The Draft Financial Markets Conduct Bill, 2018, & Cytonn Weekly #23/2018

Real Estate

Weekly Highlights:

Knight Frank released its Hotels Report 2018 indicating that the global and local hotel chains target Africa as a growth region because of its undersupply of international grade hotels. The report highlighted international brands that have presence in Africa, hotel supply in Africa and the performance of the hospitality sector in the Sub Saharan Region and Africa in general. According to the report;

i. The current hotel stock is heavily concentrated in a small number of markets along the coast line with North Africa, Southern Africa, East Africa, West Africa and Central Africa accounting for 38.0%, 30.0%, 21.0%, 9.0%, and 2.0% of branded hotels in Africa respectively, attributable to the reluctance of hotels to embrace international brands,
ii. Investors have shifted their focus to international chains supply in markets currently perceived as being undersupplied as reflected by the current projects in the pipeline. In the pipeline projects, West Africa account for the largest portion of projects under development at 35.0% followed by North Africa, East Africa, Southern Africa and lastly Central Africa at 29.0%, 27.0%, 5.0%, and 4.0%, respectively. This is mainly driven by the expectation of an increase in the demand for hospitality services, thus the multiple hotels under development in the region for international brands including Hilton, Sheraton and Marriott,
iii. The overall hotel room occupancy rate in Africa according to STR Global, was 58.0% in 2017 up from 54.9% in 2016 recording a 3.1%-point increase. The hotels also had an average ADR and REVPAR of USD 107 and USD 62 respectively, recording a 2.1% and 7.8% increase, compared to 2016 at USD 105 and USD 58, respectively. The improved performance can be attributed to the increase of occupancy rate for the North Africa region given the improved security in the region,
iv. The Sub Saharan Africa region recorded an average hotel occupancy of 60.0% in 2017, from 59.3% in 2016. Hotels in the region also recorded an average ADR of USD 121.4 in 2017 from USD 121.7 in 2016, thus a 0.3% drop, while the REVPAR increased by 7.8% to USD 73 in 2017. We attribute this overall improved performance to the stable demand for hospitality services in the region,
v. Mauritius and Seychelles were ranked as 2017's top-performing markets, in terms of both occupancy and room rates, this performance is attributed to the relative immunity to the security concerns that have influenced resort locations elsewhere in Africa, and increased investor interest in the markets.

Key highlights in the Kenyan market are;

i. Kenya ranked as one of the hotel development hotspots in East Africa alongside Ethiopia and Tanzania, with the development activities being driven primarily by the expansion plans of the larger multinational hotel groups into the continent targeting increased international tourist arrivals at 8.1% increase in 2017 from 2016 according to KNBS Economic Survey 2018,

ii. Kenya ranked the fifth African country with the highest number of chain and branded hotels—excluding lodges, safari camps, chalets and cruise-hotels at 68 chain and branded hotels, while South Africa topped the list with 430, followed by Egypt at 300, Morocco at 153 and Tunisia at 103. This is attributable to Nairobi's position as a major regional hub attracting business travelers, improved security and diversity in tourism activities.

This performance is in line with our report Cytonn Weekly #7/2018 , where we reported that internationally branded hotels have been on an expansion offensive in Nairobi with a total of 1,882 internationally branded hotel rooms expected to come to the market by the end of 2018, and a 4.0% increase in occupancy rates. We expect the trend to continue, driven by, (i) political calm, (ii) growth of MICE and domestic tourism, (iii) sustained international business and travel tourism and (iv) increased marketing by the Kenya Tourism Board (KTB).

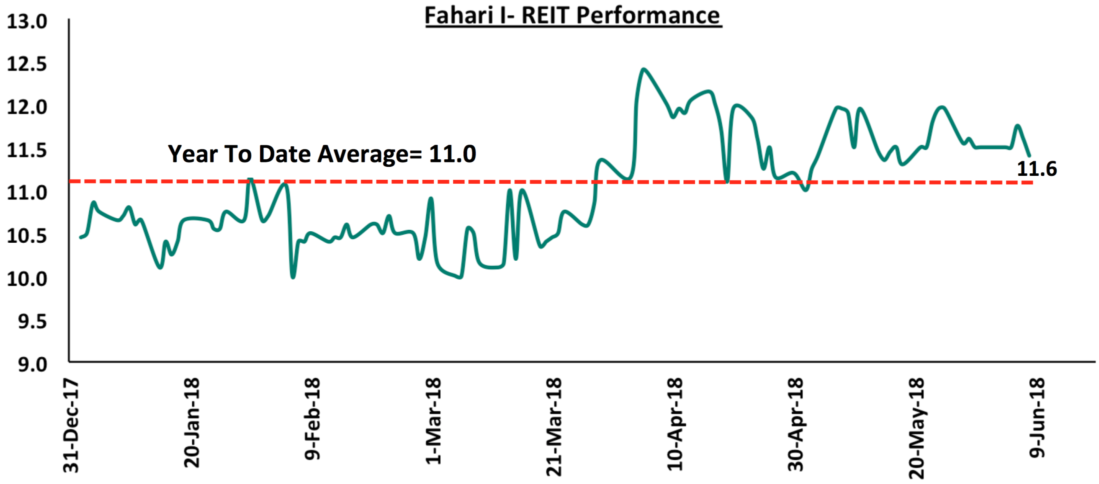
The real estate sector continues to witness increase in collapse of the buildings, evidenced by the collapse of a 5-storey building in Huruma, Nairobi, during the week, causing harm to 7 and casting a shadow doubt on the implementation approvals awarded before the building started construction. The collapsed building was adjacent to Huruma Estate Primary School and was marked for demolition by the National Construction Authority (NCA). This is as a demolition exercise of unsafe buildings and structures by the National Building Inspectorate (NBI) commenced on 14th March 2018. An Audit recently conducted by the Inspectorate revealed that, half of the 2,260 buildings evaluated in selected estates in Nairobi had foundation defects. 13 buildings were earmarked for demolition at the beginning of this year of which 2 have been brought down. The remaining ones include; 2 in Zimmerman, 5 in Huruma, 1 in Mathare, 1 in Umoja and 1 in Kariobangi area. Other buildings that have collapsed in the capital Nairobi this year include a four-storey flat in Zimmerman and a seven-storey building in Kware Pipeline Estate. We attribute the increased number of similar tragedies to; (i) lack of adherence to set rules by property developers as they rush to meet the high demand for houses ii) poor workmanship (iii) poor regulation enforcement in the sector, and (iv) compromise on quality resulting in the use of sub- standard construction materials. To eliminate these tragedies, the National Construction Authority must thus put in place strict regulations such as frequent inspections, training of artisans, easing the building approval process by reducing costs and time and ensure they are adhered to, and demolish the substandard developments.

Other Weekly Highlights:

- The retail sector continues to record increased activities, with Java setting up plans to open two new branches in Nairobi and Mombasa. Java Group, recognized as the biggest restaurant chain in the East African region, currently has 64 branches in the East African Region. The retail sector has witnessed many retailers adopting the expansion strategy driven by increased demand driven by positive demographic trends such as, i) 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%, and iii) an expanding middle class with increased purchasing power due to higher disposable income, which increased to Kshs 6.6 tn in 2016 from Kshs 5.7 tn in 2015,
- Local airline carrier Silverstone Air Services is set commence flights between Nairobi and Mombasa, this July. The flight that targets tourists on the coastal circuits, is set to have a positive impact on the hospitality industry through increased inbound traffic,
- During the week, tenants of Jevanjee/Bachelors quarters in Ngara filed a complaint that they were not consulted in laying out the redevelopment plan of old housing estates by Nairobi Urban Housing Project. The tenants complained about the manner in which the redevelopment was being carried out without involving them. The projects affected are Old Ngara, Jevanjee Bachelors Accommodation that comprises of 114 and 80 housing units respectively. The issues risen revolve around the state not acquiring the Department of Public Works and necessary documentation lawfully.

Listed Real Estate:

On the bourse, Stanlib's Fahari I-REIT price rose by 0.1%, closing at Kshs 11.6 from Kshs 11.5 the previous week. The I -REIT continued to trade at 44.2% lower than its listing price of Kshs 20.8 in November 2015. In general, low performance of REITs is attributed 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 I -REIT and Fusion D-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.



Our outlook remains positive for the real estate sector given the increased traction of economic activities in the real estate sector, as depicted in the hospitality sector through increase in international investors. Other factors likely to result in this positive trend include; positive demographic trends such as i) 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).