Rate Cap Review Should Focus More on Stimulating Capital Markets, & Cytonn Weekly #19/2018

Real Estate

During the week, Erdemann Property Ltd, a Nairobi based property development company, announced their plans to construct eight 34-storey blocks, on 5.7 acres of land (2.3 hectares) in Ngara Estate, Nairobi. The mixed-use development dubbed "The Rier Estate", will feature a total of 1,632 apartments (537, 3-bedroom units, 1,088, 2-bedrooms, and 7, 1-bedroom units), with 875 parking slots and a shopping complex with 60 outlets. In our opinion, the project targets families, hence the higher number of the 2 and 3 bedroom units, compared to the of 1 bedroom units. The developer intends to adopt an affordable housing model; however, the unit prices and sizes remain unspecified. To fast-track commencement of the development, the firm went ahead to seek approvals from the Nairobi City County to allow for the upgrade of Jadongo Road to improve accessibility to the property. This will mark the firm's fourth residential project after Metro Fairview, which is a 12-storey development with 206 units in Pangani, Greatwall Gardens with approximately 2,070 apartments in Athi River and Great Wall Apartments Phase I, II and III comprising 1,422 units in Mlolongo. The project is an example of how local and international investors are making inroads in the real estate sector, riding on the back of positive fundamentals such as:

i. A high urbanization rate of 4.4% against the global average of 2.1%,
ii. An expanding middle class with increased purchasing power due to higher disposable income, whichincreased to Kshs 6.6 tn in 2016 from Kshs 5.7 tn in 2015 according to KNBS Economic Survey 2017,
iii. High population growth with a 5-year CAGR at 2.6% compared to the global average of 1.2%, and,
iv. Government incentives such as the 15.0% corporate tax relief to developers who put up at least 100 low-cost residential houses annually, digitization of the Lands Ministry, scrapping of NEMA and NCA levies, and inclusion of provision of affordable housing in its 4 key strategic pillars of focus for the period 2017-2022, "***Big Four***", alongside food security, manufacturing and universal healthcare.

The project, however, highlights one of the challenges that the sector continues to face, that is, inadequate infrastructure, where developers are forced to incur the costs of providing vital services such as roads and sewerage systems in order to deliver bankable developments. Such costs are passed on to end-buyers limiting the affordability of houses. The government has, however, through the ***Big Four*** strategy, proposed deductions on taxable income of 25.0% of the development cost, where infrastructure has been provided by a developer, which is an incentive that aims to encourage investment in affordable housing.

The mapping of about 7,000 acres of land for the construction of low-cost houses in Mombasa, Kisumu, Eldoret, Nairobi and Nakuru through Public Private Partnerships shows the commitment of the government in achieving its agenda on low-cost housing. Nevertheless, the residential sector has

its challenges, where during the week we saw, Nakuru County Governor, Lee Kinyanjui, issue a request to the Ministry of Lands to revoke deeds issued for a piece of land in Naivasha. The 22.4-acre piece of land planned for a Kshs 2.0 bn housing project supported by the World Bank, had allegedly been allocated to a private developer initially in an irregular manner. This is a setback to the 5-year strategy by the government to address the housing deficit, since the project would have added stock of 2,000 low-cost houses to the market, comprising 1 and 2-bedroom units. We recommend that developers ensure they obtain all the relevant valid approvals and conduct thorough due diligence on their development sites to minimize the disruption of project progress.

During the week, the Kenya Mortgage Refinancing Company (KMRC) received support of Kshs 15.1 bn from the World Bank. KMRC, which is currently being incorporated, was created to reduce the liquidity risk that commercial banks face in offering long-term credit, as well as enable potential home-buyers access financing with ease. According to Hon. Henry Rotich, Treasury's Cabinet Secretary, the government is discussing the likelihood of increasing the funding of the project with other development partners such as local commercial banks and the African Development Bank (AfDB). We are however of the view that in order for the KMRC to be effective, there is need for more effort towards the attainment of a stable and lower interest rate environment, and especially on government securities, which may crowd out KMRC from accessing the needed funding. Our topical on The Kenya Mortgage Refinancing Company, expounds more on how the facility works and the effect of the same on housing in Kenya.

In other highlights;

i. On safety, the Energy Regulatory Commission (ERC) has kicked off the vetting of buildings, both under construction and existing premises, for compliance with solar heating rules. According to the energy (solar water heating) regulations, premises with hot water requirements of more than 100 litres per day must be fitted with solar heating systems, with the aim of encouraging use of renewable sources of energy. The regulation applies to domestic houses with at least 3-bedrooms, colleges and boarding schools with 20 or more students, hostels and lodges with at least 4-beds, just to mention a few. Failure of compliance to these regulations will see property owners risk a Kshs 1.0 mn fine or one year in jail,
ii. In the retail sector, troubled retail chain Nakumatt Holdings closed its City Hall and Galleria Mall branches owing to its accumulated unpaid dues. The latest closure was occasioned by Tuskys pulling the plug on a rescue partnership it had been pursuing with Nakumatt. The retailer, which had 62 branches across East Africa, also recently closed its branches at City Hall Mombasa and the Village Market in Nairobi, bringing the number of branches still in operation to approximately 20. We attribute the closure to challenges regarding accumulated debt incurred during the retail store's rapid expansion and poor supply chain management. The closures have resulted in the expansion of other local and international retailers such as Naivas, Carrefour and Tuskys, who have occupied the vacated spaces, an indication of sustained optimism in the retail sector.

We expect the real estate sector to continue recording increased activity, with the continued supply of housing units to meet the existing deficit, mortgage liquidity facility enabling more home purchases, and thus, boosting investor confidence in the sector, in addition to the stable economic environment.