

Cytonn Monthly – May 2018

Real Estate

During the month of May, the real estate sector recorded an increase in activities from both investors and developers driven by (i) the huge housing deficit of 2 mn units according to the National Housing Corporation, (ii) high returns, with the sector recording total returns of on average 24.3% p.a. over the last 5 years, (iii) stable macro-economic environment, (iv) government incentives such as a 15% corporate tax relief to developers who construct more than 100 low cost units per annum, (v) continued infrastructural improvements, and (vi) continued government focus on affordable housing. The following were the key highlights this month in each theme;

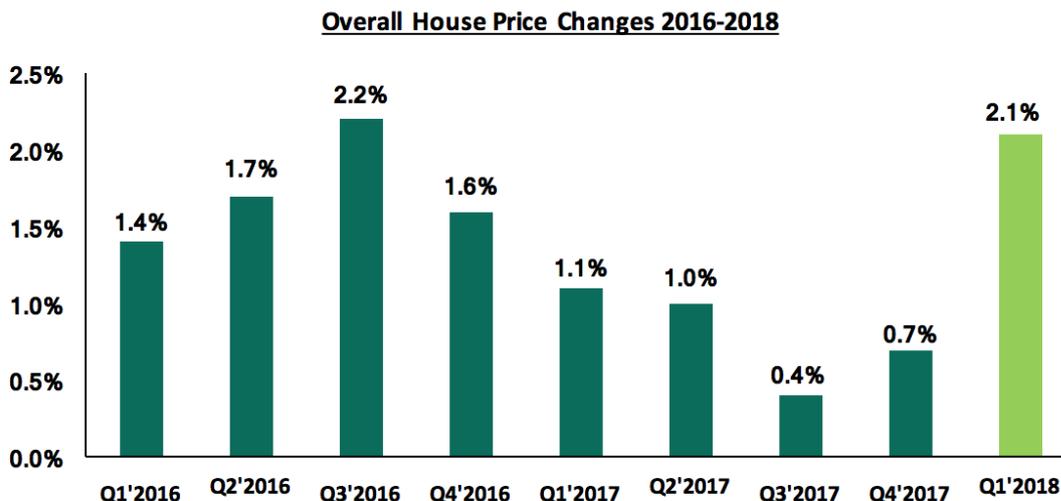
highlights this month in each theme;

Industry Reports:

Kenya Bankers Association released its Q1'2018 Housing Price Index (KBA-HPI), which tracks both qualitative and quantitative factors that determine pricing in the housing sector. The report showed house price changes and units uptake in Q1'2018. The key takeout from the report include;

?. House prices increased by 2.1% in Q1'2018 compared to 0.7% increase in Q4'2017. The increase in price appreciation is attributed to: (i) conclusion of market transactions put on hold during the prolonged electioneering period as investors adopted a wait and see approach, and (ii) improved macro-economic environment,

The graph below shows the performance of the house prices between 2016 and 2018 exhibiting the market recovery in 2018.



Source: KBA Housing Price Index (HPI) Q1'2018

?. Maisonettes accounted for 56.2% of the total number of units sold in Q1' 2018, with bungalows and apartments accounting for 39.1% and 4.7%, respectively different from the norm, where typically apartments have been accounting for bigger market share. This is attributable to the

increased demand for detached units by the increasing upper middle-income segment looking for privacy and exclusivity,

- i. The factors that significantly impacted house prices in Q1'2018 include: (i) house plinth area, (ii) number of bedrooms, (iii) number of bathrooms, (iv) presence of backyard, (v) master ensuite, (vi) availability of a gym, and (vii) other attributes such as the type of the house, age, location, number of floors especially for apartments, and presence of parking slots.

These findings are in tandem with our Q1'2018 markets review, in which we noted that the market recorded a 1.3% point increase in price per SQM q/q, indicating a recovery of the market from the adverse effect that the electioneering period had on the real estate sector's performance in 2017.

During the month, the activities in various real estate themes was as outlined below:

Residential:

The residential real estate sector continued to experience increased activities mainly driven by the large housing deficit of 2 mn units, growing by approximately 200,000 units per annum according to the National Housing Corporation (NHC). During the month, many developers announced their interest to venture into the low to mid - income housing segment. These included:

- ?. Erdemann Property Ltd, a Nairobi based property development company who announced plans to construct eight, 34-storey apartment blocks on a 5.7-acre piece of land, in Ngara Estate Nairobi, with a focus on an affordable housing model. The development named "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, **Cytonn Weekly #19/2018**
- i. Cool Breeze Development Limited, a Nairobi-based group of investors, announced plans to construct 5, 14-storey blocks of apartments on a 2.3-acre parcel of land acquired from Nextgen Suites behind Nextgen Mall, along Mombasa Road with a focus on middle to high income earners. The development will consist of 120 studio units, 240 1-bedroom units, 148 2-bedroom units, and 16 3-bedroom units, **Cytonn weekly #20/2018**
- ii. The United Bank of Africa (UBA) announced that it had set aside Kshs 3.0 bn to be used in construction of over 1,000 affordable housing units in Kakamega County. This will be done in partnership with the National Housing Corporation (NHC), **Cytonn Weekly #20/2018**
- iii. In a move to actualize the affordable housing initiative, the Housing Principal Secretary Hon. Charles Hinga announced that housing developers participating in the government's low-cost housing plan would be allocated land on which they will develop affordable housing on 70% and high-end units on 30%, thus allowing the developers to recoup their costs. This initiative will be rolled out for the first lot comprising of 36,840 housing units in Starehe, Muguga Green, Shauri Moyo, Makongeni all in Nairobi County, and Mavoko, in Machakos County. On the other hand, the High Court dismissed a case filed by civil servants blocking the Ministry of Lands and Housing from ejecting them from their houses in Starehe and Shauri Moyo estates to pave way for the construction of the new housing units. The government has been granted mandate to develop the estates as it has no legal obligation to furnish civil servants with alternative accommodation before demolishing the existing structures. The project was introduced by the government in 2016 with an aim of providing housing to the civil servants. These initiatives, and subsidies by the government in our view, are a step in the right direction towards the goal of achieving affordable housing through public private partnerships.

We expect to continue witnessing increased activities in the residential sector driven by (i) high urbanization rate which stands at 4.4% against the global average of 2.1%, (ii) a high population growth rate in the country of on average 2.6% p.a. compared to the global average which stands at 1.2% p.a., (iii) government incentives, such as the 15% corporate tax relief to developers who construct more than 100 affordable units annually, and (iv) the huge housing deficit of 2 mn units, growing by approximately 200,000 units per annum according to National Housing Corporation

(NHC) creating demand for residential units.

Commercial-Office:

During the month, the Federation of Kenya Employers (FKE) announced plans to build an 8-storey office building in Upper Hill, at a cost of Kshs. 620 mn exclusive of land costs. Upperhill has the highest office supply, with a market share of 18.0%, and it is oversupplied by 700,000 SQFT, representing 14.9% of the total office space oversupply that came in at 4.7 mn SQFT in 2017, according to our **Nairobi Commercial Office Report 2018**. The oversupply constrained office space performance with the average occupancy rates and rents declining by 7.2% points and 3.0%, respectively, between 2016 and 2017. The continued development of office space in Upperhill will therefore lead to further decline of occupancy rates and returns. For investors seeking exposure in the commercial office space, we recommend;

- ?. development of differentiated concepts such as green office buildings, which attract higher rents due to their use of renewable energy, and therefore cost efficiency,
- i. serviced offices with yields of up to 13.4% against office market average at 9.2%, and
- ii. mixed-use developments with occupancy rate of 95.0% against market average at 88.9% due to the live-work-play-invest mix for both end users and investors.

The Hospitality Sector:

During the month, the hospitality sector recorded a number of activities likely to boost the tourism sector. The following were the key activities;

- ?. In line with the government's efforts of marketing Kenya as the ultimate tourist destination, 31 hotels across Nyeri, Meru, Laikipia, Isiolo, Samburu and Embu Counties were classified into respective hotel star ranks according to the East African Community Classification criteria. The ranking will improve the visibility and credibility of local hotel brands, and 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, **Cytonn Weekly #20/2018**
- i. During the month, Ethiopian Airlines was 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 which is the main tourist destination in Kenya, **Cytonn Weekly #20/2018**

We expect improved performance in the hospitality sector, boosted by the improved security in the country, conclusion of the electioneering period and continued marketing efforts by the Kenya Tourism Board.

Land:

Fusion Capital partnered with Optiven Limited to sell a 100 -acre land development called Amani Ridge in Ruiru, Kiambu County. Optiven has subdivided the land plots into various sizes ranging from 0.09 acres to 0.25-acre plots with the selling price ranging between Kshs. 3.0 mn to Kshs 10.7 mn per plot. The development is controlled, and buyers will have to adhere to pre-approved plans, which consist of 3 and 4-bedroom standalone houses, a shopping centre on 1.0 acre and Education centre on 4.5 acres. Ruiru market has over the past 6 years attracted many investors and developments such as Tatu City by Rendeavour Group Holdings, and RiverRun Estate by Cytonn Real Estate driven by (i) increased housing demand in satellite towns driven by increased urbanization rate at 4.4% against a global average of 2.1%, (ii) high capital appreciation with land prices in the area growing by a 6-year CAGR of 20.0% as at 2017 compared to a market average of 17.0%, according to **Cytonn Land Report**, and (iii) infrastructural development in the area such as connectivity via the Eastern by-pass and sewer connection in Ruiru Town.

Infrastructure:

Kenya National Highways Authority's (KeNHA), announced plans to open phase one of the Kshs. 11 bn Dongo Kundu By pass to the public in June, this is an 11 km stretch connecting Mombasa Port and Miritini. The opening is expected to ease traffic on the Nairobi-Mombasa Highway, and connect the North Coast with the South Coast. On completion, the By-pass will directly have an impact on the real estate sector by opening up the Coastal region for development and increasing its accessibility from Nairobi thereby boosting the hospitality industry.

The President of Kenya, H.E Uhuru Kenyatta, launched the reconstruction of 80 kilometres of roads in 11 constituencies in Nairobi's Eastlands suburbs. The roads to be reconstructed include; Komarock Road, Harambee Estate Sacco Roads, Eastern by-pass -Kayole Spin Road, Donholm Phase V and VIII Roads, Eldoret Road and Nyasa Road. The project is part of the Nairobi Regeneration programme, which focuses on housing, infrastructure and transport, energy and water resources, among others. The repair of the above roads will ease congestion in Nairobi Eastlands and enhance accessibility, boosting the real estate performance in the region, where currently Eastlands areas such as Donholm record 18.4% annual uptake, lower than residential market average at 24.0% attributable to traffic congestion in the area.

We expect to continue witnessing increased government expenditure on infrastructure to boost economic activities, including the real estate sector in the country.

Real Estate Financing:

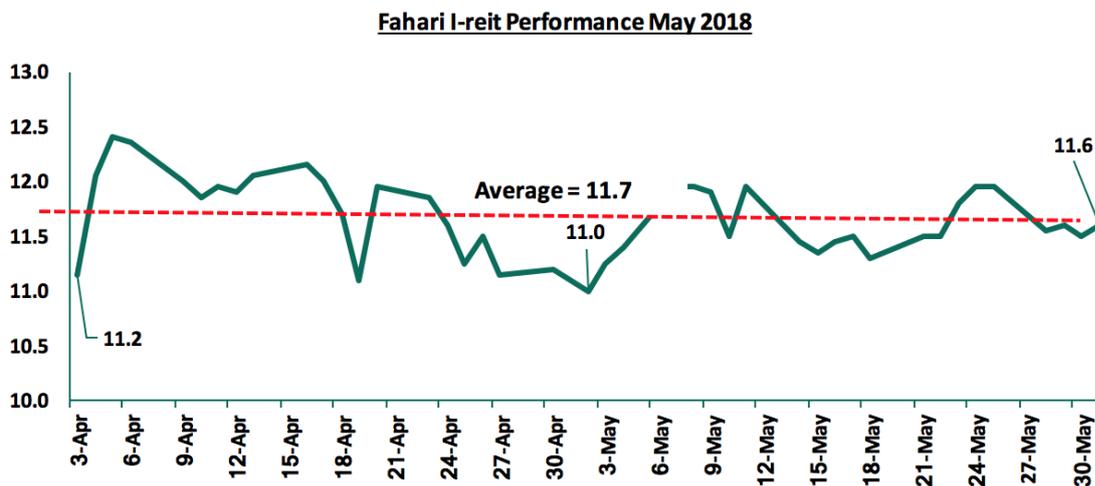
The real estate sector continued witnessing an increase in capital injection. Investors are attracted to the sector by; (i) high returns, which have averaged at 24.3% p.a. over the last 5 years, compared to an average of 13.2% p.a. recorded in traditional asset classes, (ii) high demand, with the sector having a deficit of 2 mn housing units, growing by approximately 200,000 houses p.a., and (iii) government incentives such as increased focus on affordable housing, and a 15% tax reduction for developers delivering at least 100 affordable units p.a. The following were the key highlights during the month;

- ?. During the month, 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. We expect the body to result to a rise in (i) the number of mortgage lenders, (ii) the number of mortgage undertakings, and thus (iii) increased uptake of homes by the low-income population. Our topical on **The Kenya Mortgage Refinancing Company**, expounds more on how the facility works and the expected effect of the same on the mortgage market in Kenya,
- i. 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. Cytonn Weekly #20/2018

Listed Real Estate:

During the month, Stanlib's Fahari I-REIT price rose by 3.6%, closing at Kshs. 11.6 from Kshs. 11.2 at the end of April. The REIT traded at an average unit price of Kshs. 11.6 in May 2018, 42.0% lower than the listing price of Kshs. 20.0 in November 2015. We attribute the low performance to (i) opacity of the exact returns from the underlying assets, (ii) the negative sentiments currently engulfing the sector given the poor performance of Fahari and Fusion REIT (FRED), (iii) inadequate investor knowledge, and (iv) lack of institutional support for REITs. We expect the REIT to continue trading at low prices and in low volumes.

The graph below shows the REIT's performance in May 2018;



Statutory Reviews:

During the month, various bodies proposed or adopted policies that affect the regulation of the real estate sector. The following are the key reviews;

- ?. The Cabinet Secretary of the Ministry of Lands and the Law Society of Kenya (LSK) agreed to form a 15-person task force to look into the issues raised by the LSK on the inadequacies of the Land Information Management System (LIMS). The task force is tasked to recommend guidelines on how the implementation of the electronic registration and conveyancing system will be undertaken, in compliance with Regulation 90 of the Land Registration (General Regulations, 2017) that states that the register as well as documents required under the Electronic Registration and Conveyancing Act shall be maintained in an electronic format. The digitization of land registries will enhance efficiency and transparency of land dealings through improved transfers and payments and reduce conveyance related costs, *Cytonn Weekly #21/2018*
- i. The Energy Regulatory Commission (ERC) kicked off vetting of both existing buildings and those under construction to ensure that they have complied with solar heating rules, *Cytonn Weekly #19/2018*
- ii. The National Construction Authority (NCA) announced that it was drafting a construction industry policy that will streamline operations in the construction and real estate sectors in the country. *Cytonn Weekly #21/2018*

Another real estate highlight of the month was that Saint-Gobian, a French Multinational Corporation that manufactures, designs, and distributes construction and building related materials opened its first showroom in Nairobi. The firm joins the list of multinational companies such as Betchel from USA, and Power China from China, which have their operations in the country.

We retain a positive outlook for the real estate sector in Kenya driven by: (i) positive demographic trends such as rapid urbanization that currently stands at 4.4% against a global average of 2.1%, (ii) rapid population growth rates of 2.6% against a global average of 1.2%, (iii) sustained infrastructural development, and (iv) government initiatives to tackle the huge housing deficit of 2 mn units, growing by approximately 200,000 units per annum according to National Housing Corporation (NHC).

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