Developing Technical Education Institutions with a Focus on Vision 2030, & Cytonn Weekly #27/2018

Real Estate

Last week, Cytonn released the Nairobi Metropolitan Area Residential Report 2017/18, a report that seeks to inform on the Real Estate residential sector in Kenya and the best areas of investment for both detached units and apartments. The report showed that the sector recorded annual total returns of 8.2% in 2017/18, which marks a marginal decline of 1.2% points from the 9.4% cumulative returns recorded in 2016/17. This was attributed to stagnation and a decline in prices in selected markets, a spill-over effect of last year's electioneering period and tight access to financing especially for potential home buyers, with private sector credit growth falling to 2.1% as at April 2018 compared to a 5-year average of 14.0%. Despite the slight decline, we noted that the sector still has pockets of value with some sub-markets recording double-digit returns of between 11.0%-14.0% including Kilimani, Thindigua, Ruaka, Kitisuru and Ruiru. During the past week, two other firms released reports highlighting areas of value in the real estate sector. Hass Consult released their House Price Index Report Q2'2018 and the key take-outs were:

i. Asking prices increased by 3.6% q/q and by 5.1% on an annual basis compared to a 3.1% q/q decline and a 2.2% y/y decline recorded during Q2'2017. The increase is attributed to renewed investor confidence following the conclusion of the elections held last year,
ii. Rental prices also grew by 3.3% q/q compared to a 2.0% q/q decline recorded in 2017, and this was on account of landlords initiating rent escalations that had been halted as confidence restored in the market,
iii. As a result, total returns comprising of rental yields and price appreciation came in at 11.4%, which is 3 times higher than the returns in 2017 at 4.3%,
iv. The best performing submarkets for the rental market were as follows:
    a. For detached units, Kitisuru recorded the highest rental price increase at 2.7% attributable to a relatively low supply of housing compared to the demand for up-market housing, while Lang'ata posted the highest increase at 3.7% for apartments due to its attractiveness to the middle-class being in close proximity to main business hubs such as the CBD and Upperhill,
    b. In satellite towns, Ruaka outperformed other areas, with rents appreciating by 11.5% annually and 3.9% over the past quarter; this we attribute to the increased demand for housing in Ruaka being one of the fastest growing towns in Kiambu County with a good transport network, serene environment and available social amenities,
v. The best performing submarkets in the sale market were:
    a. Detached units, Gigiri outdid other areas to record a price increase of 2.7% attributable to its prime location in a secure environment thus leading to increased demand especially from expatriates. For apartments, Westlands posted a sales price increase of 2.0%, the highest in the Nairobi region, attributable to accessibility, given its proximity to commercial nodes such as the CBD and Parklands as well as its own status as a recognized commercial zone

b. For satellite towns Ngong Town recorded the highest price rise across all typologies with detached units and apartments increasing by 5.8% and 6.9%, respectively, due to it tranquility and ease of accessibility from areas such as Magadi, Kikuyu, Nairobi and Magadi as a result of the construction of the Southern bypass and the ongoing expansion of Ngong road.

vi. In terms of unit typologies, semi-detached units outperformed other typologies to record a q/q growth of 4.7%, compared to detached typologies and apartments that came in at 3.9% and 1.0%, respectively. We attribute this performance to increased demand for semi-detached units as they tend to be more affordable compared to detached units and offer the privacy of an own-compound as opposed to apartments.

According to Hass Consult, there is restored investor confidence in the market; however, liquidity is still a big challenge due to the effects of the interest rate cap. Comparing the findings to our Nairobi Metropolitan Area Residential Report 2017/18, the total returns according to Hass Consult are 3.2% points higher, which we attribute to differences in sampling and areas covered. The outlook on investment in the sector is positive, supported by; (i) positive demographics, such as Kenya's population growth rates that average at 2.6% p.a., 1.4% points higher than global averages of 1.2% p.a., high urbanization rates of 4.4% p.a. against global averages of 2.1% p.a., that would mean sustained demand, (ii) a better operating environment with digitization of lands ministries and slashing of statutory fees such as NEMA and NCA, and (iii) a relatively stable economy with GDP growth rates averaging at 5.3% p.a. over the last 5-years and driven by a rising middle-income class with steady incomes, and the intensified focus on affordable housing.

Hass Consult also released their Land Price Index Report Q2'2018, where the key take-outs were:

i. Asking land prices in Nairobi suburbs softened recording a growth of 0.2% q/q as compared to a similar period in 2017 where the growth recorded was 2.5%, while in satellite town, land prices grew by 0.5% q/q, 7.6% points lower than the 8.1% growth in Q2'2016. The slow growth is attributable to a constrained operating environment characterized by interest rate caps,
ii. Kileleshwa was the best performing suburb on a quarterly basis recording a growth of 4.0% between Q1'and Q2'2018, while Ngong was the best performing satellite on an annual basis recording growth of 4.3%, which were all attributable to investors warming up to the area due to infrastructural development such as the expansion of Ngong' Road, the Southern Bypass and the Standard Gauge Railway (SGR) with a station at Kimuka.

The findings are in tandem with Cytonn Nairobi Metropolitan Area Land Report 2018, where we had indicated that the Nairobi Metropolitan area had recorded slow capital appreciation rates, reducing by 1.2% points from 8.2% to 9.4% in 2018 from 2017. We attribute the slow-down in price growth to increase in supply in lower mid-income segments prompting owners to reduce prices. This was evidenced by the price decline that we saw for lower suburb detached and apartments that reduced by 4.1% and 0.1%, respectively. We however expect renewed growth in land prices given the restored investor appetite that will result in scaling up of development activities, creating demand for land. Overall, the land sector remains a safe investment bet given its long-term potential gains, with a 6-year CAGR of 17.4% since 2011, driven by (i) improved systems such as the digitization of the land's ministry and the scrapping of land search fees, (ii) shortage of development class land, and iii) improved infrastructure such as sewer lines and roads that have opened up areas for development, for instance Ngong Road and Outer Ring Roads opened up Donholm and Ruaraka for Real Estate development.

During the week, Knight Frank also released their H1'2018 Market Update tracking trends and performance in the residential, retail, commercial office, industrial and hospitality sectors, listed real estate, infrastructure and the institutional market. They key take-outs for each sector were;

- The **retail sector** posted occupancy rates averaging between 60.0% and 75.0% for new retail centers and 90% for established malls and this was as a result of relatively high demand for retail in prime locations. Prime retail rents remained unchanged at 55 USD/SQM/Month and service charge was Kshs 480.0 – Kshs 615.0 per SQM attributed to increase in supply exceeding demand in some market segments and slow recovery due to the protracted electioneering period,

- In the **commercial office sector,** prime rents reduced by 7.1% to USD 1.3 per SQFT per month in H1'2017 from USD 1.4 per SQFT monthly between H1'2018. Knight Frank, however, expects improvement during H2'2018 mainly driven by economic recovery and take up of office space in prime locations. Fewer completions were recorded during H1'2018 due to the political environment that was as a result of the elections, with the notable completions being Galleria Office Park and Sanlam Towers,
- In the **residential sector,** prime rents grew by 0.4% in H1'2018 as compared to a 1.8% decline in H2'2017 as a result of a generally better operating environment,
- In the **industrial sector,** Knight Frank noted the commitment of Kshs 73.0 bn by the government for ongoing projects such as the Konza Technopolis with an ambitious completion timeline of 2020. Africa Logistics Properties, a logistics and warehouse company, located at the Watermark Business Park along Ndege Rd, Karen, signed a contract with Copia, an E-commerce company in the retail sector for 4,500 SQM of warehousing space, and has currently pre-let 63% of its 50,000 sqm logistics complex, showing the demand for modern warehousing space,
- In **infrastructure and policy**, Kshs 115.9 bn was allocated, during the Budget Statement, for ongoing road and rail projects, with the SGR taking up Kshs 74.7 bn and the Mombasa Port Development Project allocated Kshs 2.7 bn. The allocation is a 22.4% increment compared to the allocation in 2017/18 of Kshs 204.3 bn, showing the commitment of the government towards improving infrastructure in Kenya.

In our view, the report mirrors our findings and recommendations where we have a positive outlook on the real estate sector supported by a good operating environment indicated by the current stable political environment as well as stable GDP that has averaged at 5.3% for the last 5 years.

Below are other highlights in the various sectors in the real estate market;

Residential Sector:

In the residential sector, Francis Kamande, the Chairman of the National Co-operative Housing Union (NACHU) supported the proposed 15.0% tax waiver on Housing Co-operatives. If implemented, the move will enhance the affordable housing agenda, which falls among the government's 4 key pillars of focus for the next 5-years. NACHU is an umbrella of savings cooperatives comprising 23,000 savings societies, a capital base comprising clients' savings of Kshs 1.0 tn, and an asset base of Kshs 1.0 tn spread across the country. In our view, if actualised the 15.0% tax will contribute to reducing the housing deficit, as it will encourage Saccos to unlock their savings, which will be used for development and provision of favourable housing loans to their members.

Infrastructure Sector:

The main highlights were

i. The construction of the 530 km Lamu – Isiolo road is set to commence in August, this follows government securing Kshs 62.0 bn in funding from the Development Bank of South Africa. LAPPSSET Chairman Francis Muthaura, highlighted that the 4-year project, which is the biggest of its kind in Africa, will comprise: ports, pipeline, railways, highways, airports, power and water supply as resort cities, and
ii. Works on the Kshs 1.4 bn, 23 km road that connects Gilgil to Njoro officially commenced. The project dubbed the Soto Mbili- Miti Mingi road was launched by the Principal Secretary for Infrastructure and is set to be complete in 3-year.

The government's continued investment in infrastructure will not only have a positive impact on the overall economic growth, but is also an enabler to real estate as more areas are opened up for development. We expect further investment in the sector as the Government seeks to advance its agenda, maintain a stable macroeconomic environment and sustain GDP growth at the current year average of 5.0%, this is expected to boost Real Estate development positively and open more areas for Real Estate development.

Listed Real Estate Sector:

i. **The Fahari I- REIT, Kenya**

During the week, Fahari – I REIT recorded an increase in price, closing at Kshs 11.0 per share, a 2.8% gain from an average of Kshs 10.7 the previous week and 4.8% above its opening price of Kshs 10.5 per share at the beginning of the year. The prices of the REIT have remained relatively stable with low trading volumes, indicating low investor demand on account of poor market sentiments regarding its performance since listing. The REIT is currently trading at a 47.1% discount to its listing price of Kshs 20.8 per share.

We still maintain a negative outlook on Stanlib Fahari I - REITs given: i) the market has generally remained sceptic about the positive performance of the instrument due to poor past trends with the I- REIT never able to attain its listing price of Kshs 20.8 and falling by almost half, 47.1% ii) inadequate investor education and iii) lack of transparency regarding the actual returns that will be generated.

ii. **REITS on the Nigeria Stock Exchange**

This week, we introduce other I-REITs in Sub-Saharan Africa to assess their performance over time and benchmark against the Kenyan Fahari – I REIT. We have selected the following REITs listed on the Nigerian stock Exchange;

i. The **Nigerian Homes Real Estate Investment Trust** also known as the Union Homes REIT (UH REIT) was first listed in the Nigerian Stock Exchange (NSE) in 2008 but commenced full operations in February 2009 with a net asset value of N12.8 bn (Kshs 3.5 bn). This amount is 3.6% higher than Kenya's Fahari I REIT net amount of Kshs 3.4 bn after listing in 2015. The UH REIT invests its funds in a portfolio of both commercial and residential developments in the high-end nodes of Abuja and Lagos and has plans to expand to Ibadan and Jos. The REIT is currently trading at N45.0 (Kshs 12.7),
ii. **UACN Property Development Company (UPDC)** was launched in 2013 by UACN Property Development Company, a Real Estate and development company. The REIT was publicly quoted upon listing at N30bn (Kshs 8.3 bn). The REIT ventures in both the commercial and residential property within Lagos, Abuja and Aba. The stock is currently trading at N10 (Kshs 2.8), and,
iii. The **Skye Shelter Fund** is Nigeria's first, publicly quoted closed-ended REIT Scheme. The REIT was launched in 2007. It is a subsidiary of Skye Bank, a Nigerian based tier 1 bank. The fund invests close to 65.0% of its fund in direct property, 25.0% in real estate through: i) real estate backed securities, ii) mortgages, and iii) real estate related equities, and approximately 10% in cash for liquidity purposes. The REIT was first publicly quoted at N2bn (Kshs 558.5 mn). In terms of property investment, the fund focuses on the commercial office, retail and the residential sector. The REIT is currently trading at N95 (Kshs 26.5).

In terms of performance, on a YTD basis the REIT prices have remained unchanged with minimal to no market activity recorded during the period. The UH REIT and UPDC have maintained share prices of N45.0 (Kshs 12.7) and N10.0 (Kshs 2.8) since January while the Skye Shelter REIT price has declined by 5.0% from N 100.0 at the year start and is currently trading at N95.0 (Kshs 26.5). In comparison to their listing prices, we see that UH REIT and Sky Share Fund have shed 10.0% and 5.0% of their value respectively from their list prices of N50.0 (Kshs 13.9) and N100 (27.9). UPDC on the other has maintained its par prices of N10 (Kshs 2.8).

Like in Kenya, REITs in Nigeria are underperforming due to the following reasons: (i) the low investor knowledge about the market which makes it difficult for REITs to generate investor interest, (ii) high interest rate environment, which although viewed temporary fails to work for REIT firms, risk free rates in the area currently stand at approximately 23.0%, (iii) firms operating REITs provide shallow quality assets classes in the region that are not durable, and (iv) poor standards of valuation, the market doesn't have enough valuers and the few are inconsistent thus provide poor appraisals.

Our outlook for the Real Estate sector in Kenya is positive given: (i) increased interest by major players such as Cytonn Investments, Hass Consult and Knight Frank to educate the market on areas to invest in and caution about areas to invest cautiously, (ii) increased expansionary moves by existing local players such as Massmart who are finding new areas to tap into such as industrial sector attracted by high yields of 6.1% against residential sector 5.5% that increases traction, and (iii) infrastructure investment by State and supported by funding from international players thus open up new areas for development and decongestion of congested areas.