Cytonn Monthly – July 2018

Real Estate

During the month of July, the real estate sector recorded an increase in activities from both local and multinational investors, driven by:

i. The huge housing deficit of 2 mn units according to the National Housing Corporation,
ii. High returns, with the sector recording total returns of on average 24.3% p.a. over the last 5-years,
iii. An attractive macro-economic environment with GDP growth averaging at 5.5% over the last 5-years,
iv. Government incentives such as a 15% corporate tax relief to developers who construct more than 100 low cost units per annum,
v. Continued infrastructural improvements, and,
vi. The intensified government focus on the affordable housing initiative, through the Big 4 Agenda.

Industry Reports:

During the month, a number of reports were released, highlighting the real estate sector performance. The various reports are as explained in the table below;

Theme	Report	Key Take Outs
Residential	Cytonn Nairobi Metropolitan Area Residential Report 2017/18	• 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 is attributed to (i) stagnation and a decline in prices in selected markets, (ii) a spill-over effect of last year's electioneering period, and (iii) tight access to financing, with private sector credit growth falling to 2.1% as at April 2018 compared to a 5-year average of 14.0%
	Hass Consult House Price Index Report Q2'2018	• The residential market performance improved in Q2'2018 attributed to renewed investor confidence following the conclusion of the elections held last year
		• The asking prices for residential property sales increased by 3.6% q/q, while the asking rents also increased by 3.3% during Q2'2018. For more information, please see CytonnWeekly#27/2018

Theme	Report	Key Take Outs
Hospitality	**Jumia Travel Hospitality Report Kenya 2018**	• The sector contributed approximately 3.7% to the 2017 GDP, 0.6% points higher than the 3.1% in 2016, and this is expected to increase to 5.2% in 2018, • 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
	PWC Hotel Outlook 2018- 2022	• The sector will exude improvement in the next 5-years with guest nights expected to rise at a 6.9% CAGR from 3.6 mn in 2018, to 4.6 mn in 2022, and the occupancy rates to rise by 10.8% points to 58.1% from 47.3% during the same period • The sectors performance was boosted by (i) new air routes such as direct flights to the United States of America by Kenya Airways, expected to commence in Q4'2018, (ii) increased tourist arrivals, and (iii) continued marketing of the country as a destination for experiences. For more information, please see CytonnWeekly#26/2018
	Bloomberg World Airbnb Cost Index 2018	• Nairobi ranked the 97th most expensive home rental city in the world, with the average daily rate of a house accommodating two adults coming in at USD 53.0 per day, a 3.0% drop from USD 54.6 recorded in 2017, attributable to the prolonged electioneering period in 2017. For more information, please see CytonnWeekly#29/2018
Land	**Hass Consult Land Price Index Report Q2'2018**	• Land in satellite towns around Nairobi recorded a 0.5% q/q growth in land prices, outperforming Nairobi suburbs, which recorded a 0.2% q/q increase in Q2'2018. For more information, please see CytonnWeekly#27/2018

Theme	Report	Key Take Outs
Market Updates	**Knight Frank H1’2018 Market Update**	• H1’2018 performance of the real estate sector in Kenya improved, with sectors such as office and residential registering increase in rental charges by 7.1% and 0.4%, respectively
	The Kenya National Bureau of Statistics (KNBS) -Gross Domestic Product Report Q1'2018	• The real estate sector grew by 6.8% in Q1’2018, 0.7% points higher than the 6.1% growth recorded in Q1’2017 • This is despite the sector’s development activities slow down, with 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 dropping by 12.5% to 1.4 mn tonnes in Q1'2018, from 1.6 mn tonnes in Q1'2017. For more information, please see CytonnWeekly#27/2018
	Global Real Estate Transparency Index 2018	• The 2018 Global Real Estate Transparency Index by Jones Lang LaSalle (JLL) ranked Kenya at number 53 with a score of 3.3 points, up from number 61 in 2016 out of 100 nations covered. This shows improved real estate operations in the country attributed to land registry digitisation and improved infrastructure • The report covers six areas, that is Performance Measurement, Market Fundamentals, Governance of Listed Vehicles, Regulatory & Legal Frameworks, Transaction Process and Environmental Sustainability
• The reports indicate a positive outlook for the real estate sector, evidenced by improved performance and or increased activities in different sectors as follows: (i) Residential sector recorded 3.6% increase in asking prices and 3.3% increase in asking rents in Q2’2018, (ii) Hospitality sector occupancy rates expected to rise by 10.8% points to 58.1% in 2022 from 47.3% in 2018, (iii) offices recorded 7.1% increase in rental charges, and (iv) Land recorded 0.5% q/q and 0.2% q/q growth in land prices in satellite towns and Nairobi suburbs, respectively.		

During the month, activities in various real estate themes were as outlined below:

I. **Residential Sector**

The residential real estate sector continued to experience increased activities especially with regard to provision of affordable housing in Kenya. These included:

1. H.E President Uhuru Kenyatta signed into law amendments to the Income Tax Act that will allow buyers get a 15.0% tax relief up to a maximum of Kshs 108,000 p.a., or Kshs 9,000 p.m., under the newly introduced Affordable Housing Relief section. He also signed into law 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. Buyers of affordable homes will therefore receive significant financial relief related to tax burdens, hence facilitating home ownership and offtake of the affordable homes that are to be delivered over the next 5-years. For more information, please see CytonnWeekly#28/2018
2. The National Housing Co-operatives Union (NACHU) board 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 guarantees from the Kenya Mortgage Refinancing Company. The NACHU board also plans to raise funds for its mass housing initiative via the launch of a REIT. In our view, if implemented, this will enable the board, which mainly focuses on provision of decent and affordable housing and infrastructure for low-income communities, to participate in the Kenyan Government’s Big 4 Agenda, by giving it financial muscle. For more information, please see CytonnWeekly#28/2018
3. Housing Finance (HF) Group Limited, a mortgage provider in Kenya, announced plans to sell its

existing home 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. For more information, please see CytonnWeekly#29/2018

4. 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. The MoU will provide a framework for the 2 countries to engage in various business opportunities with regard to the Big 4 Agenda. For more information, please see CytonnWeekly#26/2018
5. In its efforts to drive the affordable housing initiative, the government has contracted consultancy firm, KPMG, to prepare a public participation masterplan for the planned affordable houses to be put up in all counties. The masterplan will inform the housing models to be designed as well as prices to be set for individual units in each county depending on off-takers purchasing power. In our view, this is a positive move, as it will ensure the government and private sectors understand and effectively address the target citizens' need for affordable housing, and
6. Mombasa County Land, Housing and Physical Planning Executive Hon. Edward Dzila Nyale announced plans to break ground on a Kshs 200 bn low cost housing project in August 2018. The project is set to deliver 32,000 units in the next 2-years in Mzizima, Miritini, Greenfields, Changamwe, Likoni and Nyerere estate, all in Mombasa County, through Public Private Partnership (PPP). PPP'S have various advantages such as, better public services through improved operational efficiency, timely projects delivery and within budgets, however PPP structured projects in Kenya such as construction of hostels by Kenyatta University (K.U) and Moi University are yet to kick off. The key constraints have been;
    a. Regulatory hindrances such as lack of a mechanism to transfer public land to a Special Purpose Vehicle (SPV) to facilitate access to private capital through the use of the land as security,
    b. Lack of clarity on returns and revenue-sharing,
    c. The extended time-frame of PPPs while private developers prefer to exit projects within 3-5 years, and,
    d. Bureaucracy and slow approval processes.

We therefore remain sceptical on the success of the initiative, based on the above challenges unless the National and County Governments of Kenya address them.

II. **Commercial Sector:**

In the commercial theme, the Anti-Corruption Agency is set to acquire the Integrity Centre Building, which hosts Ethics and Anti-Corruption Commission's (EACC) headquarters along Valley Road in Milimani, Nairobi. The National Land Commission (NLC) approved the acquisition of the building built on 1.2 acres from Tegus Limited at Kshs 1.5 bn. Tegus Limited is thus exiting the development at a return of 30.3% p.a. over 5-years, where they bought the development at Kshs. 400 mn in 2013 and exiting at Kshs 1.5 bn in 2018. The increase in value is driven by land capital appreciation in the area currently at Kshs 387.0 mn per acre compared to Kshs 263.0 mn in 2013 and growing at a 6-year CAGR of 22.5%. Based on market performance, the development is expected to record a rental yield of 9.6%, in line with Kilimani office performance, against a Nairobi market average of 9.3%.

In retail sector, French retailer Carrefour's franchise in Kenya, released its H1'2018 financial report, recording a 143.0% increase in revenue from Kshs 8.2 bn recorded in FY'2017 to approximately Kshs 19.9 bn in H1'2018. This is attributable to the retailer's accelerated expansion in Nairobi currently operating at the Two Rivers Mall in Runda, the Thika Road Mall at Roy Sambu, the Junction Mall along Ngong' Road, the Sarit Centre in Westlands, and The Hub and Galleria Malls in Karen.

During the month, the retail sector witnessed an increase in activities in Nairobi with a number of retailers, both local and international expanding, as shown below:

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
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

• The aggressive expansion by the retailers is being driven by; i) the increased prudent marketing methods employed by main stream retailers to attract clientele and enhance footfall, and ii) shifting consumer habits as Kenyans increasingly shop in formal retail centres and are increasingly appreciating international brands

Source: Cytonn Research 2018

III. **Industrial Sector**

Centum Investments Plc broke ground on its Kshs 100.0 bn industrial park in Kilifi County named Vipingo Investment Park, out of which 1,150-acres of the serviced plots will be set aside for manufacturing, warehouses, logistics and commercial developments. The firm is expecting to leverage on industrial park’s proximity to the port of Mombasa, Moi International Airport and the Mombasa SGR Terminal, which are located 35 km from the industrial park and the LAPPSET Corridor and Lamu Port. The industrial parks in Nairobi recorded a 0.7% points increase in rental yields from 5.4% as at H1’2017 to 6.1% in H1’2018, according to our Cytonn H1'2018 Market Review, attributed to an 11.8% increase in occupancy levels. The performance is majorly driven by (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 4-years.

IV. **The Hospitality Sector**

During the month of July, the hospitality sector continued to attract investment from both local and global players as follows;

1. Airlines continue to increase their flights frequency driven by increased tourist arrivals into the country. The following airlines announced an increase in flight frequency during the month;
   a. 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, and,
   b. 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.

2. PrideInn Hotels announced plans to open a 3-star business hotel in Mombasa comprising of 40 rooms and conference facilities that can accommodate up to 500 people. For more information, please see our CytonnWeekly#26/2018, and,
3. Kenya Airways, KQ, signed a memorandum with Fairmont Hotels & Resorts, where travellers will be accommodated in the Fairmont facilities; The Norfolk in Nairobi County, Fairmont Mount Kenya Safari Club in Laikipia County, and Fairmont Mara Safari Club in Narok County, a move aimed at benefitting both institutions in terms of attracting high end clientele and also more tourist activity for the country. For more information, please see our CytonnWeekly#28/2018.

We retain a positive outlook for the hospitality sector in Kenya driven by (i) increased demand for accommodation and other hospitality services by both local and international guests, with the number of international arrivals growing by 16.7% from 1.2 mn in 2015 to 1.4 mn in 2017, (ii) improved security following the end of the electioneering period, (iii) the revision of negative travel advisories, warning international citizens, e.g. from the United States against visiting Kenya, (iv) positive reviews from travel advisories such as Trip Advisor who ranked Nairobi as the 3rd best place to visit in 2018, (v) continued marketing efforts by the Kenya Tourism Board, (vi) Jomo Kenyatta International Airport (JKIA) ranking as the best airport in Africa and 38th globally according to Worldwide rankings by Airhelp, and (vii) improved flight operations and systems, which will make it easier and more convenient for travellers.

V. **Land**

During the month, the land sector recorded various controversial cases regarding ownership. However, we note that mitigations have been put in place therefore not disrupting development activities. The key activities are;

1. The families displaced by the Kshs 5.6 bn Eldoret Southern Bypass from Cheplaskei to Maili Tisa are set to be compensated by the National Land Commission after land acquisition is finalised, and,
2. The Nairobi County Government issued a 14-day notice on 30th July 2018 to private developers who have encroached on public land and road reserves to evict. This is to pave way for county projects that had stalled due to land-grabbing.

VI. **Infrastructure**

Infrastructural development has continued to boost growth in, not only real estate, but also other sectors in Kenya and has a significant impact on the country's macro-economic growth. This has thus led to both the National and County Governments actively undertake expansionary infrastructural initiatives.

During the month of July, we saw the launch and completion of various infrastructural projects across the country, including:

Infrastructural Project in Kenya as at July 2018

	Name of Project	Type	Length (Kms)	County	Project Value	Progress
1.	Lamu – Isiolo Road	Road	530 km	Lamu/Isiolo	Kshs 62.0 bn	To commence in August 2018
2.	Gilgil to Njoro Road	Road	23 km	Nakuru	Kshs 1.4 bn	Commenced in July 2018

Infrastructural Project in Kenya as at July 2018

	Name of Project	Type	Length (Kms)	County	Project Value	Progress
3.	Sewerage systems in Murang'a County	Sewer system		Muranga	Kshs 4.0 bn	Capital sourced from Arab Development Bank
4.	Konza City Infrastructure	Road, fiber cable connectivity and electricity reticulation	40 km	Machakos	Kshs 40.0 bn	The Kenyan Government has committed capital
5.	Konza City Infractructure	Data center		Machakos	Kshs 17.0 bn	The Kenya Government has committed capital
6.	Industrial area's Enterprise Road to the City Centre flyover	Flyover	2.0km	Nairobi	Plans underway	Plans underway

Source: Cytonn Research 2018

Other key highlights in infrastructure in July 2018 were:

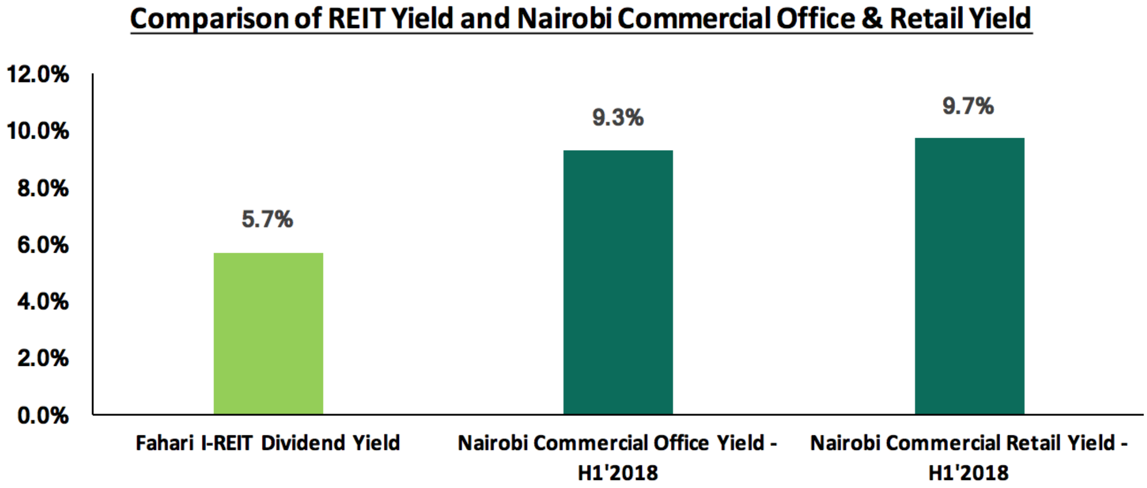
1. The Capital Markets Authority announced that Kiambu, Meru, and Machakos Counties may spearhead the country into an initiative that will see counties raise funds from the public for the financing of their infrastructural projects through the sale of bonds, and,
2. Plans are underway for the establishment of nine major cities along the ongoing Kshs 2.5 trillion 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.

The increased investment in infrastructure is an indication that the government is committed to its developmental agenda and guarantees overall growth of the Kenyan economy and a positive impact on real estate as more areas are opened up for development.

VII. **Listed Real Estate**

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

Stanlib Fahari I-REIT released their H1'2018 earnings, registering a 16.3% y/y decline in earnings to Kshs 0.36 per unit from Kshs 0.43 per unit in H1'2017, attributable to 7.7% decline in operating income outpacing the 0.9% decline in operating expenses. The operating income decline is attributable to an 18.1% decline in interest income to Kshs 41.9 mn from Kshs 51.1 mn in H1'2017, coupled with a 2.1% decline in rental income to Kshs 135.1 mn from Kshs 138.0 mn in H1'2017. The company, however, noted that the decline in rental income is attributable to a temporary increase in vacancies, coupled with some tenants bargaining for reduced rentals upon the renewal of leases, despite the additional 1-month rental income contribution by their newly acquired property 67 Gitanga Place, which was acquired in May 2018. For example, one of the properties owned by the REIT, the Greenspan Mall had an occupancy of 74.0% in 2018 from 90.0% in 2017, which is 5.5% points lower than the Nairobi retail market average at 79.5%. Property expenses also declined by 9.5% to Kshs 38.1 mn from Kshs 42.1 mn in H1'2017. The faster decline in property expenses compared to rental income led to a decline in the property operating expense ratio to 28.2% from 30.5% in H1'2017. The I-REIT recorded a dividend yield of 5.7%, based on Kshs 10.5 market price per share as at 1st August 2018, assuming the dividend pay-out ratio remains at 91.0%, similar to the FY'2017 pay-out. The yield is relatively low compared to brick and mortar assets with commercial retail and office achieving rates of 9.7% and 9.3% in H1'2018, respectively, as shown below;

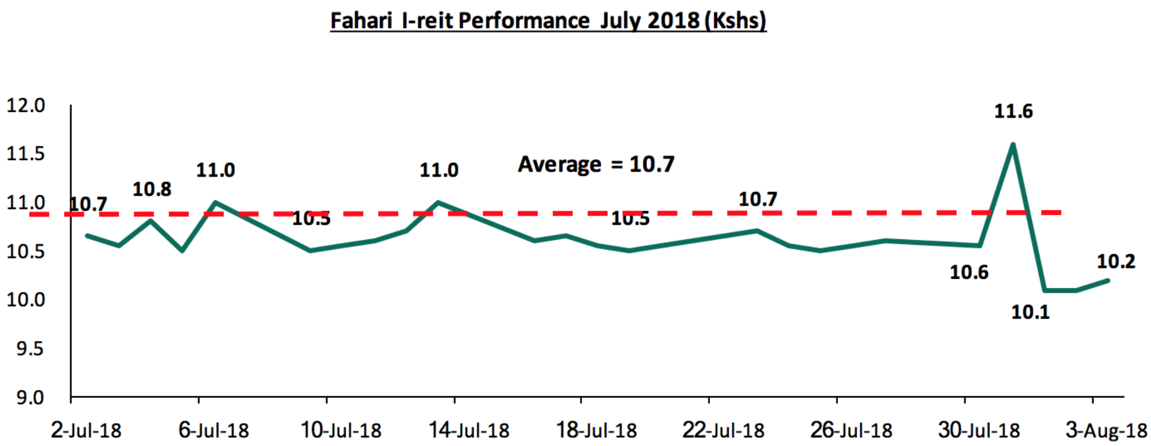


Source: Cytonn Research 2018

For a more comprehensive analysis on the REIT H1'2018 performance, see our Stanlib Fahari I-REIT Earnings Note.

On the bourse, during the month, Stanlib's Fahari I-REIT price rose by 2.7%, closing at Kshs 11.6 per share from Kshs 11.3 per share at the end of June 2018, but still trading at a 42.0% discount from its listing price of Kshs 20.0 in November 2015. During the past week, the Fahari I-REIT price declined by 3.8% closing at Kshs 10.2 per share attributable to the 16.3% Y/Y decline in earnings in H1'2018 hence negative investor sentiments. In addition, at Kshs 10.2 per share as at 3rd August 2018, the REIT is trading at a discount of 48.7% to its Net Asset Value per share, which currently stands at Kshs 19.9 as per H1'2018 reporting. The prices for the instrument have remained low averaging at Kshs 10.7 in July 2018 largely due 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 and Fusion REIT (FRED), iii) inadequate investor knowledge, iv) the poor performance of Fahari I-REIT recording a dividend yield of 5.7% compared to office and retail at 9.3% and 9.7%, respectively, and v) lack of institutional support for REITs. We expect the REIT to continue trading at low prices and in low volumes.

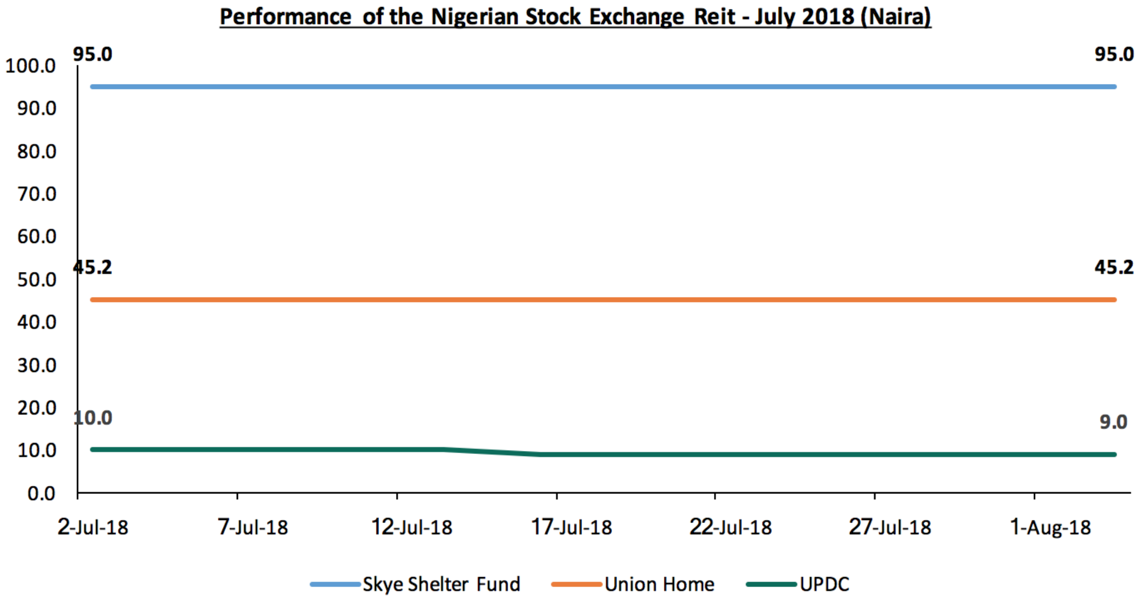
The graph below shows the REIT's performance in July 2018;



Source: Bloomberg

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

In Nigeria, the REITs market continued to remain flat. Of the three REITs we cover, two, that is, Union Home and Skye Shelter's prices, remained unchanged, while the UPDC REIT declined by 10.0% to NGN 9 from NGN 10 at the beginning of the month. 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 retain a positive outlook for the real estate sector in Kenya driven by: (i) positive demographic trends such as rapid urbanization that currently stands at 4.4% against a global average of 2.1%, and rapid population growth rates of 2.6% against a global average of 1.2%, (ii) stable macro-economic environment, (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).

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