Nairobi Metropolitan Area Residential Report 2017/2018 & Cytonn Weekly #26/2018

Real Estate

During the week, The Kenya National Bureau of Statistics (KNBS) released their Gross Domestic Report Q1'2018, the key take- outs for the real estate sector were;

i. The sector’s development activities slowed down, with the construction sector growing by 7.2% in Q1’2018, 1.0% point lower than the 8.2% growth recorded in Q1’2017, and consumption of cement dropped by 12.5% to 1.4 mn tonnes in Q1’2018, from 1.6 mn tonnes in Q1’2017. The slowdown in activities has been attributed to a tough operating environment experienced in H2’2017, as well as drought and inflationary pressures that dampened the country’s overall economic growth, hence affecting the purchasing power of potential clients. Despite the slowdown, the sector’s growth is attributed to the ongoing public infrastructural projects such as, the expansion of Ngong Road Phase 2 and phase two of the Standard Gauge Railway (SGR), as well as the continued development of buildings, and,
ii. The real estate sector grew by 6.8% in Q1’2018, 0.7% points higher than the 6.1% growth recorded in Q1’2017, and we attribute the growth to increased investor confidence, and thus investments in real estate following the conclusion of the extended electioneering period.

Source: KNBS

According to KNBS, the contribution of the real estate and construction sector to GDP has continued to increase as shown above, and we expect the trend to continue driven by; (i) political stability, (ii) economic recovery with the GDP projected to come in between 5.3% and 5.5% in 2018, higher than the 4.7% recorded in 2017, and (iii) government incentives such as (a) tax relief of 15.0% for developers putting up more than 100 affordable housing units p.a., (b) the scrapping of the land title search fees, NEMA and NCA Levies, and (c) digitization of the Lands Ministry.

In the hospitality sector, industry reports have been released, indicating that the sector is expected to record improved performance in 2018 driven by factors such as; (i) increased international arrivals, (ii) continued marketing, and (iii) domestic tourism and international conferences.

These reports include;

I. Jumia Travel Hospitality Report Kenya 2018 –The report focused on the travel and hospitality sector contribution to GDP, the sector’s performance and main trends shaping the sector.
The key take-outs from the report include;

   i. The sector contributed approximately 3.7% to the 2017 GDP, 0.6% points higher than the 3.1% contribution to GDP recorded in 2016, and this is expected to increase to 5.2% in 2018, driven by a) enhanced security in the country, b) infrastructural developments such as The Standard Gauge Railway, c) a stable macroeconomic environment, d) improved budgetary allocations by the government, which increased by 1.0% p.a. to Kshs 4.5 bn in 2018 from Kshs 1.5 bn in 2016, and e) the resilience of the tourism sector where the contribution is expected to increase by 5.3% from Kshs 294.6 bn to rise to Kshs 310.1 bn,

ii. Hotel bed-nights occupancy rose by 11.0% to 7.2 mn in 2017 from 6.4 mn in 2016, and this is attributable to increased international arrivals, which stood at 1.4 mn in 2017, compared to 1.3 mn in 2016, representing an annual increase of 9.8%, despite a turbulent electioneering period,

iii. On hotel star establishments, 3- stars attracted the highest number of total bookings comprising 35.0% of the total hotel bookings in Kenya, while 2-star and 4-star hotels recorded 30.0% and 26.0% of the total hotel bookings, respectively, attributable to relatively lower average daily rate for the 3-star hotels, at approximately Kshs 7,672 compared to 4 star hotels at Kshs 12,164, and also better-quality amenities compared to 2-star hotels,

iv. On local travel destinations, Nairobi was the most popular destination with 35.0% of the total number of guests visiting the city, followed by Mombasa and Diani at 30.0% and 15.0%, respectively. We attribute the high numbers in Nairobi to meetings, incentives, conferences and exhibitions (MICE), and the city's recognition as a regional hub,

v. Domestic expenditure on tourism grew by 16.0%, with Kenyans taking up approximately 4.0 million bed nights in 2017, compared to 3.5 million in 2016, and this we attribute to increased domestic tourism, resulting from the implementation of various policies such as; the scrapping of VAT charges on national park fees and domestic marketing efforts that have encouraged Kenyans to visit various hospitality establishments across the country,

vi. Technology is the main factor driving the travel and hospitality industry, through enhancing accessibility of flights bookings via the internet. This is evidenced by the bookings trends demonstrated in June 2017, where Jumia Travel web bookings stood at 11.0%, direct bookings at 60.0%, while travel agents contributed 29.0% of the bookings. Comparatively, during the same period in 2018, the web bookings increased to 23.0% with direct bookings dropping to 47.0%, while travel agents recorded 30.0% of the bookings,

vii. Technological trends shaping the hospitality sector include; a) internet and mobile penetration, which stood at 83.0% in 2017, 16.0% points higher than the 67.0% penetration in 2016, b) Wi-Fi connectivity that is one of the most sought after amenity by travelers, c) online video marketing given its high level of memorability, d) mobile bookings, with Jumia Travel recording 44.0% bookings via mobiles in Q3'2017 compared to 41.0% during Q2'2017, e) virtual reality aimed at enhancing customers' experience, f) Internet of Things (IoT), which involves the use of apps and automated systems by both guests and hotel managers, and g) artificial intelligence to enhance user experience.

II. PWC Hotel Outlook 2018- 2022- the report focused on the hospitality sector's outlook for the period between 2018 and 2022, highlighting that the sector will exude improvement in the next 5 years with guest nights expected to rise at a 6.9% CAGR during the next five years from 3.6 mn in 2018, to 4.6 mn in 2022, and the occupancy rates rise by 10.8% points to 58.1% from 47.3% during the same period. Other key take- outs from the report include;

i. Kenya is expected to benefit from a number of new hotels opening, among them Hilton, Radisson Blu, Pullman, Best Western, and Mövenpick, which will result in a 1,800 increase in rooms in the next 5 years. In addition, 13 hotels are expected to enter the market in the next 5 years, adding a total of 2,600 rooms and thereby accounting for a 14.0% increase in hotel capacity and a 2.6% CAGR in room availability between 2018 and 2022,

ii. Hotel room revenues are expected to grow by a 9.6%, CAGR, from 461 mn USD in 2018 to 690 mn USD in year 2022, attributable to the rising number of domestic and foreign business and leisure visitors, with the number of guest nights expected to rise at a 6.9% CAGR from 3.6 mn in 2018 to 4.6 mn in 2022, driven by; (i) the introduction of direct flights to the United States of America by Kenya Airways, expected to commence in Q4'2018, which is expected to boost U.S. travel to Kenya, (ii) the rising tourist numbers from India, Poland, Russia, the Czech Republic and China, (iii) continued marketing of the country as a destination for experiences, and (iv) the promotion of the country as a beach destination, aided by the 'Beach & Bush' tourism campaign with Mauritius to promote both countries as tourist destinations.

The findings from the PWC Hotel Outlook 2018-2022 and Jumia Travel Hospitality Report Kenya 2018 are in line with our Cytonn Annual Outlook Report 2018, where we stated that we expect the performance of the hospitality sector to improve in 2018, with the room occupancy in Nairobi expected to increase by 4.0% points y/y from 49.0% in 2017 to 53.0% in 2018. The Average Daily Rate(ADR) is expected to increase by 11.0% y/y from 125.5 USD in 2017 to 139.3 USD in 2018, and Revenue per Available Room (RevPAR) by 20.6% y/y from 61.2 USD to 73.8 USD, driven by; (i) the stabilizing political situation, (ii) growth of meetings incentives conventions and exhibitions (MICE) and domestic tourism, (iii) sustained international business and travel tourism, and (iv) increased marketing efforts by the Kenya Tourism Board (KTB) both locally and internationally. The projections are shown below:

Nairobi Hospitality Sector Performance Projections 2018

Factor	2014	2015	2016	2017*	2018F	Δ 2017/18
International Visitor arrivals ('000)	1,350	1,181	1,340	1,453	**1,612**	**11.0%**
Total Bed Nights ('000)	6,282	5,879	6,449	6,584	**7,244**	**10.0%**
Total Beds Available ('000)	19,877	20,187	21,259	22,351	**23,499**	**5.1%**
Kenya Bed-Night Occupancy Rate	31.6%	29.1%	30.3%	29.5%	**30.8%**	**1.4%**
Nairobi Room Occupancy Rate	54.0%	53.0%	53.0%	49.0%	**53.0%**	**4.0%**
Nairobi ADR (USD)	145.2	142.9	137.0	125.5	**139.3**	**11.0%**
Nairobi RevPAR (USD)	77.5	75.9	72.0	61.2	**73.8**	**20.6%**

·In Nairobi alone, we expect the ADR to increase by between 11.0% and 19.0% y/y to average at between USD 139.3 and USD 150.0, average room occupancy to increase by 4.0% points to average at 53.0% resulting in an increase in RevPAR by between 20.6% and 29.9% y/y to average at between USD 73.8 and USD 79.5

Source: KNBS, Cytonn Research 2018

Centum Investments Plc broke ground on Kshs 100 bn industrial park in Kilifi County named Vipingo Investment Park. The development is expected to sit on 10,254 acres of land, and will comprise of a mixed-use economic hub, industrial, commercial, residential, hospitality and institutional use. 1,150-acres of the serviced plots will be set aside for manufacturing, warehouses, logistics and commercial developments, while 200-acres for a residential estate with an affordable model dubbed *Ridge Homes*, which will consist of 1,200 units of one, two and three bedroom apartments priced at approximately Kshs 4.0 mn per unit. The firm is expecting to leverage from the good performance of the industrial sector, which according to our Cytonn H1'2018 Market Review, recorded 0.7% points increase in rental yields from 5.4% as at H1’2017 to 6.1% in H1’2018, attributed to an 11.8% increase in occupancy levels. Some of the major drivers of the sector include; i) the renewal of investor confidence following the conclusion of the prolonged electioneering period, and ii) increased focus by the government on manufacturing, with the sector being included among the governments Big Four Agenda of focus for the next four-years. For more details, please see our Cytonn H1'2018 Market Review.

In the retail sector**,** South Africa’s Massmart announced plans to open hardware outlets in Kenya.

The multinational, which currently operates The Game supermarket at Garden City Mall along Thika Road, is set to open 6 new builder stores in Kenya, Mozambique and Zambia, though the exact number of outlets in each country has not been specified. The Kenyan retail sector has seen entry of other huge brands like French Retailer Carrefour, which has 5 stores and plans to open 2 new stores at Village Market and Galleria Mall, South Africa's Shoprite, which is planning to open 7 new stores in Westgate, Garden City and 5 other undisclosed locations, and Botswana's Choppies, which has 13 stores running and 1 planned outlet in Nanyuki Mall. We expect the expansion by retailers to lead to improved performance of the retail sector. For instance, in H1'2018, occupancy rates in malls in Nairobi increased by 0.9% points from 80.3% in FY'2017 to 81.2% resulting in a 0.1% point increase in rental yields from 9.6% in FY'2017 to 9.7% in H1'2018 according to Cytonn H1'2018 Market Review. This is as international retailers took up space in the malls, vacated by Nakumatt Holdings and Uchumi Supermarkets. We therefore have a positive outlook on the retail sector going forward, and we expect the sector to be boosted by; (i) high economic growth rates with the GDP growth rate expected to come in at 5.5% compared to the 4.7% recorded in 2017, thus leading to an increase in disposable incomes, and increasing purchasing power, (ii) Kenya's growing position as a regional and continental hub, hence witnessing an increase in multinationals operating in the country, (iii) huge opportunity, with Kenya having a formal retail penetration of 35.0% according to Oxford Business Group, compared to markets like South Africa with a penetration of 60.0%, and (iv) the rise of e-commerce, as seen through the increased digitization of cash systems and a rise in mobile penetration at 90.4%, according to Jumia Mobile Report 2018, hence increased market coverage.

Other highlights in the sector include;

i. Tuskys Supermarket is set to open a new branch in Westlands Nairobi in mid-July 2018, taking over a space initially occupied by Uchumi Supermarket. The move is part of Tusker Mattresses Group strategy to broaden its footprint in the country's retail sector. The retailer will take over the space, previously occupied by Uchumi, which is undergoing a financial crisis as a result of poor supply chain management,
ii. The residential sector is expected to record increased activities following the signing of a Memorandum of Understanding that will see United States of America (USA) companies and Kenyan companies collaborate with the aim of implementing the Big 4 Agenda which include i) ensuring food security, ii) provision of affordable housing, iii) manufacturing, and iv) provision of affordable healthcare. According to the Treasury CS, Henry Rotich, the signed MOU will provide a framework where the two governments and the private sectors of the two countries will engage in business opportunities with regard to the Big 4 Agenda, however further detailed on the same are yet to be disclosed,
iii. Fly Tristar Airline announced plans to increase its flights from Nairobi to Mombasa, from four times a week to everyday, and also start flights from Nairobi to Malindi, and Nairobi to Ukunda. This follows a move by Silverstone Airline to increase flights between Nairobi and Kisumu, from 14 times a week to 17 times. This is driven by the increased number of guest arrivals to the Kenyan Coast and thus increased demand for accommodation. We expect increased activities 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 (KTB),
iv. PrideInn Hotels has announced plans to open a 3-star hotel in Mombasa this month. The business hotel, will have 40 rooms and conference facilities that can accommodate up to 500 people. In addition, the hotel will feature amenities such as concierge service, shuttle services, ample parking, laundry services, room service and a currency exchange bureau. The hospitality sector in Kenya continues recording increased investments due to the increased demand for accommodation and other hospitality services by both local and international guests, with the number of international arrivals have been growing by 16.7% from 1.2 mn in 2015 to 1.4 mn in 2017. Other brands that have opened new hotels in 2018 include; Hilton Hotel, City Lodge and Movenpick Hotels & Resorts. This is a clear indication of the attractiveness of the sector and thus

expect continued grow driven by; (i) the improved security following the end of the electioneering period, ii) the revision of negative travel advisories, warning international citizens, e.g. from the United States against visiting Kenya, iii) positive reviews from travel advisories such as Trip Advisor who ranked Nairobi as the 3rd best place to visit in 2018, only behind Ishigaki Island in Japan and Kapaa in Hawaii, and The Travel Corporation who ranked travel to Kenya as one of the top 10 transformative travel experiences in the world, iv) improved hotel standards with the entry of global hotel brands while existing hotels refurbish their developments, v) classification of hotels into their respective hotel star ratings, as a way to improve visibility and credibility of local hotel brands and, vi) improved flight operations and systems, which will make it easier and more convenient for travelers.

Listed Real Estate

During the week, the share prices for the Fahari I- REIT declined, with the instrument closing the week at Kshs 11.0, 3.5% lower than the average price of Kshs 11.4 the previous week. Year to date the instrument has gained 4.8% from the 10.5 Kshs at the start of the year. The instrument is however trading at a 45.0% discount from its listing price of Kshs 20.8 per share. We attribute the poor performance to; i) inadequate investor knowledge ii) opacity of the exact returns from the underlying assets, iii) the negative sentiments currently engulfing the sector given the poor performance of Fahari and Fusion REIT (FRED) and iv) lack of institutional support for REITs

We retain a negative outlook for the listed real estate sector mainly due to market structures and poor market sentiment, and thus expect the REIT to continue trading at low prices and in low volumes.

Our outlook for the real estate sector remains positive driven by: (i) increased investor confidence in the market, (ii) positive demographic trends such as rapid urbanization that currently stands at 4.4% against a global average of 2.1%, (iii) rapid population growth rates of 2.6% against a global average of 1.2%, (iv) sustained infrastructural development, opening up areas for real estate development, and (v) a better operating environment due to political calm.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com