The Fight Against Corruption in Kenya…Yet Another Chapter, & Cytonn Weekly #29/2018

Real Estate

The real estate sector continues to attract positive investor sentiments, as seen through increased activity across all real estate themes, as investors conveniently position themselves in a bid to benefit from the high returns from the sector. This week, in the retail sector, Shoprite, a South African retail outlet, announced plans to open a new store in Mombasa City Mall. The move will see Shoprite take over space that was previously occupied by struggling local retailer Nakumatt, and is part of its 2-year strategy to open 7-outlets across the country, 2 of which are expected to be opened before the end of 2018, at Westgate mall and Garden City mall in Nairobi. Shoprite joins other international retailers who have entered the Kenyan market attracted by positive fundamentals such as (i) attractive levels of GDP growth, which has averaged at 5.5% over the last 5-years and we forecast a 5.8% GDP growth for 2018, (ii) the growing middle class with increased purchasing power, (iii) shifting consumer habits that have driven the development of new shopping malls as Kenyans increasingly visit formal retail centers, (iv) Kenya's positioning as a regional and continental hub, hence witnessing an increase in multinationals operating in the country, and (v) a relatively high formal retail penetration rate of 35.0%, only 2nd to South Africa, which has a penetration of 60.0%, according to Oxford Business Group.

The table below highlights key international retailers dealing in household products in Kenya and their attempts to increase foothold over time:

International Retailers (Household Products) in Kenya

Retailer	Country of Origin	Nature of Store	No of Stores Opened	Branches Opened	Branches Planned to be Opened
Carrefour	France	Supermarket	5	Two Rivers Mall, Thika Road Mall, The Hub Karen, Sarit Centre and The Junction Mall	Village Market, Galleria Mall
Shoprite	South Africa	Supermarket	0		Westgate Mall, Garden City, Mombasa City Mall and 4 undisclosed
Choppies	Botswana	Supermarket	11	Kiambu Mall, Nairobi CBD, Nakuru, South Field Mall, Kisii etc	Signature Mall

International Retailers (Household Products) in Kenya

Retailer	Country of Origin	Nature of Store	No of Stores Opened	Branches Opened	Branches Planned to be Opened
Game	South Africa	Supermarket	2	Garden City Mall, The Waterfront Karen	
Miniso	Japan	Household and consumer goods	3	Village Market, Thika Road Mall, The Junction	The Hub Karen, South Field Mall

Source: Cytonn Research 2018

We expect the continued expansion by retailers to result in increased demand for retail space. In 2017, according to Cytonn's Kenya Retail Sector Real Estate Report 2017, the sector's performance had softened, with rental yields declining by 0.4% points to 8.3% in 2017 from 8.7% in 2016, attributable to a 2.7% points decline in occupancy rates to 80.2% from 82.9%, respectively. This was attributed to increased supply in some submarkets such as Nairobi, which recorded a 41.6% increase in supply and a tough economic environment lowering retailers returns, hence a reduction in expansion measures by retailers. Despite the expansion of retailers, we expect the performance of the sector to remain flat, given the increasing supply which is expected to grow by a 3-year CAGR of 7.3% to 6.9 mn SQFT in 2020.

In the commercial office sector, Britam Tower, a 32-storey building, owned by British-American Investments Company (Britam), is letting in Upperhill. The building whose construction started in September 2013, brought into the Upperhill market a total of 350,000 SQFT of office space. According to Cytonn Nairobi Commercial Office Report 2018, Upperhill, classified as a high rise commercial office zone, recorded a flat yield of 9.0% in 2016 and 2017, while occupancy declined by 7.8% points from 89.8% in 2016 to 82.0% in 2017, and rent decreased by 2.9% from Kshs 102 per SQFT to Kshs 99 per SQFT in 2016 and 2017, respectively. The decline in rents and occupancy was as a result of the increase in office space, through completion of projects such as Britam Towers in 2017, KCB Towers and UAP Tower in 2016. According to the report, on overall, the Nairobi office market had a total oversupply of 4.7 mn SQFT as at 2017, and recorded decreased occupancy by 3.4% points from 88.0% in 2016 to 84.6% in 2017, and rent charges dropped during the same period by 1.9% from Kshs 103 per SQFT to Kshs 101 per SQFT, attributable to increased supply, coupled by the slowed down economic environment in 2017, due the prolonged electioneering period and the interest cap that negatively affected credit supply. As per the Cytonn Annual Market Outlook 2018, we expect the occupancy and rent charges in the office sector to decline further in 2018, given the increase in office space and therefore a decline in rental yields.

Other highlights in the week include;

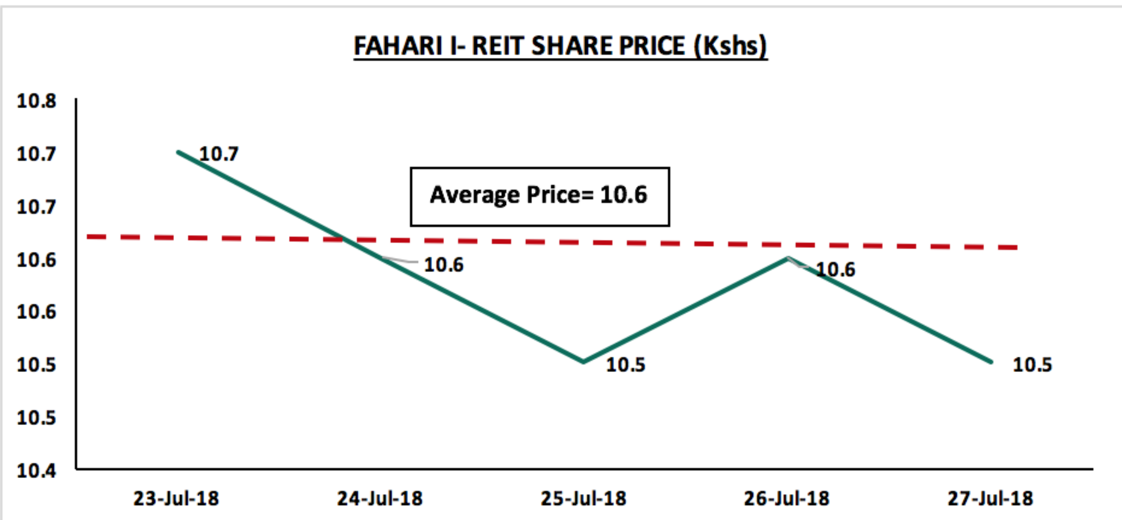
i. The first group of 20 National Construction Authority (NCA) staff have concluded the recently launched Concrete Technology Training Course, at Jomo Kenyatta University of Agriculture and Technology (JKUAT's) Center for Sustainable Materials, Research and Technology (SMARTEC). The intensive course is aimed at adopting the latest sustainable technologies in the construction industry and achieving efficiency in construction. In our view, the course will facilitate the implementation of the affordable housing pillar of the Kenyan Government's Big Four Agenda by provision of sustainable low-cost construction methods;
ii. Nairobi has been ranked the 97th most expensive home rental city in the world, according to Bloomberg World Airbnb cost Index 2018, with the average daily rate of a house accommodating two adults coming in at USD 53.0. This marks a 3.0% drop compared to the USD 54.6 recorded in 2017, attributable to the prolonged electioneering period in 2017, which prompted home owners

to reduce their rates to attract international tourists. Other African cities that were ranked in the index included; Cape Town, which recorded a rate of USD 127.0, coming in 1st in the continent and 27th globally, Lagos at a cost of USD 103.0, which is 2nd in the continent and 43rd globally, Abuja at USD 91.0 coming in at 54th globally, Harare at USD 65.0 and 85th globally and Johannesburg that was 5th in the continent and 92nd globally. The index ranks cities based on their average daily rate of renting a private home through Airbnb, an online platform that enables individuals to lease or rent private accommodations like apartments, hostels and homestays for a short-term period;

iii. In the residential sector, Housing Finance (HF) Group Limited, a mortgage provider in Kenya, intends to offload its home loans book, with the aim of benefiting from government plans to construct 500,000 affordable housing units in the next 5-years. HF plans to sell its existing loans to the Kenya Mortgage Refinancing Company (KMRC), then use the proceedings to provide new housing loans as low as Kshs 2.5 mn for about 200 new housing units over the next year. KMRC is a financial institution that is meant to support long-term lending activities by Primary Mortgage Lenders (PML) such as banks, credit unions and mortgage brokers, with the core function being to act as an intermediary between PMLs and the bond market. It enhances liquidity by sourcing funds from the capital markets and providing it to the PML. In our view, KMRC will have a significant impact on enhancing affordability of housing units by enabling PMLs to lend for longer tenors and thus have lower instalments. However, the key conditions necessary for the success of same include; i) transparent and effective regulation of KMRC by a regulatory body, ii) governance rules designed to ensure its efficiency, especially with the government as the biggest shareholder, iii) a clear and efficient land titling process, iv) sufficient support from the private sector, especially in regards to bond issuance, v) attainment of a stable and lower interest rates environment, especially on government instruments, which may crowd out MRC from accessing the needed funding, and vi) provision of affordable homes. For more details on the structure and operations of KMRC, see Cytonn Weekly #14/2018.

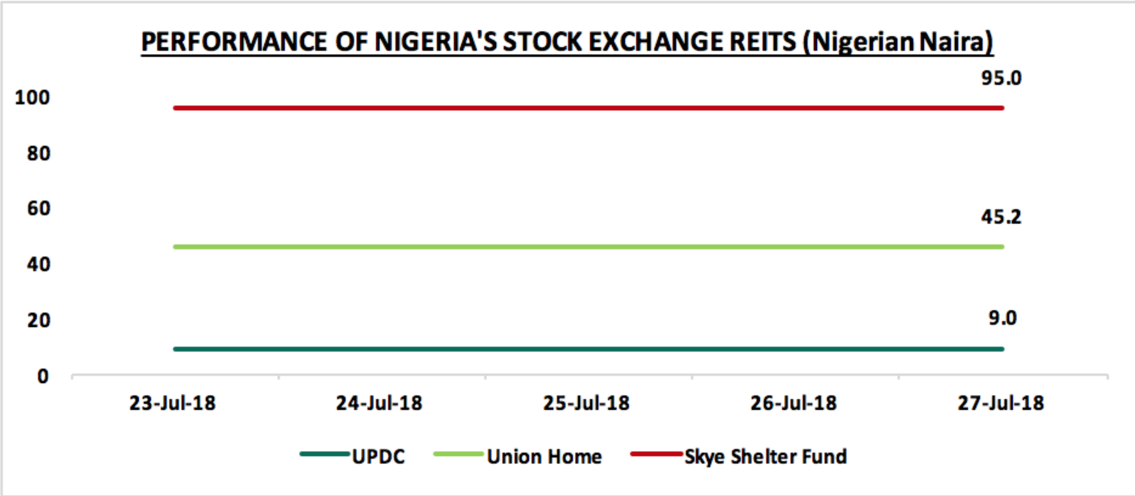
Listed Real Estate

During the week, the Fahari I-REIT recorded a slight drop in performance closing at Kshs 10.5 per share compared to the closing price of Kshs 10.6 per share last week, indicating continued lack of investor appetite for the instrument. With the current share price of Kshs. 10.6, assuming the dividend per share and the dividend payout ratio remain constant at Kshs 0.8 and 91.0% respectively, the Fahari I-REIT will have a yield of 7.1%. 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 iv) lack of institutional support for REITs.



West Africa

REITs market in Nigeria continue to flat line. The three REITs in the market plateaued this week, an indication of stalled demand for the REITs 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.



Our outlook for the real estate sector remains positive given the continued traction of economic activities evidence by; i) the growing number of international retailers in the Kenyan market, and ii) continued government focus on the 4 pillars, among them being the affordable housing agenda.