Safaricom’s 44% of NSE Market Cap. and Portfolio Construction, & Cytonn Weekly #50/2017

Real Estate

During the week, the Kenyan Government announced an ambitious plan to reduce the housing deficit in the country by 25%, from the estimated 2.0 mn units to 1.5 mn units, by facilitating the construction of 500,000 houses in the next 5-years. The government plans to achieve this through several initiatives, which include: (i) reduction of mortgage costs, though details regarding the percentages have not been disclosed (In December 2015, the government subsidized the mortgage rates for civil servants from market rates of about 14.5% to 5.0% p.a. on reducing balance), (ii) cutting down of construction costs through utilization of innovative construction methods and alternative building technologies, and (iii) reduction of licenses and fees at a County and National level such as the land search fees, which were waived completely, as well as NEMA and NCA submission fees. The government plans to collaborate with private developers, co-operatives, financial institutions and building materials manufacturers to deliver this. This is the latest move by the government following previous initiatives undertaken to mitigate the housing deficit, which include: (i) the digitization of the lands ministry, and (ii) the announcement of a 15% tax cut for developers constructing more than 100 units p.a. Still in their nascent stages of implementation, the effect of the aforementioned regulations in the market is yet to be felt, but in our view, the active involvement by the government to solve challenges in the real estate sector is a move in the right direction. If successfully implemented, the measures will ease transactions in the real estate sector, reduce development costs and consequently increase the affordability of real estate and housing in the country, which currently stands at 66 out of a requisite 100 according to our Mortgage Affordability Index Report 2017. Generally, an index value of 100 or more means the incomes earned by the residents are sufficient to cater for purchasing a house using a mortgage, and a value of less than 100 indicates that mortgages are unaffordable by the population, as is the case in Kenya. The main issue will be how each of the above initiatives shall be actualized as the steps towards it are yet to be released

The Nairobi County Assembly amended the zoning regulations by-laws to allow for densification in some of Nairobi’s high-end suburbs. The suburbs affected are those in Zone 4, consisting of areas such as Spring Valley, Kileleshwa and Riverside Drive, Zone 5 areas like Kyuna, Loresho, Lavington and Upper Spring Valley, and Dagoretti in Zone 15. The zones selected have experienced increased investment in infrastructure including roads and sewerage and are thus capable of accommodating larger populations. In our opinion, this is a move in the right direction as the relaxed zoning will:

1. Open up the areas for further real estate development – this is as developers will be able to develop a variety of concepts on the land such as high-rise apartments and commercial buildings; previously development in these suburbs was restricted to stand alone houses and low-rise apartments;
2. Increase the affordability of housing in the zones – This is as the number of houses per unit of land

will be higher and thus units can be lower in prices; The impact of the increase in land prices will be reduced due to higher number of units as a result of densification;

3. Increase the property values in these estates as more value will be able to be derived per unit of land. This was seen in other suburbs such as Kilimani where following relaxation of zoning regulations, land prices have increased by a 5-year CAGR of 17.7%, between 2011 and 2016 as per Cytonn Land Report 2017;
4. Reduce the housing shortage in the country by facilitating the development of more houses, and;
5. Reduce congestion in the CBD and other estates surrounding the rezoned estates as well as the rise of new business districts. This is due to a shift in population to the newly zones estates. For instance, rezoning of Upperhill and Kilimani enabled companies to migrate to these areas, which have now emerged as new business districts following congestion in the CBD.

However, further infrastructural development should be undertaken in these areas to prevent human and traffic congestion in the newly rezoned suburbs and thus a reduction in the allure of the upper middle income status they currently have.

In the hospitality sector, Kenya was named the world’s top Safari destination during the World Travel Awards held in Phu Quoc Emerald Bay Hotel, Vietnam, ahead of regional competitors such as Botswana, South Africa, Tanzania, Namibia, Zimbabwe, and Uganda. This marks the fourth time Kenya has won the accolade after emerging top in 2016, 2015 and 2013. Other awards won during the event were: i) Africa’s leading National Park, which went to Maasai Mara National Reserve, and ii) Africa’s leading Tourist Board, won by the Kenya Tourism Board (KTB).

Despite a challenging operating environment in the second half of 2017, Kenya’s tourism sector has been on the world map in 2017, with other awards won in the year being:

i. Africa’s leading national park, which was won by Maasai Mara National Reserve at the World Travel Awards - Africa Gala 2017;
ii. Africa’s Leading Tourism Board won by the Kenya Tourism Board (KTB) for the 6th year running at the World Travel Awards - Africa Gala 2017;
iii. Africa’s luxury adventure destination and luxury tented safari camp won by Sarova Mara Game Camp Hotel in Maasai Mara at the World Luxury Hotels Awards 2017;
iv. Best luxury hotel in the continent and the luxury spa resort won by The Sarova Stanley and the Sarova Whitesands Beach Resorts, respectively, at the World Luxury Hotels Awards 2017.

In our view, the increased number of international awards accorded to the Kenyan hospitality industry will market it globally increasing the number of arrivals which despite a slowdown between 2011 and 2015 due to security concerns picked up in 2016, increasing by 13.4% y/y. In 2017 the performance was upbeat in the first half with arrivals increasing by 16.7% between January and July compared to a 14.0% increase over the same period in 2016, slowing down in the second half due to the extended electioneering period. We thus have a positive outlook for the hospitality sector for 2018, supported by an increase in international arrivals, increased domestic tourism as Kenyans accounted for 54.2% of total bed nights in 2016 compared to 53.7% in 2015 and continued marketing by the KTB of Kenya as not just a Safari destination but also a Business Tourism and MICE destination which resulted in the number of business travellers increasing by 13.9% from 0.8mn persons in 2015 to 1.0 mn in 2016.

Our outlook for real estate is positive supported by government support as they invest in infrastructure and ease transactions in the land offices, a stable and peaceful country, good demographics and increased international investments in the country. The opportunity in the sector will largely be in the residential sector having a huge backlog of 2.0mn units and in the hospitality sector recovering from the effects of insecurity between 2011 and 2015.