Cytonn Weekly #20/2018

Real Estate

Investors continue to cash in on the real estate sector in Kenya driven by (i) the huge housing deficit, (ii) high returns which came in at 24.3% as of December 2017, and (ii) various government incentives and continued infrastructural improvements. The following were the key highlights this week;

Consonance Kuramo Special Opportunities Fund I, a subsidiary of New York-based Kuramo Capital, bought an undisclosed equity stake in Century Developments Limited, a Nairobi based Pan-African real estate development and investments company, focusing on building affordable housing communities across Africa. The deal will see Kuramo invest Kshs 20.0 bn over the next five years towards the development of 10,000 Purpose-Built Student Housing units and 7,500 affordable houses targeted for young people and middle-income families in major towns and cities and along growth corridors across East African countries. This is a step in the right direction towards addressing the high demand for accommodation across Kenyan institutions of higher learning, as well as addressing the housing deficit by construction of affordable housing. According to a Jumia Research in 2016, there are approximately 280,000 bed spaces in institutions of higher learning against a student population of 769,000 in Kenya. Other firms that have shown interest in the sector, are Helios, a UK-based private equity firm, which signed a memorandum with Kenyan-based property development firm, Acorn, for construction of 3,800 student housing units across Nairobi at an estimated cost of Kshs 7.4 bn. According to Cytonn Research 2017, several private hostels have come up in areas neighboring universities due to the lack of adequate accommodation for the growing student population. For example, in areas such as Juja with Jomo Kenyatta University of Agriculture and Technology (JKUAT) and Rongai with Catholic University of East Africa, JKUAT Karen, Multimedia University, and Nazarene University, private investors have developed hostels where students pay rent ranging from Kshs 4,000 - Kshs 8,000 per month for a studio room of approximately 20-30 SQM. However, we have seen modern hostel facilities coming up along Lang'ata Rd, Jogoo road and Thika Road, who charge higher monthly rents of Kshs 15,000- 20,000 per student mainly due to the added facilities such as elevators, CCTV cameras, generators, gym and services such as 24-hr security, transport to and from school, garbage collection and entertainment. With rent ranging from Kshs 750 - 1,000 per SQM, occupancy of above 80% and an estimated development cost of Kshs 100,000 per SQM, modern student hostels have potentially high yields of between 7.2% - 9.6% compared to the conventional real estate sectors i.e., commercial office, retail, industrial and residential, whose average yields were 7.4% as at 2017, and thus in our view, this is a viable investment for both Consonance Kuramo and Century Developments.

Cool Breeze Development Limited, a Nairobi-based group of investors, unveiled plans to construct five 14-floor blocks in a gated community behind Nextgen Mall along Mombasa Road, on a 2.3-acre parcel of land acquired from Nextgen Suites. The development will consist of 120 studio apartments, 240 one-bedroom apartments, 148 two-bedroom units and 16 three-bedroom units. Prices have not been revealed but according to the developers, the project targets middle to high income earners. The residential sector has continued to offer high returns to investors with returns averaging at over 20.0% in the last five years, with demand growing in areas of low supply such as areas along

Mombasa Road, while the availability of land and continued infrastructural improvements along the area, continue to attract investors. Also in the residential sector arena, United Bank of Africa (UBA) Bank, a bank operating in 20 African Countries including Kenya, announced plans of an affordable housing scheme in Kakamega County, in which it will finance over 1,000 affordable housing units for Kshs 3.0 bn, the estimated development cost, and will be in partnership with National Housing Corporation. The continued investment in homes for low and mid income earners is in tandem with the government’s affordable housing initiative, which aims to deliver 1.0 mn homes in the next 5 years, out of which 80.0% will be affordable housing and 20.0% will be social housing. The residential sector continues to present a huge opportunity for investors, especially in the affordable housing sector for the low to mid income earners, with an estimated deficit of 2.0 mn units. Government incentives that continue to attract investors, both local and international include (i) 50.0% cut on corporate tax for developers of at least 100 low cost units from 30.0% to 15.0%, (ii) Continued provision of infrastructure, and (iii) The proposed land bank to be acquired from land already owned by government entities such as Kenya Prisons, International Livestock Research Institute, Ministry of Agriculture and Livestock, among others.

The Federation of Kenya Employers (FKE), a trade union which seeks to represent collective interests of employers in Kenya, unveiled plans to put up an 8-storey office building in Upperhill, along Argwings Kodhek Road, estimated to cost Kshs 620.0 mn, exclusive of land costs. The project, which will be funded from the scheme’s internal reserves is aimed at generating extra revenue for the union. The move affirms increased appetite for real estate investment as investors seek to diversify their sectoral exposure and benefit from the high yields. The office sector ‘s rental yields have averaged at 9.2% in the last two-years, a result of (i) increased foreign direct investment from international institutions, (ii) demand for office space from growing local SMEs, and (iii) Nairobi’s status as a key regional hub that has continued to attract foreign firms. It is imperative to note, however, that we expect Upperhill’s performance to decline in the short to mid-term, given the oversupply of office stock in the node which came in at 700,000 SQFT in 2017, representing 14.9% of the total office sector oversupply that came in at 4.7 mn SQFT, according to Cytonn Research. As at 2017, offices in Upperhill recorded a rental yield of 9.0%, which was the same as 2016, and 82.0% average occupancy rates, a 7.8% points decline in occupancy from 89.8% in 2016. In our view, addition of more stock will result to further decline of occupancy rates and returns. We therefore recommend the development of differentiated concepts such as green office buildings, which attract higher rents, serviced offices with yields of up to 13.4%, and mixed-use developments.

The hospitality sector recorded activity with 31 hotels across Nyeri, Meru, Laikipia, Isiolo, Samburu and Embu Counties getting classified into respective hotel star ranks as per the East African Community Classification Criteria. The criteria which is based on the facilities’ location, services, size of rooms, cuisine, amenities, style, décor and staff competency, follows directives by the Tourism Regulatory Authority for all tourism facilities to be classified within the next 6-months. The move is in line with the government’s efforts of marketing Kenya as the ultimate tourist destination. Some of the hotels that got a 5-star rating include Segera Retreat Lodge in Laikipia County, Lake Elementaita Serena Camp and Enashipai Resort and Spa in Nakuru County, Olare Mara Kempinski, and Mara Serena Safari Lodge in Narok County, while White Rhino Hotel, Aberdare Country Club in Nyeri County and Fairmont Mt Kenya Safari Club in Laikipia County, among others, were rated as 4-star hotels. In addition to promoting tourism through better visibility and credibility of local hotel brands, the rating is also bound to promote healthy competition among hoteliers in Kenya, especially in terms of quality of hospitality services offered in a bid to attract tourists, and attain better ratings.

The tourism and hospitality sector in Mombasa is set to get a boost after Ethiopian Airlines was this week granted a second frequency flight to Mombasa, meaning the airline will now fly twice a day to Mombasa. This is a move in the right direction as it will increase tourist arrivals in the general coastal region. However, more needs to be done to increase international direct flights to the Coast region as currently, Ethiopian Airlines and RwandAir are the only regional airlines with direct access, while other airlines need to land tourists in Nairobi who then have to connect to Mombasa or Malindi. The Coast region is a main tourist destination in Kenya accounting for majority of the total occupied bed nights at 42.6% in Kenya in 2017, according to the KNBS Economic Survey 2018, and out of these 48.1% were local while 51.9% were international visitors. The inclusion of more direct flights, coupled with infrastructural developments in the region such as the Mombasa West Integrated Urban Roads Network, which entails upgrading of the Moi International Airport, and construction of Port Reitz, and their respective access roads, is thus, expected to continue boosting the performance of the hospitality sector in the region.

Other highlights during the week include:

- Garden City, a 355,000-SQFT mixed use development located along Thika Road, announced plans to have a Huduma Centre within the mall set to open by June 2018. The Huduma Centre, whose role is decentralizing access to various government services, aims at serving the eastern and northern parts of Nairobi and will be the first of its kind within a fully privately-owned facility. In our view, this will help increase occupancy at the mall, which came in at 86.0% as at 2017 and in our view, will increase footfall due to the convenience created for shoppers and residents who can access government services as well as other retail services all under one roof,
- Also, Homa Bay County Government announced plans to construct a modern industrial park that will cost approximately Kshs 1.0 bn, in line with the government plan to have at least one Export Processing Zone (EPZ) in every county and increase the contribution of the manufacturing sector to the nation’s GDP to at least 15.0% (the sector recorded a GDP contribution of 8.4% in 2017). Currently, industrial parks in Nairobi metropolis offer relatively low rental yields of 5.8% compared to other sector in the commercial sector such as retail and office, which registered yields of 8.5% and 9.2%, respectively, in 2017.

We expect to the real estate sector to maintain the expansionary trend given (i) the high returns averaging at over 24.3% as at December 2017, (ii) Investment in infrastructure, and (iii) continued growth of the hospitality and tourism sectors.