Cytonn Monthly – January 2024

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 January 2024

#	Theme	Report	Key Take-outs
1	Hospitality and Construction Sectors	The Leading Economic Indicators (LEI) November 2023 Report by National Bureau of Statistics (KNBS)	• In the month of November, the value of building plans approved in the Nairobi Metropolitan Area decreased by 10.4% to Kshs 14.4 bn from Kshs 16.1 bn in October 2023. On a year-on-year (y/y) basis, the value of approved building plans in the NMA increased by 29.4% to Kshs 173.5 bn as at November, from Kshs 134.1 bn recorded during a similar period last year. This was attributable to the clearing of a large number of pending approvals by the Nairobi County Government, and sustained demand for Real Estate development facilitated by positive demographics which are above global averages. For more information, please see our Cytonn Weekly #03/2024

Cytonn Report: Notable Industry Reports During the Month of January 2024

#	Theme	Report	Key Take-outs
2	Real Estate, Hospitality and Building and Construction sectors	The Quarterly Economic Review Q3’2023 Report by the Central Bank of Kenya (CBK)	• In Q3’2023, year-on-year (y/y) gross loans to the Real Estate sector rose by 8.6% to Kshs 507.0 bn from Q3’2022. This growth, supported by heightened construction activities, especially in the residential sector, reflects increased demand from private firms, individual homebuyers, and the government's commitment to affordable housing. The quarter-on-quarter (q/q) increase of 2.0%, reaching Kshs 97.9 bn in gross Non-Performing Loans (NPLs) in Q3’2023, was attributed to delayed repayments amidst a challenging economic environment. Factors contributing to NPL growth included inflationary pressures, new taxes, elevated interest rates, and the continuous weakening of the Shilling against foreign currencies. • In Q3’2023, the hospitality sector saw a 7.0% year-on-year increase in gross loans, reaching Kshs 122.0 bn from Kshs 114.0 bn in Q3’2022. This growth is driven by heightened operational capital needs, including increased expenses due to rising inflation and supply chain disruptions. Acquisitions, mergers, and expansionary efforts also contributed, with industry players actively marketing both locally and internationally. Gross Non-Performing Loans (NPLs) in the sector decreased by 38.7% year-on-year to Kshs 11.7 bn in Q3’2023, indicating recovery and sector expansion, supported by a 13.3% year-on-year increase in international arrivals through key airports. • In Q3’2023, the building and construction sector witnessed a robust 11.9% year-on-year growth in gross loans, reaching Kshs 160.0 bn, up from Kshs 143.0 bn in Q3’2022. This increase also marked a 5.3% quarter-on-quarter rise from Kshs 150.2 bn in Q2’2023. The surge is attributed to sustained construction activities in both housing and infrastructure by both private and public sectors. Notably, construction costs per square foot rose by 27.0%, averaging Kshs 9,365 in Q1’2023, prompting the need for additional funding. However, the building and construction sector faced challenges reflected in a 29.5% year-on-year increase in gross Non-Performing Loans (NPLs), totaling Kshs 42.1 bn in Q3’2023. These challenges include project delays in real estate and hospitality sectors, compounded by economic pressures like inflation and a weakening shilling, affecting businesses' loan servicing capacity. This performance marked a 17.3% quarter-on-quarter increase from Kshs 35.9 bn recorded in Q1’2023, largely due to delays in project approvals by relevant authorities. For more information, please see our Cytonn 2024 Markets Outlook

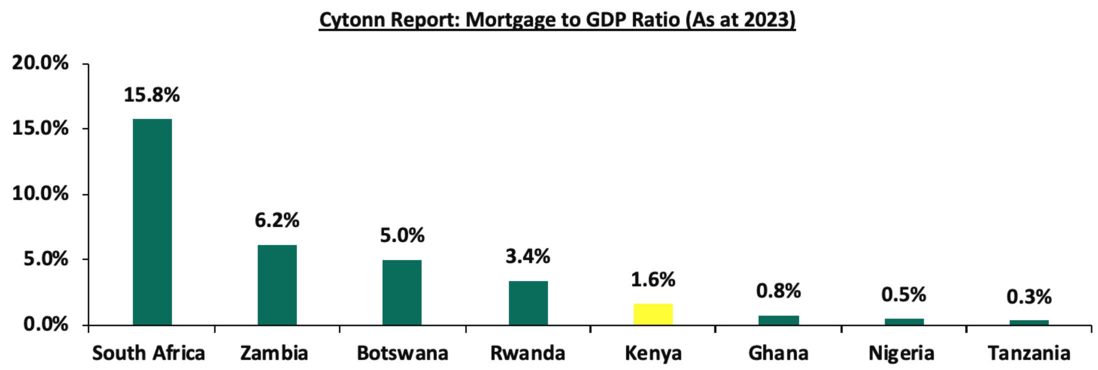
Going forward, we anticipate positive growth and enhanced performance in Kenya's Real Estate sector. This optimistic outlook is primarily fueled by an increasing influx of visitors to the country, contributing to improved metrics in the hospitality industry, including higher room and bed occupancies. Additionally, there is expected to be sustained demand for Real Estate development. Nevertheless, challenges are foreseen in the form of escalated construction costs, attributed to the rise in inflation and more stringent lending prerequisites imposed on developers due to elevated credit risk. Financial institutions, notably banks, are likely to insist on greater collateral due to perceived credit risks within the Real Estate sector. This could impede the sector's optimal performance. Indications of such challenges are evident in the 2.0% surge in gross Non-Performing Loans (NPLs) within the Real Estate sector reported by banks, rising from Kshs 96.0 bn in Q2’2022 to Kshs 97.9 bn in Q3’2023.

II. **Residential Sector**

a. **Superior Homes signed a partnership deal with Absa Kenya**

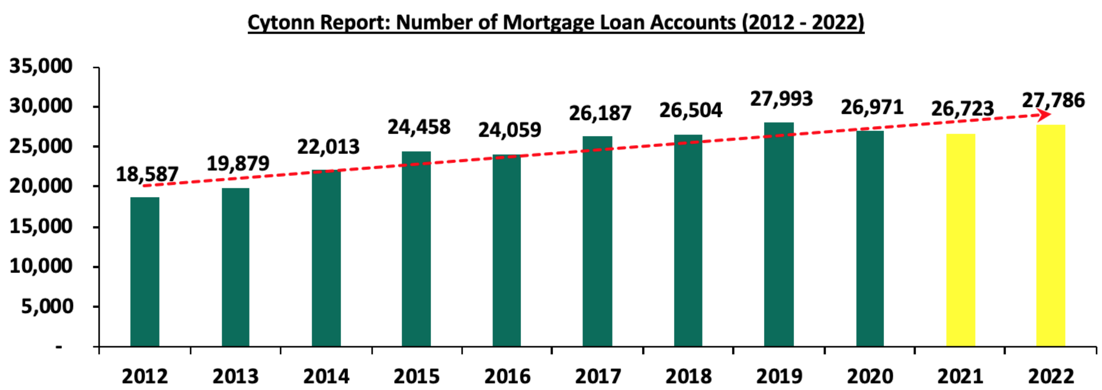
During the week, Superior Homes, a leading master-planned real estate developer in Kenya and East Africa, signed a partnership deal with Absa Bank Kenya. The partnership aims to provide 90.0% mortgage financing to buyers with a repayment period of up to 25 years for those seeking to purchase housing units at Pazuri, a holiday homes development located at Vipingo in Kilifi County. Additionally, the deal seeks to create an opportunity for mutual cross-marketing between the two entities. The agreement will be instrumental in helping the country address the current housing deficit. According to the Central Bank of Kenya's (CBK) Annual Bank Supervision 2022 Report, Kenya faces an annual deficit of 200,000 units, while both private developers and government deliver only 50,000 units annually, with low-income groups allocated a mere 2.0% of the constructed units.

With a long-term repayment period, the deal will play a pivotal role in addressing the homeownership challenge in the country. The deal also comes at a time when the Kenyan mortgage market is severely underperforming. To put this into context, according to CBK, the number of outstanding mortgage loan accounts stands at merely 27,786 loans against an estimated annual housing deficit of 200,000 units. Consequently, Kenya's mortgage to GDP ratio remains low, coming in at 1.6%, significantly lower than other African countries such as South Africa, Zambia, Botswana, and Rwanda at approximately 15.8%, 6.2%, 5.0%, and 3.4% respectively. The graph below shows the mortgage to GDP ratio in Kenya in comparison with other African countries;



Source: Centre of Affordable Housing Africa

The graph below shows the number of mortgage loan accounts from 2012 to 2022, and highlights the growth before and after the Kenya Mortgage Refinance Company (KMRC) came into effect in 2021;



Source: Central Bank of Kenya (CBK)

According to the Annual Bank Supervision 2022 Report, the challenges dampening the mortgage markets include a low level of income, limited access to affordable long-term finance, and a high cost of property purchase. This deal will supplement other government led initiatives aimed at providing long-term and affordable mortgage loans to Kenyans, such as the Kenya Mortgage Refinance

Company (KMRC) and the National Housing Corporation (NHC).

Going forward, we expect to witness more development activities from both private entities and government in the residential sector, driven by the surge in demand for housing. This demand is evidenced by relatively higher urbanization and population growth rates at at 3.7% p.a and 1.9% p.a, respectively.

b. **President Ruto laid the foundation of Kanduyi Affordable Housing Project in Bungoma County**

During the week, President Ruto laid the foundation of Kanduyi Affordable Housing Project in Bungoma County. The project aims to develop 320 housing units, integrating social, affordable, and market-rate housing units. The units will be distributed as follows: 60 social housing units, 160 affordable housing units, and 100 market-rate units. Additionally, the project will incorporate commercial space with 64 small shops. The project aims to directly employ 960 youths and indirectly contribute to the creation of 2,500 jobs, injecting Kshs 295.0 mn into the local economy. Local artisans from the Jua Kali industry will be engaged to deliver doors and windows with an estimated value of Kshs 35.2 mn. The tables below provide a summary of the unit types, sizes, and prices for social housing, affordable housing, and market-rate units, respectively;

Cytonn Report: Kanduyi Affordable Housing Project - Social Housing

Typology	Size (SQM)	Price (Kshs in mns)	Price per SQM	Monthly Payment
1-bedroom	20	0.8	42,000	3,200
2-bedroom	30	1.3	42,000	4,800
3-bedroom	40	1.7	42,000	6,400
Average	**30**	**1.3**	**42,000**	**4,800**

Source: Online Research

Cytonn Report: Kanduyi Affordable Housing Project - Affordable Housing

Typology	Size (SQM)	Price (Kshs in mns)	Price per SQM	Monthly Payment
Studio	20	0.8	48,000	3,200
2-bedroom	40	1.7	42,000	4,800
3-bedroom	60	1.9	32,000	6,400
Average	**40**	**1.5**	**40,667**	**4,800**

Source: Online Research

Cytonn Report: Kanduyi Affordable Housing Project - Market Rate Housing

Typology	Size (SQM)	Price (Kshs in mns)	Price per SQM	Monthly Payment
2-bedroom	60	4.3	72,000	4,800
3-bedroom	80	5.8	72,000	6,400
Average	**70**	**5.1**	**72000**	**5,600**

Source: Online Research

Going forward we expect the government to continue implementing its Affordable Housing Agenda in different counties guided by its Bottom-Up Economic Transformation Agenda (BETA) which aims at delivering 250,000 housing units annually. This project will help curb the housing shortage, create employment opportunities, stimulate economic activities and improve livelihoods. Notable highlights in the sector during the month include;

i. The World Bank launched Pand Pier and Jiw Dendi slum upgrading projects aimed at benefitting residents in the two informal settlements in Migori County. The projects form part of World Bank’s initiative dubbed ‘Kenya Informal Settlement Project (KISIP)’ which envisages improving living conditions in the informal settlements in the selected areas. Additionally, President William Ruto launched the construction of the Timau affordable housing project. This ambitious project, situated in Buuri, Meru County, aims to deliver 320 housing units, contributing not only to the region's housing needs but also making substantial economic impact. For more information, please see our Cytonn 2024 Markets Outlook,
ii. President Ruto laid the foundation stone for the Emgwen Affordable Housing Project in Chesumei Sub-County, Nandi County. The project will comprise 220 units incorporating studio, one, two, and three-bedroom typologies, a well-designed landscape, adequate parking, an underground tank, and pavement for pedestrian use. For more information, please see our Cytonn Weekly #03/2024, and,
iii. President Ruto launched the Pioneer Affordable Housing project located in Uasin Gishu County. The project will comprise 1,506 housing units incorporating one, two and three-bedroom typologies, a kindergarten, mixed-use commercial spaces, a social hall, and extensive supportive infrastructure including sewer and water infrastructure. Additionally, the President launched the Kapsuswa Affordable Housing Project, also located in Uasin Gishu County. The project will sit on a 3.2-acre piece of land and aims at developing 220 housing units consisting of 60 studio apartments, 40 one-bedroom units, 100 two-bedroom units, and 20 three-bedroom units. In Laikipia County, President Ruto laid the foundation for the construction of 200 housing situated on a 2.5-piece acre of land under the Nanyuki Affordable Housing project. Furthermore, Kilifi County government, in partnership with the National government identified 11 sites for the construction of affordable housing units. The government plans to build two mini-cities in the coastal region, and has identified Mtwapa and Mariakani as suitable locations on which it intends to build 10,000 housing units. For more information, please see our Cytonn Weekly #02/2024.

We expect increased completions and the initiation of more affordable housing projects, reflecting the government's commitment to address the substantial 80.0% annual housing deficit. We also expect an uptick in the involvement of institutional investors in the affordable housing sector, traditionally overshadowed by mid to high-end developments. Furthermore, a continued rise in the popularity of Mixed-Use Developments (MUDs) is foreseen, both within Kenya and globally. This trend is attributed to the diverse amenities and social offerings that MUDs provide, aligning with the evolving preferences of modern homebuyers who seek value beyond the residential unit. However, challenges persist in Kenya's housing sector, marked by the prohibitive cost of financing and the escalating expenses in construction. These challenges contribute to elevated development costs, posing obstacles for individuals aspiring to afford homes.

III. **Retail Sector**

During the week, local retailer and budget supermarket chain Jaza opened two outlets, bringing its total number of stores countrywide to 6. The newly opened outlets are located in Chokaa in Embakasi and Gachie in Kiambu respectively. Additionally, the retailer launched an e-commerce channel, allowing customers to order goods virtually from their homes, offices, and businesses. Jaza was launched in December 2023 with four stores in Mihango Utawala area, Kayole Soweto, Buruburu, and Githurai 44. The retailer capitalizes on friendly prices as one of its competitive advantages. This launch comes a week after the global retailer Panda Mart and Naivas Supermarket opened new outlets in Nairobi. Jaza focuses on aligning itself with the evolving market needs, allowing purchases to be made online via WhatsApp. The following table outlines the current store counts of major local and international supermarket chains operating in Kenya and international supermarket chains operating 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 as at FY'2023	Branches opened in FY'2024	Closed Branches	Current Branches
Naivas	Hybrid*	46	61	69	79	91	100	2	0	**102**
Quick Mart	Hybrid**	10	29	37	48	55	59	0	0	**59**
Chandarana	Local	14	19	20	23	26	26	0	0	**26**
Carrefour	International	6	7	9	16	19	22	0	0	**22**
Cleanshelf	Local	9	10	11	12	12	13	0	0	**13**
Jaza Stores	Local	0	0	0	0	0	4	2	0	**6**
Tuskys	Local	53	64	64	6	6	5	0	59	**5**
Uchumi	Local	37	37	37	2	2	2	0	35	**2**
Panda Mart	International	0	0	0	0	0	0	1	0	**1**
Game Stores	International	2	2	3	3	0	0	0	3	**0**
Choppies	International	13	15	15	0	0	0	0	15	**0**
Shoprite	International	2	4	4	0	0	0	0	4	**0**
Nakumatt	Local	65	65	65	0	0	0	0	65	**0**
Total		**257**	**313**	**334**	**189**	**211**	**22**	**5**	**181**	**236**

***51% owned by IBL Group (Mauritius), Proparco (France), and DEG (Germany), while 49% 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

Notable highlight during the month includes;

i. Naivas Supermarket opened its latest outlet located at Mwanzi Road in Westlands, Nairobi. This new addition brings the retailer's total number of outlets in the country to 102. The outlet is strategically positioned, with close proximity to Westgate Mall, and comes a month after the retailer opened its 101st outlet in Kakamega County. For more information, please see our Cytonn 2024 Markets Outlook, and,
ii. Global retailer Panda Mart opened its first outlet in Kenya at Garden City Mall in Nairobi. The retailer invested about USD 7.0 mn (Kshs 1.1 bn) to set up the outlet, acquiring 8,956 SQM within the mall. For more information, please see our Cytonn 2024 Markets Outlook.

Going forward, we expect to continue witnessing more retailers implementing aggressive expansion strategies. These strategies aim to capitalize on opportunities created by the vacancies left by prominent retailers like Uchumi, Shoprite, Game Stores, and Choppies supermarkets. Furthermore, we foresee the retail sector's positive performance being bolstered by a surge in foreign investments entering the Kenyan retail market.

IV. **Infrastructure Sector**

During the week, Kenya National Highways Authority (KeNHA) finalized an agreement with the Japan International Cooperation Agency (JICA) for the construction of the Mombasa Gate Bridge project. Subsequently, construction of the 1.4 Km bridge project linking Mombasa Island and South Coast, valued at Kshs 47.0 bn is set to begin. The cable-powered bridge will encompass four traffic lanes and will be 69 metres high at midpoint thus allowing the passage of ships underneath it. The Mombasa Gate bridge will replace the old ferries as the main means of crossing at the Likoni channel.

The project is planned to conclude in 36 months from the commencement of the project. Financing for the project was already approved last week during a delegation meeting between Kenya and Japan. Initially set to take off in June 2021 and to be completed this year, the project was delayed due to compensation challenges.

We note that the project will be pivotal in addressing the challenges associated with frequent ferry breakdowns and congestion which have remained a major hurdle at the crossing over the years. Additionally, the project is set boost tourism in the Coastal region by facilitating the seamless movement of motorists ferrying tourists across the two areas, thus positioning the region as major investment hub and boost the area’s economy through the creation of an estimated 80,000 jobs. Notably, the second phase of the Dongo Kundu Bypass project is also expected to be completed and opened to the public during the year. With the delivery of the two above projects, ferries operating at the Likoni channel will be rendered obsolete. The Dongo Kundu Bypass will act as a link between Mombasa and Kwale Counties connecting Port-Reitz areas with Kwale mainland areas via the Mteza bridge thus eliminating the need for tourists to cross the Likoni channel to access Kwale County.

We expect to continue witnessing the government completing major development and rehabilitation projects including roads, bridges, railways, and airports among others in its agenda to increase infrastructure connectivity in the country. In support of this, according to the Draft 2024 Budget Policy Statement, the government’s allocation to the Infrastructure, Energy, and ICT sectors for the FY'2024/2025 is forecasted to increase by 8.0% to Kshs 505.7 bn from Kshs 468.2 bn FY'2023/2024.

Notable highlights during the month include;

i. President William Ruto launched road construction projects spanning 43.2 kilometers in Meru County. This strategic endeavor, including the upgrading of key routes like Kwa Mumero-Kithithina Primary-Mia Moja, Timau-Rugirando-Ngusishi, and Makutano-X Lewa-Mbuju-Ngare Ndare to Bitumen standards, was unveiled during the President's three-day state tour of the region. For more information, please see our Cytonn 2024 Markets Outlook, and,
ii. President Ruto launched several road projects, including Lamuria-Solio-Kihara primary school road, in Laikipia County and Boiman-Kwa-Mumbi Road in Nyandarua County. President Ruto highlighted that the two projects will cover over 400-Kilometres and are poised to boost the agricultural sector in the region. For more information, please see our Cytonn Weekly #02/2024.

Moving forward, we anticipate increased completions of development, maintenance and rehabilitation projects as the government endeavours to enhance the nation's infrastructure. However, it is worth noting that there might be a potential deceleration in the initiation and completion of construction and maintenance projects within Kenya's infrastructure sector, especially in the roads category. This slowdown is attributed to an 8.0% decrease in budget allocations in the FY’2023/24 to Kshs 230.1 bn from Kshs 250.8 bn in FY’2022/23.

V. **Statutory Review**

During the week, a new directive mandating all operators of short-term accommodation rentals, including Airbnb hosts, to register with the Tourism Regulatory Authority (TRA) was issued. The purpose of this registration is to ensure that all accommodations adhere to the highest standards of security for guests. This measure has been implemented in response to resident safety concerns arising from the increased cases of homicides occurring in Airbnbs in the country.

In addition, the Private Security Regulatory Authority (PSRA) has enforced stringent safety protocols to enhance accountability and security within short-term rentals. Moving forward, security guards will now legally be required to record the identification details of all individuals entering these premises, documenting their entry and exit times. Furthermore, operators of short-term accommodation rentals must install CCTV surveillance systems and ensuree that all footage is regularly updated.

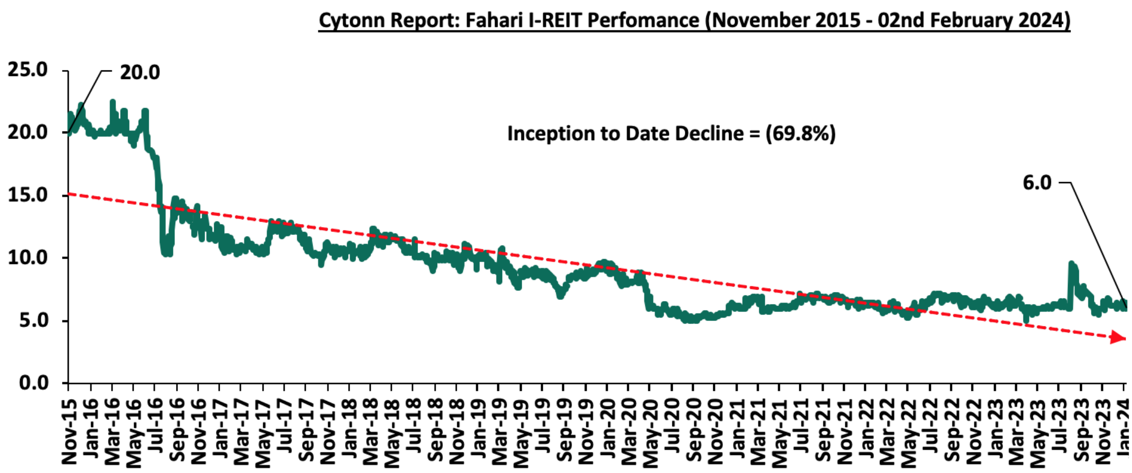
Commencing next week, the TRA and National Government Administrative Officers (NGAO) will jointly embark on strict inspections of all registered properties. Moreover, these entities will collaborate with booking platforms to restrict unregistered properties, imposing penalties such as fines and revocation in cases of non-compliance. Last year, the Ministry of Tourism noted that only 10.0% of all listed homes had registered with the tourism fund. The move to register all short-term rentals will support Tourism Fund by collection 2.0% under tourism levy stipulated by Tourism Act, 2011 Cap.383, Section 105.

The implementation of these regulations will be pivotal especially in improving security in the short-term rental businesses which is steadily growing attributable by the changing consumer behavior where guests are more inclined towards short-term rentals than traditional hotels. In addition, the regulations will help the government consolidate more funds under Tourism Funds when more businesses comply with the tourism levy.

VI. Regulated Real Estate Funds

a. Real Estate Investments Trusts (REITs)

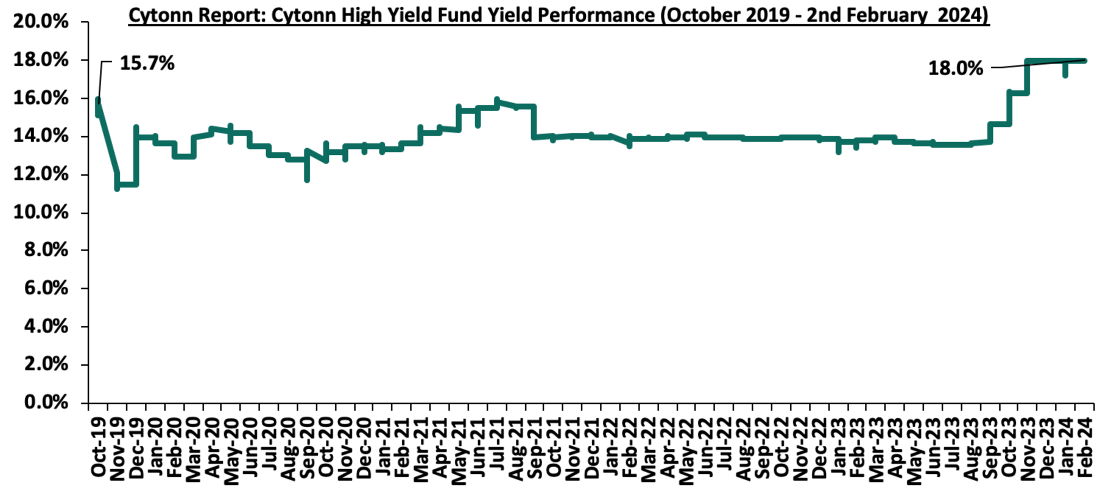
In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.0 per share. The performance represents a 4.1% decline from Kshs 6.3 per share recorded last week. The performance represents a 4.1% Year-to-Date (YTD) loss from Kshs 6.3 per share recorded on 2 January 2024, taking it to 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 2nd February 2024;



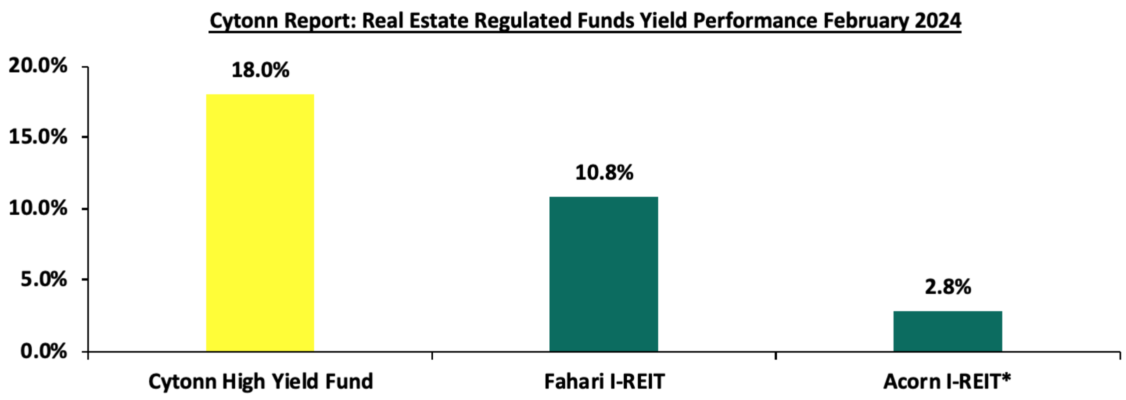
In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 24.4 and Kshs 21.7 per unit, respectively, as of 2nd February 2024. The performance represented a 22.0% and 8.3% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT 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.

b. Cytonn High Yield Fund (CHYF)

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 18.0%, representing a 0.8%points increase from the 17.2% recorded the previous week. The performance remained relatively unchanged from the price recorded on 1st January 2024, and represents a 2.3% Inception-to-Date (ITD) increase from the 15.7% yield. The graph below shows Cytonn High Yield Fund's performance from November 2019 to 2nd February 2024;



Notably, the CHYF has outperformed other regulated Real Estate funds with an annualized yield of 18.0%, 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 resource 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 resilient, supported by factors such as; i) increased launch and completions of affordable housing projects in line with the government's affordable housing agenda, ii) focus on mortgage financing through initiatives like the KMRC and mortgage partnerships between developers and banks, iii) relatively positive demographics in the country increasing demand for housing and Real Estate, iv) the increasing number of visitor arrivals into the country, , and, v) increased foreign investments into the country positioning Kenya as a regional hub. However, factors such as; i) rising costs of construction, ii) existing oversupply in select Real Estate sectors, and, iii) limited investor knowledge in REITs will continue to hinder optimal performance of the sector by limiting developments and investments.

Disclaimer: *The views expressed in this publication are those of the writers where particulars are not warranted. This publication is meant for general information only and is not a warranty, representation, advice or solicitation of any nature. Readers are advised in all circumstances to seek the advice of a registered investment advisor.*