Nairobi Metropolitan Area (NMA) Industrial Report 2024 and Cytonn Weekly #46/2024

Real Estate

I. **Statutory Review**

During the week, the government proposed amendments to cap interest on land rates default. Under the proposed changes to the National Rating Bill of 2022, the interest charged on defaulted rates across the 47 counties will not exceed the prevailing Central Bank of Kenya (CBK) lending rate, currently set at 12.0%. This is a shift from the current framework, where counties independently determine the interest rates.

The proposed cap aims to provide a uniform legislative framework for setting and collecting property rates, replacing the Rating Acts adopted in 2014. Property owners, who often face difficulties settling rates due to high penalties, stand to benefit from this standardization. However, the new structure could also result in higher interest rates if the CBK raises the base lending rate.

The bill, tabled before the National Assembly on Wednesday 13th November 2024, also mandates counties to update their property valuation rolls every five years. This measure seeks to ensure that counties capitalize on property appreciation, a step aimed at boosting revenue collection.

This amendment is critical for counties seeking to address high default rates, which hinder revenue generation. While property rates remain a major income source, businesses struggling due to economic challenges, such as the Covid-19 pandemic, have faced significant hurdles in meeting payment obligations.

If passed, the National Rating Bill of 2022 will unify property rate frameworks, alleviating businesses from excessive penalties while offering counties a more structured path to improving revenue collection.

II. **Residential Sector**

a. **Centum Real Estate strategic partnership with Gulf African Bank**

During the week, Centum Real Estate announced a strategic partnership with Gulf African Bank to offer Shariah-compliant mortgage financing to its customers. This collaboration aims to expand home financing options and drive the uptake of Centum's property portfolio. Under the agreement, customers will access up to 90.0% mortgage financing with a repayment period of up to 20 years and an expedited 48-hour approval process.

This initiative is set to boost homeownership rates among individuals seeking Shariah-compliant financial products. By addressing a growing demand for ethical financing in the Real Estate market, Centum Real Estate positions itself as a customer-centric developer while enhancing its market competitiveness. The partnership also provides Gulf African Bank an opportunity to deepen its footprint in the housing finance sector.

Shariah-compliant mortgages adhere to Islamic principles, including the prohibition of charging interest. Instead, the model typically involves profit-sharing or leasing arrangements, making it attractive to Muslim homebuyers and others seeking alternative financing solutions. This offering aligns with Centum Real Estate's broader strategy to diversify financing options and cater to varied customer preferences.

We expect this partnership will positively influence housing demand particularly among niche markets seeking Shariah-compliant solutions. Additionally, similar collaborations between Real Estate developers and financial institutions could become a trend, further diversifying home financing options and promoting inclusivity in Kenya's residential sector.

b. **Underutilization of the Housing Levy**

Additionally, during the week, the Controller of Budget disclosed that only 30.8% of the Kshs 54.1 bn collected through the housing levy in its first year of enforcement was utilized for affordable housing projects. This amounts to Kshs 16.7 bn, leaving a significant portion of funds idle amidst delays in project implementation.

The low absorption rate, reported at 26.0%, underscores challenges in implementing the Affordable Housing programme, which had initially budgeted Kshs 64.8 bn. Of further concern beyond absorption is that even for the Kshs. 16.7 bn deployed so far, there is no transparency as to what the funds have been used for.

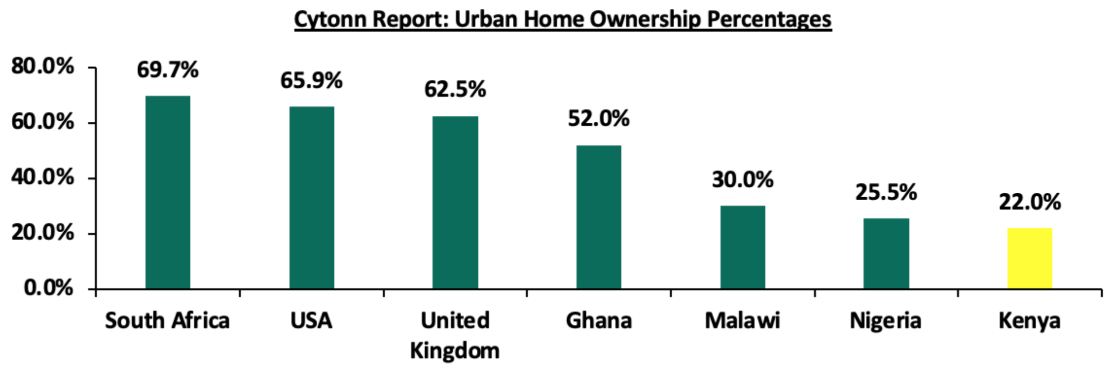
The slow rollout impacts the government's ambitious target of delivering 250,000 affordable housing units annually, thus delaying efforts to address the country's housing deficit, which currently stands at 80.0%. Furthermore, the majority of the collected funds have been redirected to Treasury bills and bonds, reflecting delays in aligning the Affordable Housing Board's expenditure framework.

The Affordable Housing Act of 2024, enacted in March, mandates contributions from workers in both formal and informal sectors, with employees contributing 1.5% of their gross salaries. However, implementation bottlenecks persist, including a lack of finalized investment plans from implementing agencies like the National Housing Corporation.

We anticipate continued scrutiny of the Affordable Housing Board's expenditure strategies as stakeholders demand accelerated implementation to meet annual housing targets. Streamlining fund allocation and project execution will be critical to fulfilling the government's promise of addressing Kenya's housing deficit and ensuring transparency in the use of housing levy funds.

The Affordable Housing Program (AHP) in Kenya is a key component of the government's Big Four Agenda, targeting the construction of 250,000 affordable homes annually. Despite these ambitious targets, the current housing supply falls significantly short, with only about 50,000 units being delivered annually against a demand of 250,000 units. This deficit underscores the critical need for initiatives like the Finsco-Greenwood partnership to boost affordable housing supply.

Homeownership in Kenya remains a challenge, with the majority of the population unable to afford homes due to high property prices and limited access to financing. The national homeownership rate stands at approximately 21.3% in urban areas sprawling the national average of 61.3% while 78.7% of urban dwellers rent. The government's push for affordable housing aims to improve this rate by making homes more accessible to lower and middle-income earners. The graph below highlights home ownership rates in different African countries;



Source: Centre for Affordable Housing Finance Africa (CAHF), US Census Bureau, UK Office for National Statistics

III. Commercial Office Sector

During the week, Stanbic Bank Kenya announced that it had extended a Kshs 3.3 bn (USD 25.6 mn) loan to Gateway CCI Limited, a subsidiary of Mauritius-based real estate firm Grit, for the ENEO CCI project located in Tatu City. This development is part of Grit's efforts to expand its real estate portfolio in Kenya, encompassing both commercial and residential properties. The ENEO CCI building, which serves as the headquarters for Call Centre International (CCI) Global, was commissioned on May 10, 2024.

The project was completed six months ahead of schedule and it is currently 90.0% occupied as of November 2024. It hosts not only the call center but also multinational corporations, including financial service firms, with expectations of full occupancy by December.

The injection of this significant loan reflects the confidence of financial institutions in Kenya's commercial real estate market, particularly in strategic hubs like Tatu City. The ENEO CCI development has already created substantial employment opportunities, with over 4,000 jobs through CCI Global. Its designation as a Special Economic Zone (SEZ) enhances its attractiveness for multinational tenants, offering tax incentives and operational efficiencies that align with Kenya's economic growth agenda.

Moreover, the project's success, including its completion under budget and ahead of schedule, positions it as a benchmark for efficiency and financial prudence in the region's real estate development sector.

Grit, through its subsidiaries Gateway CCI and Grit Services Limited, has increased its local borrowings, with the latter securing Kshs 3.9 bn (USD 30.58 mn) from NCBA Bank Kenya. This expansion underscores the growing importance of Kenya as a focal point for international real estate investments. Tatu City, as a master-planned urban development, continues to attract significant commercial investments, contributing to its emergence as a business hub.

The ENEO CCI project, designed to accommodate diverse tenants, aligns with the increasing demand for modern, well-equipped office spaces that can support global operations. Its SEZ status further strengthens its value proposition for companies looking for cost-efficient operations in East Africa.

As the ENEO CCI project approaches full occupancy by December 2024, we expect this to be a catalyst for further growth in the commercial office sector within the Nairobi Metropolitan Area (NMA). The increasing presence of multinational companies and the rise of co-working spaces will continue driving demand, particularly for modern, well-located, and efficient office spaces in strategic hubs like Tatu City.

However, with an existing oversupply of 5.8 mn SQFT of office space, market participants will need to focus on differentiation, such as sustainability, operational efficiency, and leveraging incentives like Special Economic Zone (SEZ) benefits. Projects like ENEO CCI demonstrate the potential for innovative developments to overcome these challenges, offering a path forward for Kenya’s commercial office sector to balance supply and demand while fostering economic growth.

IV. **Real Estate Investments Trusts (REITs)**

On the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 25.4 and Kshs 22.2 per unit, respectively, as per the last updated data on 31st October 2024. The performance represented a 27.0% and 11.0% 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 Kshs 12.3 mn and Kshs 31.6 mn shares, respectively, with a turnover of Kshs 311.5 mn and Kshs 702.7 mn, respectively, since inception in February 2021. Additionally, ILAM Fahari I-REIT traded at Kshs 11.0 per share as of 31st October 2024, representing a 45.0% loss from the Kshs 20.0 inception price. The volume traded to date came in at 138,600 for the I-REIT, with a turnover of Kshs 1.5 mn since inception in November 2015.

REITs offer various benefits, such as tax exemptions, diversified portfolios, and stable long-term profits. However, the ongoing decline in the performance of Kenyan REITs and the restructuring of their business portfolios are hindering significant previous investments. Additional general challenges include: i) insufficient understanding of the investment instrument among investors, ii) lengthy approval processes for REIT creation, iii) high minimum capital requirements of Kshs 100.0 mn for trustees, and iv) minimum investment amounts set at Kshs 5.0 mn for the Investment REITs, all of which continue to limit the performance of the Kenyan REITs market.

We expect the performance of Kenya’s Real Estate sector to be sustained by: i) increased investment from local and international investors, particularly in the residential sectors ii) favorable demographics in the country, leading to higher demand for housing and Real Estate, (iii) government infrastructure development projects e.g. roads, opening up satellite towns for investment, and iv) ongoing residential developments under the Affordable Housing Agenda, aiming to reduce the housing deficit in the country which is currently at 80.0%. However, challenges such as rising construction costs, strain on infrastructure development, and high capital demands in REIT sector will continue to impede the sector’s optimal performance by restricting developments and investments.
