) continuous weakening of the Kenyan Shilling, currently with a Year-To-Date (YTD) depreciation of 13.8% against the United States Dollar (USD) currency, adding to the 9.0% depreciation recorded in 2022. The graph below shows the total Real Estate Non-Performing Loans against the total loans advanced

to the sector from Q1'2019 to Q1'2023;

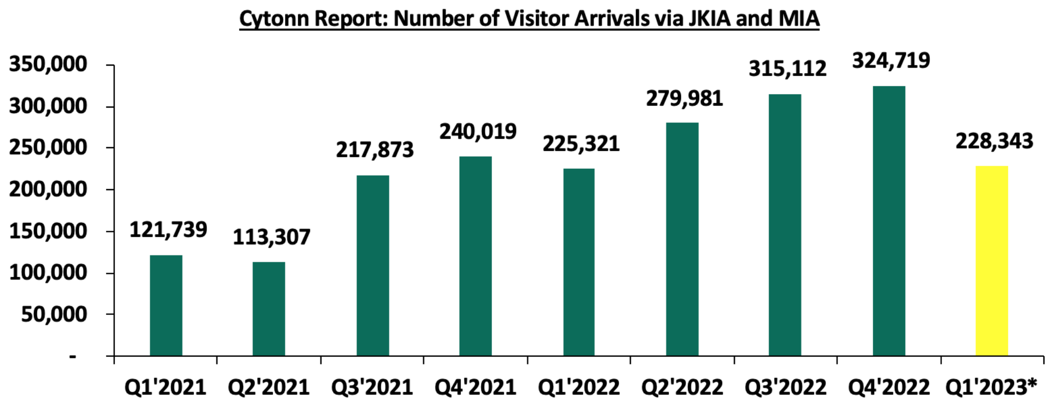


Source: Central Bank of Kenya (CBK)

b. **Leading Economic Indicators (LEI) Report March 2023**

The Kenya National Bureau of Statistics (KNBS) released the Leading Economic Indicators (LEI) March 2023 Report which highlighted the performance of major economic indicators. The key highlights related to the Real Estate sector include;

i. Overall international arrivals through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) increased by 0.2% to 114,295 in February 2023, from the 114,048 recorded in January 2023. On a y/y basis, the performance represented a 58.7% increase to 228,343 persons recorded for the months of January and February 2023 compared to the 114,882 persons recorded in January and February 2022. The improved performance is attributable to; i) increased international marketing of Kenya's tourism market by the Ministry of Tourism in collaboration with the Kenya Tourism Board, through platforms such as the Magical Kenya platform, ii) the tourism board alignment of its marketing initiatives towards targeting emerging and established source markets, and, iii) an increase in corporate and business Meetings, Events, and Conferences (MICE) from both the public and private sectors. The chart below shows the number of international arrivals in Kenya between 2021 and February 2023;

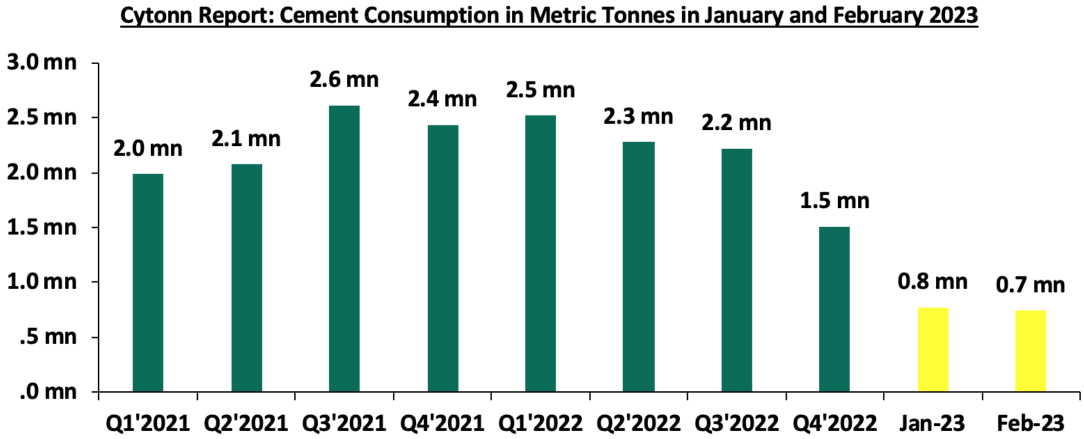


Source: Kenya National Bureau of Statistics (KNBS)

Q1'2023 - January & February 2023

ii. The consumption of cement decreased by 3.8% to 0.7 mn metric tonnes in February 2023, from 0.8 mn metric tonnes realized in January 2023. This was attributable to increased costs of the commodity driven by prevailing inflationary pressures on the back of local and external shocks.

On a year-on-year (y/y) basis, the performance represented a 7.7% decrease to 1.5 mn metric tonnes recorded for January and February 2023, from 1.6 mn metric tonnes recorded in January and February 2022. This was attributable to the consistency in the rising costs of cement, coupled with an increase in pending approvals amid delays in processing construction permits owing to backlogs in registry systems, which led to an overall decrease in the consumption of construction materials. The chart below shows cement consumption in metric tonnes in Kenya between 2021 and February 2023;



Source: Kenya National Bureau of Statistics (KNBS)

Going forward, we expect Kenya's Real Estate sector to register positive growth and improved performance mainly driven by the increasing number of visitor arrivals into the country which will enhance the performance of serviced apartments and hotels by boosting room and bed occupancies. However, the decline in construction activities evidenced by a 3.8% reduction in the consumption of cement, is expected to continue hindering the optimal performance of the sector. The decline is driven by high construction costs on the back of inflationary pressures, as well as an increase in pending approvals amid delays in processing construction permits.

II. **Industrial sector**

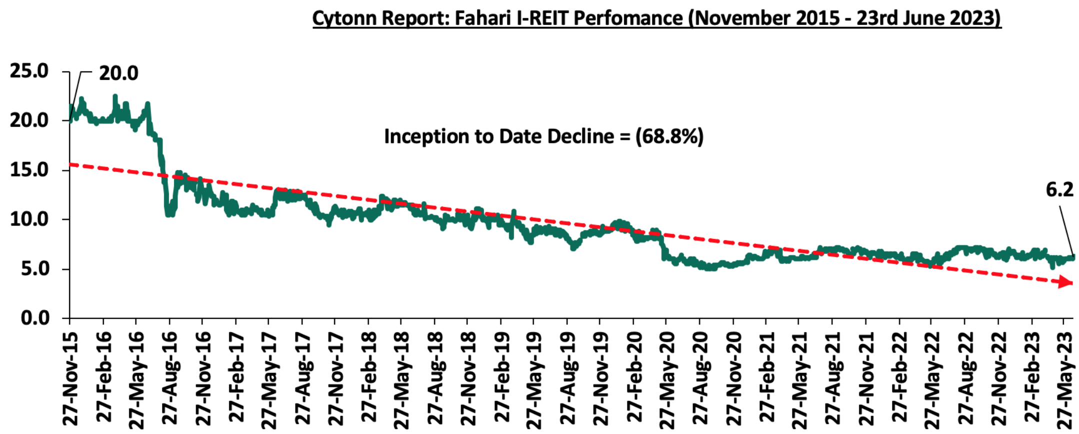
During the week, Unilever East Africa (EA) opened its Kshs 500.0 mn new modern warehousing facility located in Nairobi, Kenya. The move is part of the firm's growth bid and expansion in the East Africa region and reinforces its commitment to invest in Kenya, which is a significant market for the firm in the region. Spanning over an extensive surface area of 23,000 SQM, the newly opened warehouse is designed to efficiently handle Fast Moving Consumer Goods (FMCGs) coupled with a diverse range of health and beauty products across the East African region. The facility is equipped with advanced automated storage and retrieval systems and boasts an enhanced pallet capacity exceeding 10,000. The design is intended to facilitate seamless storage, processing, and shipment of Unilever's products. This strategic move underscores the significance of localizing raw and packaging materials in Unilever's production processes, with 70.0% of raw and packaging materials used being sourced from Africa. This localization approach will positively impact the accessibility and affordability of Unilever's products. As such, the facility is expected to; i) achieve multiple outcomes, including augmenting the firm's turnover growth, ii) expanding Unilever's warehousing capabilities across the region, iii) generating employment opportunities both within Kenya and the broader region, iv) bridging the gap between the high demand for quality warehousing facilities in Kenya and the limited supply available, and, v) reduce operation costs, and in turn cushion consumers from high product prices through innovative and cheaper strategies in the production of goods amid the soaring inflation.

We expect Kenya's industrial sector to continue recording positive performance as a result of increasing demand for superior industrial facilities, specifically targeting the expanding need for premium warehousing and logistics solutions in conveniently accessible locations beyond the conventional hub of Nairobi's Industrial Area and along Mombasa Road. This trend will unlock additional investment prospects within the industry, fostering further diversification of Kenya's Real Estate sector.

III. **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 6.24 per share. The performance represented a 1.0% increase from Kshs 6.18 per share recorded the previous week, taking it to an 8.0% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3 January 2023. In addition, the performance represented a 68.8% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 10.5%. The graph below shows Fahari I-REIT’s performance from November 2015 to 23 June 2023;

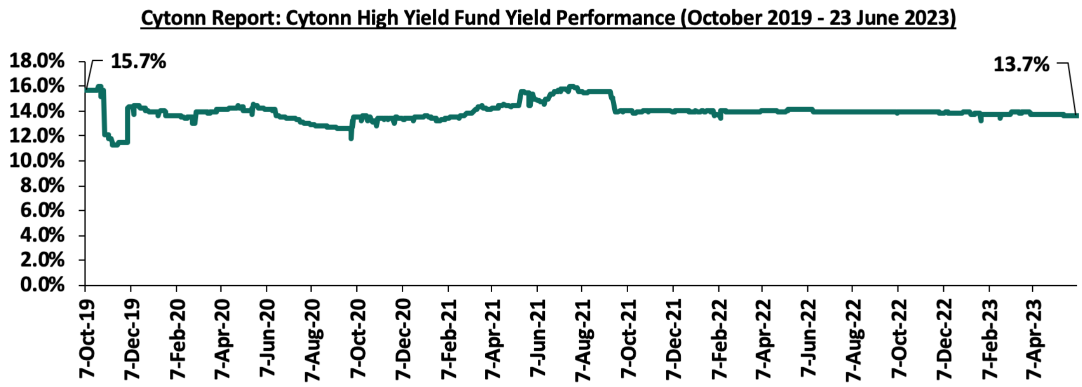


In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 23.9 and Kshs 21.6 per unit, respectively, as at 23 June 2023. The performance represented a 19.4% and 8.0% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 12.3 mn and 30.1 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 620.7 mn, respectively, since inception in February 2021.

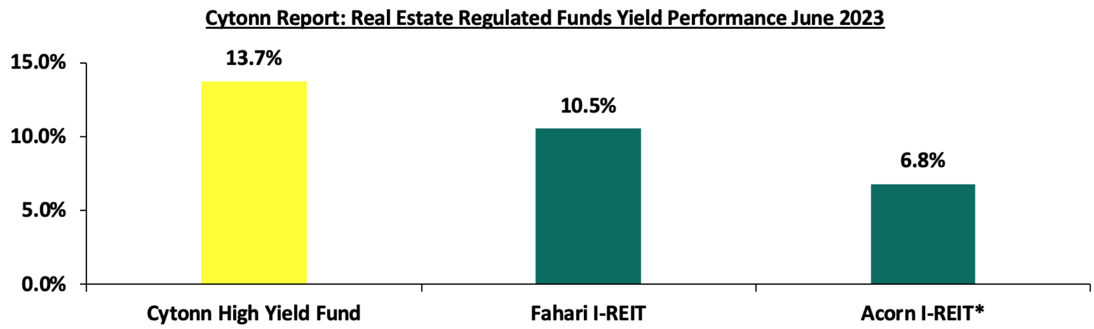
REITs provide numerous advantages, including; access to more capital pools, consistent and prolonged profits, tax exemptions, diversified portfolios, transparency, liquidity, and flexibility as an asset class. Despite these benefits, the performance of the Kenyan REITs market remains limited by several 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 13.7%, remaining relatively unchanged from the previous week. The performance also represented a 0.2% points Year-to-Date (YTD) decline from 13.9% yield recorded on 1 January 2023, and 2.0% 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 23 June 2023;



Notably, the CHYF has outperformed other regulated Real Estate funds with an annualized yield of 13.7%, as compared to Fahari I-REIT and Acorn I-REIT with yields of 10.5%, 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) initiation and development of housing projects expected to boost the residential sector, ii) relatively positive demographics in the country increasing demand for housing, iii) the increasing number of visitor arrivals into the country expected to continue boosting performance of serviced apartments and hotels in the country, and, iv) positive performance in the industrial sector driven by increasing demand for superior industrial facilities. However, factors such as; i) the rising costs of construction which have led to the decline in construction activities on the back of rising inflation, ii) increase in pending approvals amid delays in processing construction permits owing to backlogs in registry systems, iii) limited investor knowledge in REITs, and, iv) an increase in gross non-performing loans advanced to the sector signifying elevated credit risk will continue to hinder optimal performance of the sector by limiting developments and investments.