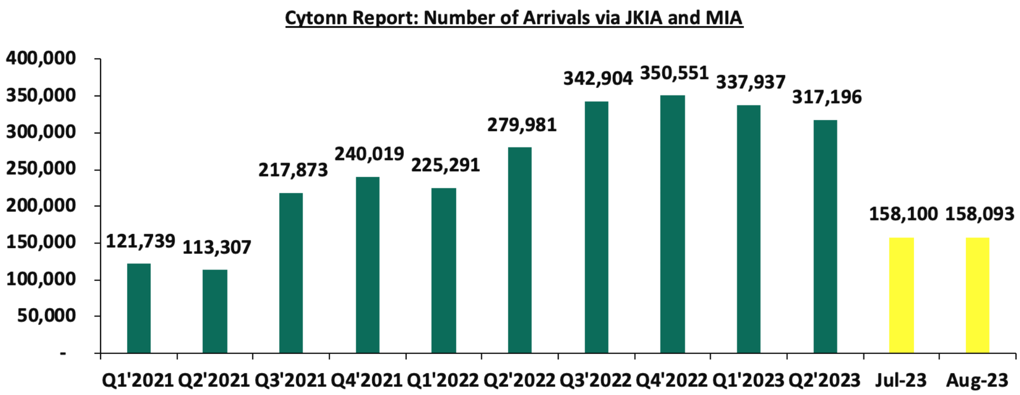
The Private Sector Credit Growth, & Cytonn Weekly #46/2023

Real Estate

I. **Industry Report**

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

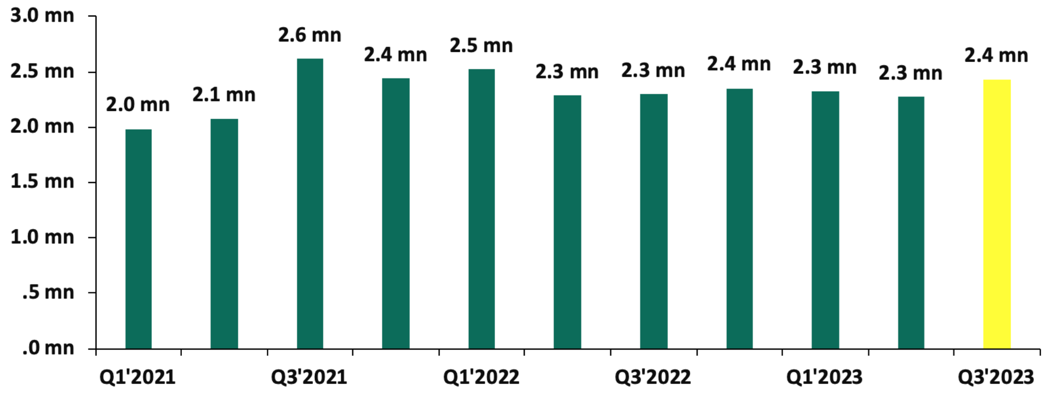
i. Overall international arrivals through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) declined marginally in August 2023 to 158,093 persons from 158,100 persons recorded in July 2023. On a year-on-year (y/y) basis, the performance represented a 34.0% increase to 316,193 persons recorded in the months of July and August 2023, compared to 235,982 persons recorded during a similar period in 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, iii) concerted efforts to promote local and regional tourism, iv) development of niche products such as cruise tourism, adventure tourism, culture and sports tourism and, iv) 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 August 2023;



Source: Kenya National Bureau of Statistics (KNBS)

ii. The consumption of cement increased by 7.0% to 2.4 mn metric tonnes in Q3’2023 from 2.3 mn metric tonnes in Q2’2023. The y/y consumption also increased by 7.0% to 2.4 mn metric tonnes in Q3’2023 from 2.3 mn in Q3’2022, attributable to the increased number of approved building plans in Nairobi Metropolitan Area (NMA), which led to overall increase in demand and consumption of construction materials;

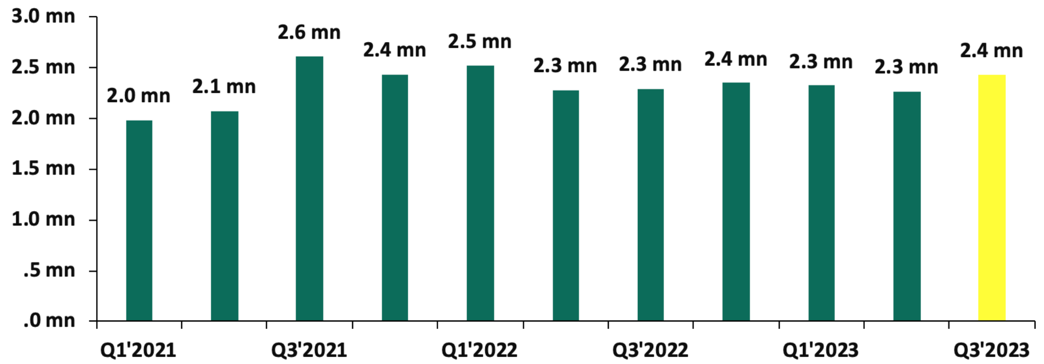
Cytonn Report: Cement Consumption in Metric Tonnes



Source: Kenya National Bureau of Statistics (KNBS)

iii. On a quarter-on-quarter (q/q) basis, the value of building plans approved in the Nairobi Metropolitan Area increased by 141.0% to Kshs 61.1 bn in Q3'2023 from Kshs 25.3 bn in Q2'2023. The y/y value of approved building plans increased by 45.8% to Kshs 61.1 bn in Q3'2023 from Kshs 41.9 bn in Q3'2022, attributable to the clearing of the large number of pending approvals by the Nairobi County Government.

Cytonn Report: Cement Consumption in Metric Tonnes



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 increasing number of visitor arrivals into the country which will enhance the performance of serviced apartments and hotels by boosting room and bed occupancies and sustained demand for Real Estate development. However, we expect increased construction costs on the back of rising inflation and stringent lending requirements to developers, with financial institutions such as banks demanding more collateral due to perceived credit risks in the Real Estate sector will hamper optimum performance of the sector. This is evidenced by a 20.9% spike in gross Non-Performing Loans (NPLs) to the Real Estate sector by banks to Kshs 96.0 bn in Q2'2023, from Kshs 79.4 bn in Q2'2022.

II. **Commercial Office Sector**

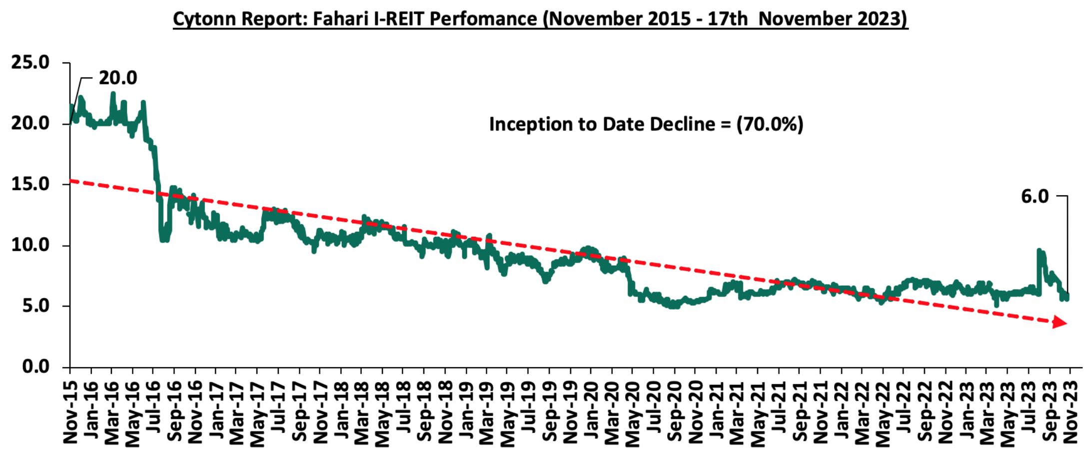
During the week, International Workplace Group (IWG) plc, a global provider of co-working, office and meeting spaces based in Switzerland announced it has, invested USD 850,000.0 (Kshs 127.5 mn) to set up a workplace facility at Global Trade Centre (GTC) Tower, located in Westlands, Nairobi. The facility which occupies 1,761 SQM will mainly target employees hired by different firms and independent contractors, and will comprise co-working spaces, private offices, and state-of-the art meeting facilities. The move by the multinational to expand its Kenyan operations places Nairobi third in terms of IWG's operations and presence in Africa, after South Africa and Morocco. IWG already has nine other flexible workspace operations in Nairobi under the Regus brand, which largely targets corporate teams with locations in; i) Westlands, ii) Kenyatta Avenue, iii) Vienna Court near State House, iv) Lenana Road, v) Britam Towers, and, vi) Village Market. The decision by IWG 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, and a growing traction in co-working spaces, both in Kenya and globally.

We expect this will in the long term assist in boosting occupancy rates in the Nairobi Metropolitan Area (NMA) by increasing the uptake rates of commercial space which have remained almost stagnant as a result of the existing oversupply estimated at 5.8 mn SQFT. However, going forward, we expect to continue witnessing more businesses scaling down their physical operations in favor of co-working spaces in efforts to reduce operational costs on the back of rising inflation.

III. Regulated Real Estate Funds

a. Real Estate Investments Trusts (REITs)

In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.00 per share. The performance represents a 0.3% decline from Kshs 6.02 per share recorded last week, taking it to a 11.5% Year-to-Date (YTD) loss from Kshs 6.8 per share recorded on 3 January 2023. Additionally, the performance represents a 70.0% 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 17th November 2023;

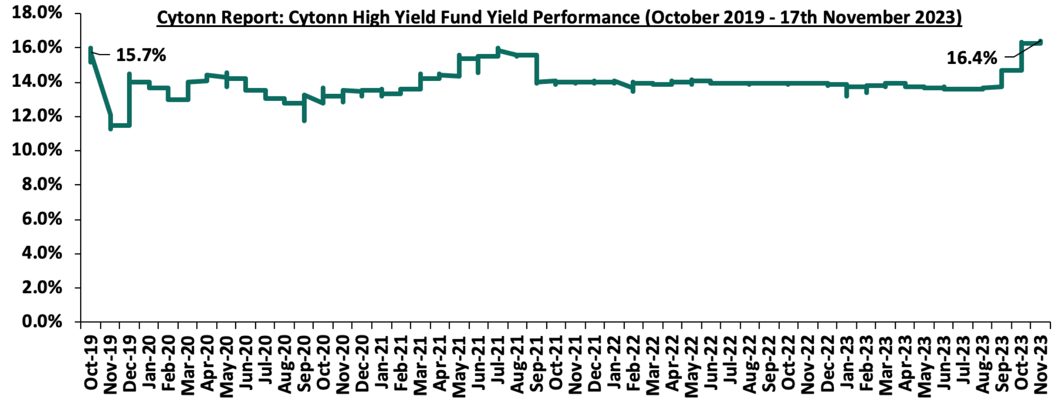


In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 25.3 and Kshs 21.7 per unit, respectively, as of 27th October 2023. The performance represented a 26.6% and 8.3% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 12.3 mn and 30.7 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 633.8 mn, respectively, since inception in February 2021.

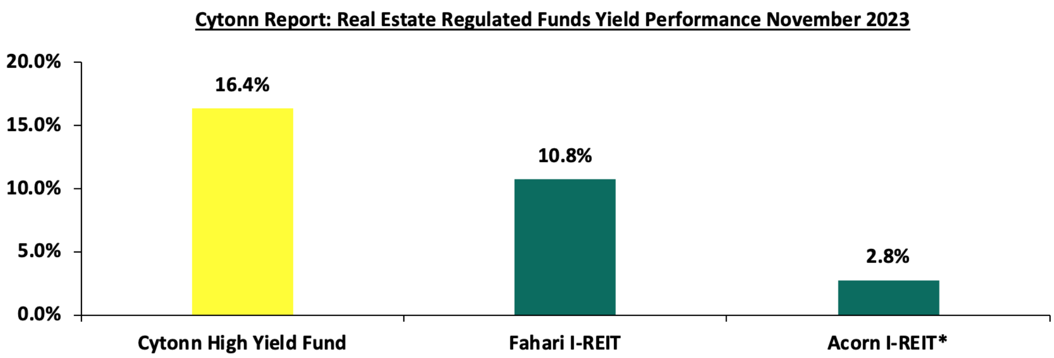
REITs provide various benefits like tax exemptions, diversified portfolios, and stable long-term profits. However, the continuous deterioration in performance of the Kenyan REITs and restructuring of their business portfolio is on top of other general challenges such as; i) inadequate comprehension of the investment instrument among investors, ii) prolonged approval processes for REITs creation, iii) high minimum capital requirements of Kshs 100.0 mn for trustees, and, iv) minimum investment amounts set at Kshs 5.0 mn, continue to limit the performance of the Kenyan REITs market.

b. Cytonn High Yield Fund (CHYF)

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 16.4%, remaining relatively unchanged the previous week. The performance represented a 2.5%-points Year-to-Date (YTD) increase from 13.9% yield recorded on 1st January 2023, and 0.7%-points Inception-to-Date (ITD) increase from the 15.7% yield. The graph below shows Cytonn High Yield Fund's performance from November 2019 to 10th November 2023;



Notably, the CHYF has outperformed other regulated Real Estate funds with an annualized yield of 16.4%, as compared to Fahari I-REIT and Acorn I-REIT with yields of 10.8%, and 2.8% respectively. As such, the higher yields offered by CHYF makes the fund one of the best alternative investment resources in the Real Estate sector. The graph below shows the yield performance of the Regulated Real Estate Funds;



**H1'2023*

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) increased foreign investments into the country positioning Kenya as a regional hub. However, factors such as; i) rising costs of construction, ii) limited investor knowledge in REITs, and, iii) 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.