Real Estate Investment Trusts (REITs) Progress Update in Kenya, & Cytonn Weekly #07/2024

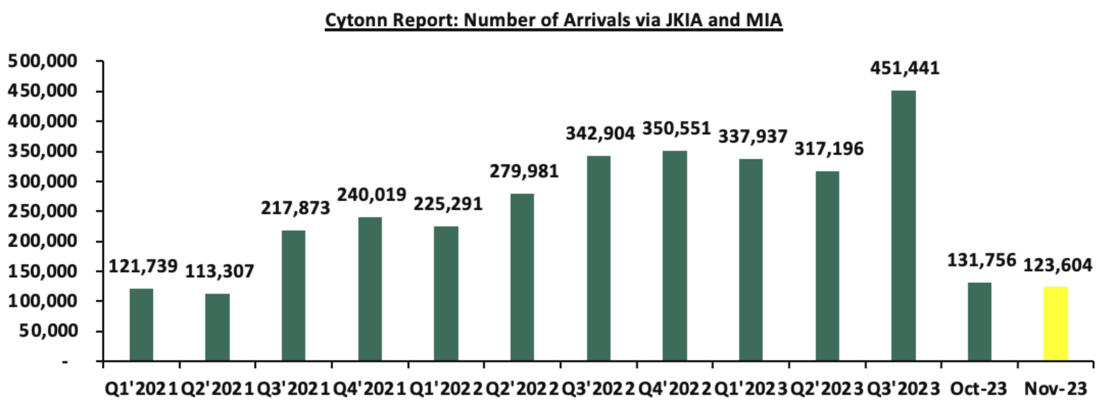
Real Estate

I. **Industry Report**

a. Leading Economic Indicators Report (LEI) December 2023 Report

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

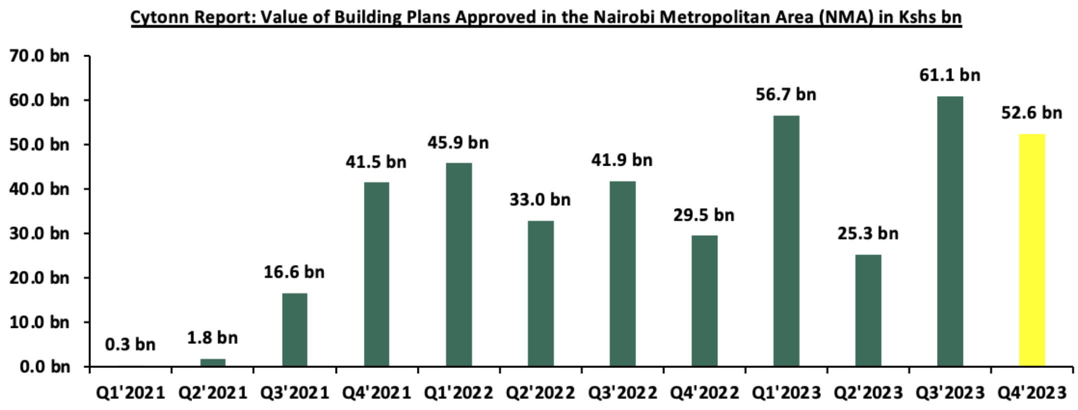
i. In the month of November 2023, the number of visitor arrivals recorded stood at 123,604 persons, compared to 107,854 persons recorded during a similar period in 2022. On a year-on-year (y/y) basis, the performance represented a 27.3% increase to 1,361,934 persons, compared to 1,070,011 persons recorded during a similar period in 2022. The improved performance is attributable to; i) increased efforts to promote local and regional tourism, ii) the tourism board alignment of its marketing initiatives towards targeting emerging and established source markets, iii) 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, iv) development of niche products such as cruise tourism, adventure tourism, culture and sports tourism, and, v) 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 Q1'2021 and November 2023;



Source: Kenya National Bureau of Statistics (KNBS)

In the month of December 2023, the value of building plans approved in the Nairobi Metropolitan Area increased by 54.1% to Kshs 22.1 bn from Kshs 14.3 bn recorded in November 2023. On a q/q basis, the value of approved building plans in Q4'2023 decreased by 13.9% to Kshs 52.6 bn from

Kshs 61.1 bn recorded in Q3’2023. On a y/y basis, the value of approved building plans in the NMA increased by 30.1% to Kshs 195.7 bn as at December, from Kshs 150.3 bn recorded during a similar period in 2022. 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. The chart below shows the trend in the value of approved building plans in Kenya between Q1’2021 and December 2023;



Source: Kenya National Bureau of Statistics (KNBS)

Going forward, we expect Kenya’s Real Estate sector to register positive growth and improved performance supported mainly by; i) increased demand for housing driven by relatively higher urbanization and population growth rates, ii) improved access to financing evidenced by a 6.2% y/y increase in gross loans advanced to the Real Estate sector to Kshs 495.0 bn in Q2’2023, from Kshs 466.0 bn recorded in Q2’2022, and, iii) the rise in visitor arrivals to the country which is poised to support the performance of the hospitality sector, bolstering both room and bed occupancies. However, we expect the sector’s growth to be dampened by; i) elevated credit risk linked to a 20.9% increase in gross Non-Performing Loans (NPLs) in the Real Estate sector to Kshs 96.0 bn in Q2’2023, from Kshs 79.4 bn in Q2’2022, ii) increased cost of construction costs as a result of the prevailing macro-economic conditions in the country, and, iii) oversupply in select Real Estate sectors,

b. **Kenya Market Update H2’2023 Report by Knight Frank**

During the week, Knight Frank, an international Real Estate consultancy and management firm, released the Kenya Market Update H2’2023 Report highlighting the performance of key Real Estate sectors in the country. The following were the key take outs from the report:

i. In the residential sector, the average selling prices for prime housing units increased by 0.3% points in H2’2023. On y/y basis, the sector registered a 2.5% increase, lower than an annual appreciation of 4.1% registered in 2022. The declined appreciation was largely attributable to depreciation of the Kenyan shilling, and a calm business environment as the country recovered from the uncertainty of the election period, and post-election jitters that occurred in H1’2023. The prime residential market in Kenya is driven by expatriates and high net worth individuals. In the prime residential rental market, prime properties continued on an upward trend and registered an annual appreciation of 5.9% in FY’2023. This was attributable to the sustained appreciation of the dollar against the Kenya Shilling which consequently led to a net increase in disposable income for expatriates hence increased demand,
ii. The average asking rents for prime commercial office spaces stagnated at USD 1.2 per SQFT in H2’2023 from H1’2023. Commercial office space occupancy increased by 5.0% to 76.5% in H2’2023 from 71.5% recorded in H1’2023. The performance was attributable to a limited supply of grade A offices, and, increased uptake of existing A-grade properties. Additionally, the growth of grade A office continued driven by growing demand from international investors, governments, diplomatic missions, and multinational corporations attracted by Kenya’s appeal as a top

investment destination in Africa,

iii. In the retail sector, prime rents ranged between Kshs 250 per SQF on the uppermost floors to Kshs 800 per SQF on the ground floor in Nairobi suburbs. Retailers responded to the evolving consumer needs which compelled them to establish their presence in residential areas. This shift, coupled with reduced disposable incomes and the surge in e-commerce, is prompting retailers to recalibrate their customer outreach strategies, and,
iv. The industrial sector in Africa has consistently posted the highest returns on investment compared to the other real estate sectors. Governments in Africa continue to encourage investments in the industrial sector via various initiatives such as establishments of special economic zones (SEZ), and export processing zones (EPZ). The limited adoption of high-end industrialization in Africa poses a challenge for potential investors, as they often need to import the majority of machinery parts in addition to the limited locally available ones.

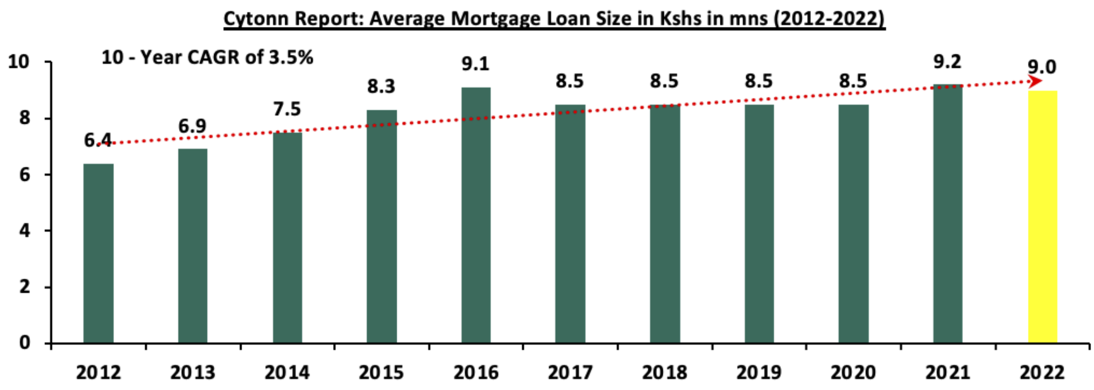
The findings of this report are in line with our Annual Markets Review 2023 Report which highlighted an occupancy increase in the commercial office segment and an increase in demand for industrial space in the region. We continue to uphold our perspective that the Real Estate sector's performance will primarily be sustained by; i) increased investment by foreigners in the retail segment, ii) demand for housing evidenced by positive demographics, iii) increased investment by the government to improve infrastructure capital, iv) increased activities by the government through the Affordable Housing Program (AHP), v) increased number of international arrivals supporting the hospitality sector, vi) aggressive expansion by both local and international retailers, and, vii) growing trend in demand for coworking office space arrangement. Nevertheless, the sector’s growth will be limited by; i) oversupply of space in select Real Estate classes, ii) increased cost of construction, iii) extended durations of building approvals, and, iv) increased stringent measures by lenders to developers amid rising credit risk.

II. **Residential Sector**

a. Kenya Mortgage Refinance increased the maximum loan size

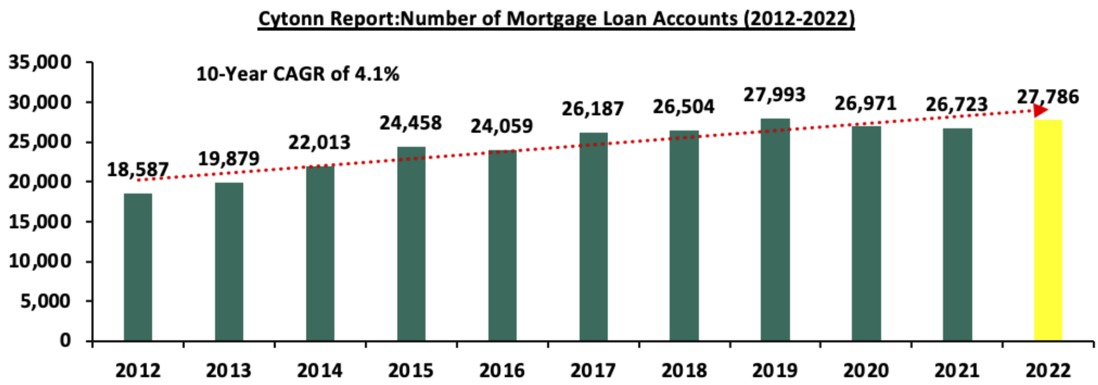
During the week, Kenya Mortgage Refinance Company (KMRC), a state-backed mortgage refinancing entity, increased the maximum loan size across the country to Kshs 10.5 mn from Kshs 8.0 mn and Kshs 6.0 mn for the Nairobi Metropolitan Area and the rest of the country, respectively. KMRC cited the heightened macroeconomic pressures as the rationale behind this decision, which have adversely affected construction costs, property prices, and consequently reduced the purchasing power of homebuyers as a result of decreased disposable income. Additionally, KMRC attributed this adjustment to the rise in household income to Kshs 200,000 from Kshs 150,000.

KMRC disburses loans to Primary Mortgage Lenders (PMLs), who subsequently lend to homebuyers at single-digit rates of 9.5%, notably lower than the average market lending rate of 12.3% as of 2022, according to the Bank Supervisory Annual Report 2022. Moreover, this increase will position KMRC's mortgage offerings above the average maximum home loan size of Kshs 9.0 mn as of 2022. The trend of average mortgage loan size has been upward in the recent past, realizing a 10-year Compounded Annual Growth Rate (CAGR) of 3.5% to Kshs 9.0 mn from Kshs 6.4 mn as shown in the graph below;



Source: Central Bank of Kenya

Notably, the increase in loan size has also been accompanied by a rise in the number of loan accounts, posting a Compound Annual Growth Rate (CAGR) of 4.1% over a 10-year period. This can be attributed to increased demand for housing, as both government and private entities have intensified their efforts to provide long-term and affordable loan options. The graph below shows the average mortgage loan accounts from 2012 to 2022;



Source: Central Bank of Kenya

We expect that the move by KMRC will enhance its competitiveness in the loan market and support government efforts to achieve the target of delivering 1,000,000 mortgages under the Bottom-Up Economic Transformation Agenda (BETA). The increase in loan size will provide significant support to aspiring homeowners who have been affected by the challenging macroeconomic conditions, which have eroded their purchasing power. Additionally, we anticipate that this move will contribute to an increase in homeownership across the country. However, the growth of the mortgage market continues to be constrained by several factors, including: i) low levels of income, ii) high costs of property purchases, and iii) limited access to affordable long-term financing.

b. **President Ruto laid foundation stone for Makenji Affordable Housing Project**

During the week, President Ruto laid the foundation for the Makenji Affordable Housing Project located in Kandara Constituency, Murang’a County. The project will consist of 220 units, including 60 studio apartments, 100 two-bedroom apartments, and 60 three-bedroom apartments. Additionally, the project will occupy a four-acre piece of land provided by the County Government under a Public-Private Partnership (PPP). It will also feature an expansive pool, green play spaces, and areas designated for small-scale traders. The ongoing project has provided job opportunities to over 600 youths, it has engaged 50 steel fabricators and carpenters from the Jua Kali industry. Furthermore, the project will involve the upgrading of Makenji Dispensary to a level 3 facility and the improvement of Makindi Primary School. Below is a table summarizing the unit types, sizes, and prices for the project

Cytonn Report: Makenji Affordable Housing Project-Affordable Housing

Typology	Size (SQM)	Price (Kshs in mns)	Price per SQM	Monthly Payment
Studio	20	0.9	48,000	5,200
2-bedroom	40	1.9	48,000	10,400
3-bedroom	60	2.9	48,000	15,600
Average	**40**	**1.9**	**48,000**	**10,400**

Source: Boma Yangu

We expect the project will; i) help addressing the prevailing problem of housing deficit in the country, ii) improve the livelihood of the local community by providing decent housing, iii) spur economic activities in the region, and, iv) create employment opportunities for the local residents. In line with the government's continued focus on providing affordable housing to its citizens, we expect to witness more project initiatives and completions under the Affordable Housing Program (AHP) going forward.

III. **Industrial Sector**

During the week, Airtel Africa announced plans to build a data centre in Nairobi, which will become its second facility in Africa after Nigeria in a move to diversify its revenue streams. The data centre in Nairobi will be mainly usable in the telecommunication sector as well as in other sectors. Additionally, the centre will have a capacity of 7.0 megawatts to trail the 36-megawatt centre that it plans to build in Lagos, Nigeria.

The construction is expected to take approximately 2 years, and completion is scheduled by mid-2026. In December last year, Airtel Africa launched Nxtra, its data hub business aimed at meeting the continent's growing need for trusted, and sustainable data center capacity and to serve the fast-growing African digital economy. Nxtra aims to build one of the largest networks of data centres in Africa with high-capacity data centres in major cities located strategically across Airtel Africa's footprint. The move will support Kenya's industrial sector which currently witnessing increasing demand driven by data centers, growth in e-commerce, and demand for cold rooms. Airtel African joins other players in the sector such as Africa Data Centre who aim at delivering quality high-grade industrial space in Kenya.

Going forward, we expect to witness growth in the sector supported by; i) Kenya's continued recognition as a regional hub hence attracting investments, ii) continued improvement in infrastructure through projects such as the Standard Gauge Railway (SGR), the Eastern and Northern Bypasses connecting Jomo Kenyatta International Airport (JKIA) and other regions in the Nairobi Metropolitan Area, among other key infrastructural improvements which we expect will increase the output of Special Economic Zones (SEZs) and Inland Container Depots (ICDs), iii) government's accelerated focus on exporting agricultural and horticultural products to the international market, with an aim to improve the quantity, quality, efficiency, and reliability of Kenya-farmed produce thereby increasing the country's competitiveness, and, vi) rising demand for e-commerce warehouses in the retail sector

IV. **Regulated Real Estate Funds**

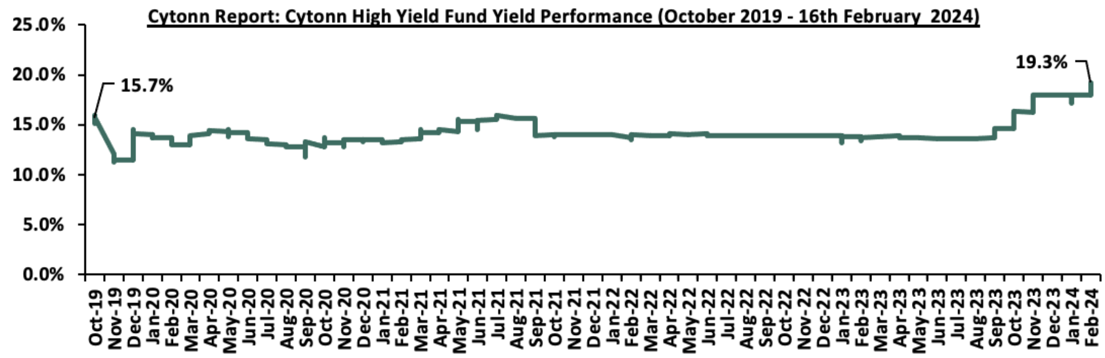
a. Real Estate Investments Trusts (REITs)

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 16th 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.

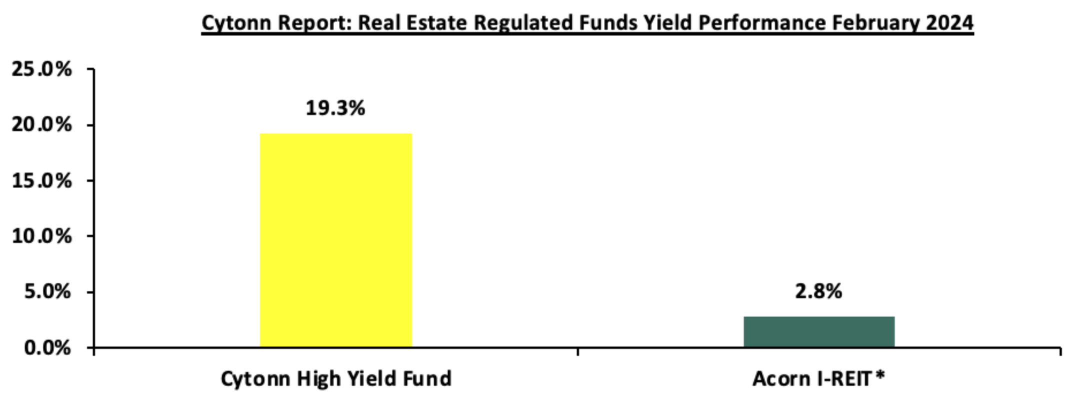
REITs provide various benefits like tax exemptions, diversified portfolios, and stable long-term profits. However, the continuous deterioration in performance of the Kenyan REITs and restructuring of their business portfolio is hampering major investments that had previously been made. The other general challenges include; i) inadequate comprehension of the investment instrument among investors, ii) prolonged approval processes for REITs creation, and, iii) high minimum capital requirements of Kshs 100.0 mn for trustees

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

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 19.3%, representing 0.1% points increase from the 19.2% recorded the previous week. On a Year-to-Date (YTD) basis, the performance represents a 1.3% increase from the 18.0% yield recorded on 1st January 2024 and a 3.6% Inception-to-Date (ITD) increase from the 15.7% yield. The graph below shows Cytonn High Yield Fund's performance from November 2019 to 16th February 2024;



Notably, the CHYF has outperformed Acorn I-REIT a regulated Real Estate fund with an annual yield of 2.8%. 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 two Regulated Real Estate Funds;



*H1'2023

Source: Cytonn Research

We expect the performance of Kenya's Real Estate sector will be supported by; i)increased activities and private institutions geared towards affordable housing, ii) increased demand for housing supported by positive demographics, iii) increased investments by local and international investors, especially in the retail segment, and, iv) continued improvement and expansion of infrastructural development by the government. On the other hand, we expect the sector's growth to be limited by; i)rising cost of construction, ii)oversupply of

select Real Estate segments, and, limited investor knowledge in REITs.

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