Restructuring an Insolvent Business – Case Study of Nakumatt Holdings, & Cytonn Weekly #12/2018

Real Estate

During the week, the Kenya National Bureau of Statistics (KNBS) released the January 2018 Leading Economic Indicators report, highlighting trends in building, construction and tourism sectors. The key take-outs were as follows:

i. In building and construction, the consumption of cement rose by 8.0% to 486,964 MT in January 2018 from 450,960 Metric Tonnes (MT) in December 2017, compared to a 5.9% decline in a similar period last year. The production of cement increased by 1.7% from 502,809 MT in December 2017 to 511,328 MT in January 2018, compared to a 2.1% increase during the same period in 2016 and 2017. Furthermore, the value of buildings approved in Nairobi City Council increased by 14.7% to Kshs 18.8bn in December 2017 from Kshs 16.4bn in November 2017, compared to 6.3% decrease during the same period in 2016. We attribute this to the lodged approvals prior to the elections as investors adopted a wait-and-see approach then bounced back after the conclusion of the elections. Key to note is that there were no buildings approved between August and October 2017 as County Planning Committees were not constituted during the extended electioneering period. This resulted in an overall 41.2% decrease in the value of building approvals to Kshs. 184.7bn in 2017 from Kshs. 314.3bn in 2016, and
ii. In the tourism sector, the total number of visitors arriving through the Jomo Kenyatta (JKIA) and Moi International Airports (MIA) increased significantly by 45.9% to 105,862 in December 2017 from 72,573 in November 2017. The number of visitors in December 2017 was also 35.9% higher than the number recorded in December 2016 at 77,869. We attribute this growth mainly to improved security and political stability following the conclusion of the electioneering period, thus increasing tourists confidence.

The above are clear indicators of positive sentiments in the real estate and tourism sector. We therefore expect increased supply mainly in the residential sector as they contributed to 68.9% of the approvals in December 2017 and recorded a growth of 22.4% from November 2017, whereas the commercial sector is likely to witness slower development as it recorded only 0.6% growth amid speculations of oversupply. The growth in tourism is expected to further boost the hospitality sector, which had got set back during the electioneering period due to concerns of insecurity, especially in the international market.

In the residential sector this week, Nairobi Hospital announced its partnership with MMC Africa Law firm and Barclays Bank of Kenya in a move aimed at providing affordable mortgages to its staff. The mortgage scheme targets over 600 of the hospital's employees and will see them enjoy a subsidized interest rate of 6.0% for any mortgage worth Kshs 10.0 mn and below. This is a move in the right direction as it will boost not only the uptake of mortgages but also home-ownership in line with the Kenyan Government's Big Four agenda to increase home-ownership through the provision of affordable housing. It comes at a time when the number of active mortgage accounts in Kenya dwindled by 1.5% to 24,085 in 2017 compared to 24,458 in 2016, a negative effect of the interest cap that saw financiers tighten their underwriting standards, making access to mortgages more difficult. Other institutions that have begun initiatives to boost mortgage uptake include:

i. Standard Chartered Bank, which in February 2018, introduced a scheme to have prospective homeowners borrow up to Kshs 100.0 mn at 13.0% p.a. or at 6.0% p.a. for dollar-denominated mortgages, compared to the Kenya Shilling lending rate of 14.0% at the time, which was 4.0% above the Central Bank Rate of 10.0%,
ii. A group of SACCOs through "Africa Tenancy Purchase Initiative" launched in July 2017 offering interest-free mortgage financing through tenant-purchase method, which will see members pay an initial 10.0% deposit and the balance paid in installments for a period of 20-years. The initiative not only eliminates interests but also overcomes the obstacle of high deposits required by some mortgage financiers of as high as 30.0% of the house value and
iii. The World Bank has also proposed having a Kenya Mortgage Refinance Company that mirrors successful models such as those in Malaysia and Morocco and this is expected to see the number of mortgage accounts in Kenya rise to an average of 60,000 mortgages a year from 25,000 mortgages.

We are of the view that the above initiatives, though positive, will boost mortgage uptake albeit at a low rate given the relatively low income levels of several Kenyans, with approximately 74.4% of employees in the formal sector earning Kshs 50,000 per month and below according to KNBS. Assuming 40.0% of their income is spent on mortgage installments, for a 14.0% interest 20-year loan with a 10.0% deposit, these individuals would only afford a house of at most Kshs 1.8 mn. At 6.0% interest, they would afford a house of at most Kshs 3.0 mn. It is therefore evident that developers ought to direct efforts to the provision of more affordable housing to offset the housing deficit in Kenya that currently stands at approximately 2.0 mn units, with an annual shortfall of 200,000 units according to the World Bank.

Shelter Afrique, in the past week, announced the winners of its "5,000 for 5,000 Housing Competition", kicking off its low-cost housing plan, that will see the construction of 5,000 low-cost units across Africa in countries such as Nigeria, Zambia, Morocco, Côte d'Ivoire, Congo and Kenya. Based on sustainability, practicability, supply chain innovation, beauty and aesthetic, the Pan Africa Housing financier, picked three winners with the winner being Teteh & Associates of Ghana, second place being Morphosis Limited of Kenya, while the third place was awarded to Sharon Davis Design of New York, United States. The competition, which was part of the firm's plan to have large-scale low-cost housing projects, will see the development of low-cost houses at a cost not more than Kshs 0.5 mn per unit. Kenya is expected to be one of the beneficiaries of the initiative, a move that is in line with the government's plan to deliver 1.0 mn affordable housing units by 2022 e.g. the Mavoko 55-acre project, which broke ground in November 2017. This and other government incentives such as the 50.0% corporate tax relief to developers who put up at least 100 low-cost residential houses annually are likely to increase supply to the largely underserved low and lower-middle income market segments.

In the hospitality sector, Executive Residency by Best Western Nairobi received the Best Property 21 to 70 Units award at the Serviced Apartments Award 2018, held at Grange Hotel Tower Bridge in London. The serviced apartment development, which is situated along Riverside Drive, came into the market in November 2016 and offers 48, 1 and 2-bedroom fully furnished and serviced units. The development also has two meeting rooms, a restaurant, bar, swimming pool and gym. It is currently the only internationally branded serviced apartment development in Kenya, showing the opportunity in the provision of international-grade serviced apartment facilities that investors could explore. The performance of serviced apartments has been good recording 78.0% occupancy compared to hotels with 49.0% occupancy in 2017, according to Cytonn Hospitality Report 2017

We expect a continued increase in activities in the real estate sector given the conducive operating environment following political calmness and thus increased investor confidence in the economy.

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