Kisumu Real Estate Investment Opportunity, & Cytonn Weekly #28/2018

Real Estate

Buyers of affordable homes are now set to receive significant financial relief related to tax burdens, after President Uhuru Kenyatta signed into law amendments to the Income Tax Act that will allow the buyers get a 15.0% tax relief to a maximum of Kshs 108,000 p.a., or Kshs 9,000 p.m., under the newly introduced Affordable Housing Relief section. Additionally, the president also signed into law an amendment to the Stamp Duty Act, which will exempt first time home buyers from paying the Stamp Duty Tax which normally is 2.0% - 4.0% of the property value. In our opinion, the move is a step in the right direction towards facilitating home ownership and offtake of the affordable homes that are to be delivered over the next five years. Taking the average price for an apartment unit in the lower-middle segment which is Kshs 8.6 mn, as per our research, a home buyer would pay stamp duty tax of either Kshs 171,000 or Kshs 342,000, depending on whether it is in an urban or a rural area; for a detached unit in the same segment, the average price is Kshs 13.6 mn, and thus a first time home buyer would pay a stamp duty tax of Kshs 272,000 or Kshs 544,000. Therefore, it is evident that the exemption of the stamp duty, while not necessarily increasing the affordability of the house, will result in significant financial savings. Since the inclusion of affordable housing as part of the Big Four Agenda, the government has introduced a raft of measures and proposals to support the initiative, which have affected both the demand side (buyers and offtake) and supply side (developers). Some of these Include;

For the demand side

i. Formation of the National Housing Development Fund which will see employees contribute 0.5% of their basic salaries, with their employers topping that with a similar contribution, to the fund which is expected to facilitate offtake of the delivered affordable homes, as well as their construction,
ii. 15% tax relief, up to a maximum of Kshs 108,000 p.a for buyers of units developed under the affordable housing scheme,
iii. Exemption of first time home buyers from stamp duty tax, amounting to 2.0% - 4.0% of property value,
iv. Tenant-purchase scheme for social housing, and,
v. Provision of multi-generational mortgages that have long tenors and can be passed on to one's heir.

For the Supply side;

i. 15.0% corporate tax cut for developers of 100 low-cost housing units p.a.,
ii. Scrapping off of NEMA and NCA levies, which has encouraged developers to deliver more units to the market,
iii. Formation of the Kenya Mortgage Refinancing Company (KMRC) which is aimed at enhancing mortgage affordability and facilitating long-term loans at attractive rates
iv. Partnerships with developers through availing of public land for development,

v. Land swaps that entail the exchange of public and private land between the government and developers, enabling the developers to access development class land that would have been tied down, and,
vi. Public-Private Partnerships (PPPs) agreements between the government and the private sector, to facilitate development.

These initiatives are a step in the right direction, and the onus will, therefore, be on the government and other stakeholders, to ensure their successful implementation, enabling the government to meet its objective of delivering 1.0 mn housing units by 2022. Currently, Kenya has a housing deficit of 2.0 mn units, growing by 200,000 units p.an and it is largely concentrated in the low to the mid-income segment.

Also during the week, the National Housing Co-operatives Union board (NACHU) announced that it would be embarking on the establishment of a regulated mortgage Sacco in a model that is set to see the board access mortgage funding from the Kenya Mortgage Refinancing Company. NACHU mainly represents persons from the low-income class, rural cooperatives, persons with informal employment and irregular income among others. The body currently represents more than 11,000 individuals, of which 84.0% are low-income earners while 16.0% are modest income earners. To this end, the board plans on establishing various bodies to drive its investments and operations such as Nacho Plaza, Nacho Insurance Agency, Nacho Development Agency. Over the past two decades, the society has been funded by institutions such as Homeless International, Centre for Housing Finance International, USAID among others; with projects such as the 228-unit Malaa Affordable Housing Project in Ruai. The board also plans to launch into the REITs market to be able to raise funds for its mass housing initiative. In our view, this will enable the board which mainly focuses on providing affordable and decent housing and infrastructure to the low-income communities, by giving it a stable financial muscle.

In the retail sector, local retail chain, Naivas, announced plans to open its 4th outlet in Mombasa which will start operations from September this year. The outlet which will occupy 27,000 SQFT at Mwembe Tayari Mall in Mombasa will bring Naivas' total store count in Kenya to 47, bucking the trend that has characterized the local retail scene where locally owned chains have been experiencing financial constraints and mismanagement issues leading to a closure of stores. Mombasa is an attractive prospect for retailers due to, (i) minimal supply of mall space compared to counties such as Nairobi, meaning less competition from other retailers, (ii) relatively high demand, as per World Bank data, Mombasa had the fifth highest GDP per Capita in Kenya as at 2015 of USD 935.0 compared to a national average of USD 1,455.0, and (iii) the region benefits from a 100.0% urbanized population, which boosts demand for formal shopping outlets. For developers, Mombasa offers the best investment opportunity as per Cytonn's Retail Report 2017, due to attractive returns with average rental yields of 9.7% for neighborhood malls compared to a market average of 9.0% and also had the highest occupancy rates of 98.4% compared to a market average of 87.4%. We thus expect to witness more developers and retailers, expand to Mombasa, from Nairobi, which is sufficiently supplied, with an estimated total mall space of 5.8 mn thousand SQFT as per the report, the highest in Sub Saharan Africa, excluding South Africa.

The table below shows the performance of the retail sector in various counties;

Kenya Regional Retail Performance Summary as at November 2017

	Neighborhood Malls		Community Malls		Destination Malls	
Region	**Occupancy**	**Yield**	**Occupancy**	**Yield**	**Occupancy**	**Yield**
Nairobi	80.9%	9.7%	79.7%	9.3%	77.3%	10.3%
Kisumu	87.5%	9.7%	66.7%	8.7%		

Kenya Regional Retail Performance Summary as at November 2017

	Neighborhood Malls		Community Malls		Destination Malls	
Region	**Occupancy**	**Yield**	**Occupancy**	**Yield**	**Occupancy**	**Yield**
Mombasa	98.4%	9.7%	75.0%	6.1%		
Mt Kenya	80.0%	9 .1%				
Eldoret	90.0%	7.0%	70.0%	5.8%		
Average	**87.4%**	**9.0%**	**72.9%**	**7.5%**	**77.3%**	**10.3%**

Source: Cytonn Retail Report 2017

Infrastructure

In infrastructure, the key highlights during the week included;

- The Capital Markets Authority announced that Kiambu, Meru, and Machakos Counties might spearhead the country into an initiative that will see counties raise funds from the public for the financing of their infrastructural projects through the sale of bonds. In our view, this is a step in the right direction towards reducing external borrowing as has been called for by the IMF, and towards finding alternative financing solutions for government activities, and promoting self-reliance for counties,
- During the week, Nairobi hosted over 20 African states' representatives together with private sector stakeholders for the Africa50 conference, during which the Kenyan Government doubled its stake in the fund to Kshs 10.1 bn. Africa50 is a pan-African infrastructure fund that focuses on high-impact national and regional infrastructural projects mainly (i) Power, that is, renewable and conventional generation, power transmission and distribution, and gas infrastructure; and (ii) Transport, that is, roads, airports, ports, and logistics. The fund avails project finance by providing equity and quasi-equity while accessing preferential debt from the African Development Bank and Development Finance Institutions. The fund also provides development expertise to its members by doing feasibility studies, obtaining permits and approvals for land acquisition, negotiating contracts and so forth. This move will enable the Kenyan Government access funding for its high-growth infrastructural plans, which in our view will help to reduce its external borrowings,
- The government has committed Kshs. 40bn for the provision of requisite infrastructure within Konza City in Machakos County. The funds will be allocated to the development of infrastructure in the city which will include a 40km road network, fiber cable connectivity and electrification reticulation, and an additional Kshs 17 bn for the establishment of a data center in the city. The Konza City Complex in Makueni is set to be complete by November this year. The project is set to change the face of Machakos county, especially in terms of real estate and we expect once the project starts coming to fruition, property prices such as land to increase significantly in an area such as Athi River where currently, the land value is approximately Kshs 4.1 mn, as per our research,
- Elsewhere, the government has sourced for Kshs 4.0 bn from the Arab Development Bank for construction of sewerage systems in Murang'a County and also announced that the Northern Water Collector Tunnel (NWCT), that was implemented with the sole aim of enhancing water supply to Nairobi County by at least 140.0 mn liters per day from the Aberdares, is 55.0% complete. The project was meant to run from 2012 to 2016. However, this has been pushed to the end of 2019, as the government pushes for its high-growth infrastructural agenda meant to drive the Big 4 Agenda,
- Plans are underway for the establishment of nine major cities along the ongoing Kshs 2.5 tn LAPSSET Corridor. The towns which will include Lamu, Isiolo, Lodwar, and Mandera, are set to be game-changers in terms of economic and social development, and will include transport rails

and highways as well as international airports in Lamu and Lodwar, in addition to the Isiolo International Airport. According to LAPSSET authorities, 7 of the cities are set to be complete by 2020. The infrastructural improvement is set to open up these areas for real estate investment with the jobs to be created and improved livelihoods pushing demand for formal and decent dwelling units in these cities,

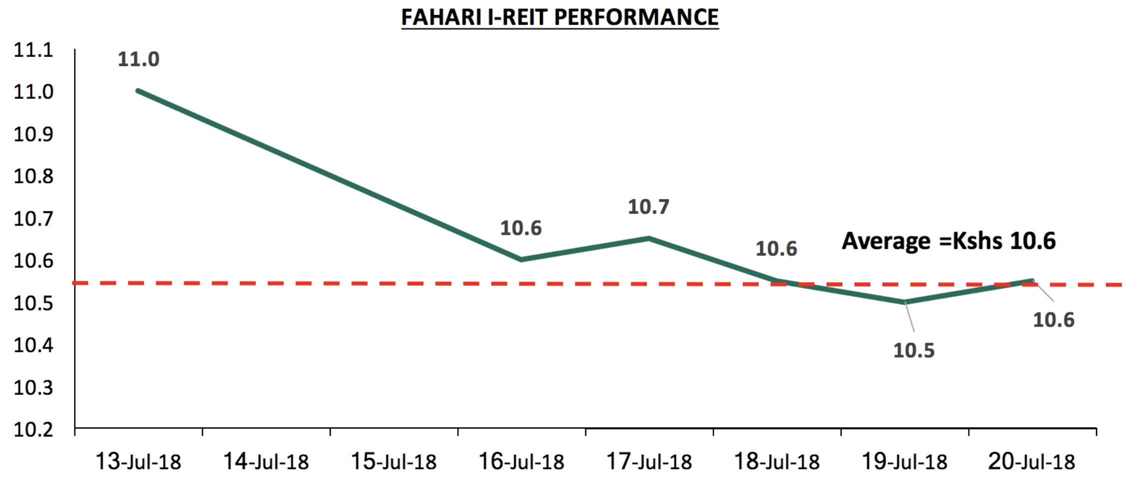
- The government also announced plans of constructing a 2km flyover, in partnership with Japanese International Co-operation Agency (JICA), that will link industrial area's Enterprise Road to the City Centre, making it the county's longest flyover. This will go a long way in easing traffic along the busy Mombasa Highway which has been an impediment to the performance of real estate sector, especially for the commercial office sector along the road due to intense traffic snarl-ups. Per Cytonn Office Report 2018, Mombasa Road came in last in 2017's performance, with average rental yields of 8.5% compared to the market average of 9.2%, and average occupancy rates of 74.2% compared to a market average of 83.9%.

Other Highlights:

- In a bid to address the shortage of accommodation in Kenyan universities, there have been calls for bidding contractors for the construction of 23,400 hostel rooms in various universities across the country including Moi University, Embu University and South Eastern Kenya Universities (SEKU). Moi University intends to build a 14,000-unit facility; Embu University will have a 4,000-bed facility while SEKU will have a 5,400-unit facility. The government has announced that the winning bids will be announced by end of 2018. Under the proposed PPP model, the hostels' developers will gain returns on their investment through a built to rent operation for 15-20 years, after which they will recover their principle and interests then hand over the facility to the respective institutions of learning,
- In the hospitality sector, KQ during the week signed a memorandum with Fairmont Hotels & Resorts, where travelers will be accommodated in the luxurious Fairmont facilities; The Norfolk, Fairmont Mount Kenya Safari Club; and Fairmont Mara Safari Club, a move aimed at benefitting both institutions in terms of attracting high end clientele and also more tourist activity for the country; Also, Air France announced plans to increase its flight's frequency from Paris to Nairobi to five times a week as from March 2019, from the current three flights. This is an indication of a positive sentiment for tourist activity, especially from Europe which as at 2017, was the largest source of tourist travels to Kenya with 517,300 departures, compared to other regions such as Africa with 285,000, Asia with 198,000 and North America with 180,700. This follows moves by other smaller airlines such as Ethiopia Airline which recently increased its flight frequency to Mombasa to twice per week, as well as KQ's launch of direct flights to the US, Mauritius, and Cape Town.

Listed Real Estate

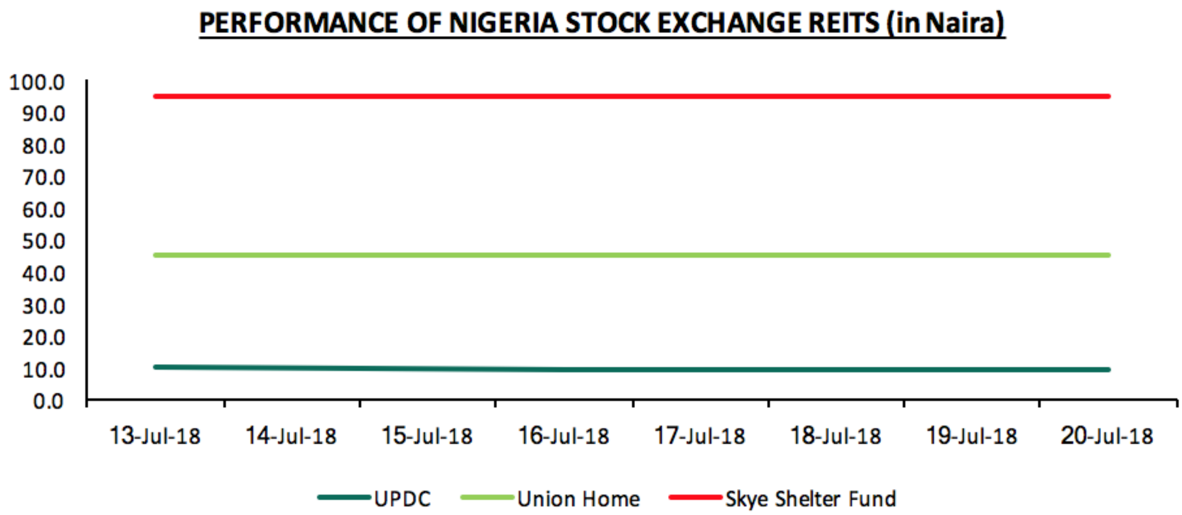
During the week, the Fahari I-REIT recorded a decline in performance with a weekly trading average of Kshs 10.6 after closing at Kshs 11.0 last week. However, this week, the REIT closed at Kshs 10.6, shedding 48.9% of its initial value. This is an indication of the continued lack of investor appetite for the instrument.



Source: Bloomberg

West Africa

In Nigeria, the REITs market continued to remain flat. Of the three REITs we cover, two, that is, Union Home and Skye Shelter, remained the same, while the UPDC REIT declining marginally by 1.0% to open the week at N9 from last week's closing of N10. Nigeria's REITs market has plateaued indicating a stalled demand for the past couple of years which is attributable to shallow investor knowledge, poor market regulation amidst a high-interest rate environment; and therefore, we expect the performance to continue on this trend for the long term.



Source: Bloomberg

We expect to see more activity in the real estate sector, especially in (i) end-user purchases, thus a rebound in the price appreciation rates, (ii) more government initiatives towards making housing affordable, and (iii) regions outside Nairobi gaining in real estate investments on the back of the increased infrastructural development.