Kenya's IMF Standby Facility, & Cytonn Weekly #31/2018

Real Estate

Residential:

During the week, Nairobi Lands, Urban Renewal and Housing County Executive, Mr. Charles Kerich, announced that implementation of the Nairobi Urban Regeneration Plan is set to start in September 2018. The project will commence in Pangani Estate, where a developer known as Technofin (details and real estate track record have not been disclosed), will break ground. SS Malonza, a local advocate, will be the county's legal consultant. In the plan, Nairobi County will partner with various developers, providing them

with free land. The developers will then finance and construct the houses, 70.0% of which will be in the affordable housing bracket, with a unit price ceiling of Kshs 3.0 mn while the developers will be allowed to charge a premium on the remaining 30.0% of the units.

As covered in our Cytonn Weekly #21/2016, the programme targets to redevelop Ngara, Pangani, Ngong Road, Suna, Uhuru, and Jevanjee-Bachelor estates in its first phase, resulting in the delivery of approximately 14,000 houses.

The details of the projects and estates are outlined below:

The Nairobi Urban Redevelopment Plan

Estate	Acreage	Number of Units	Contract Sum (Kshs)	Developers	Developers' Real Estate Track Record
Jevanjee	7.6	1,500	9.1 bn	Jabavu Village Ltd	Hilton Hotel Upperhill (ongoing)
Ngong Road Phase I	21.5	2,520	24.0 bn	Erdemann	Greatwall Apartments, Lake Basin Mall Kisumu
Ngong Road Phase II				Lordship Africa	88 Condominium, Karen Hills
New Ngara	4.1	1,500	9.0 bn	KCB	Kencom Sacco Homes Runda
Pangani	5.2	1,000	5.2 bn	Technofin	Undisclosed
Uhuru Estates	7.5	-	3.5 bn	Stanlib Group	Runs Kenya's only Real Estate Investment trust (Fahari I-REIT)
Old Ngara	5.2	1,050	7.0 bn	Kiewa Group	Undisclosed

The Nairobi Urban Redevelopment Plan

Estate	Acreage	Number of Units	Contract Sum (Kshs)	Developers	Developers' Real Estate Track Record
Suna Road	5.0	1,050	3.5 bn	Directline Assurance Limited	Undisclosed

Online Source

The Nairobi Urban Redevelopment plan, which was launched in 2016, has had challenges kicking off mainly due to:

?. Inadequate development funds,
i. Lack of proper land documents for some of the City Council-owned land parcels,
ii. Issues of transparency and accountability, especially in the face of changing government regimes, and most recently,
iii. Tepid interest from private developers due to the challenging Public-Private Partnership (PPP) model in Kenya.

We expect the project to kick off as planned as most of these challenges have been solved as, the County Government has since then obtained titles for the land parcels to be redeveloped, the new government has also settled into office, and the Special Purpose Vehicles (SPVs) for the various projects set. Additionally, seasoned and well-known real estate players with private funding have been on-boarded, including Lordship Africa, KCB, Stanlib, and Jabavu Limited. Under the model, the government will be tasked with (i) monitoring all necessary approvals, (ii) improving support infrastructure, and more importantly (iii) provide the development land. On the other hand, the private developers will be tasked with (i) designing the projects to ensure highest and best use of the land, to ensure maximum utilization, (ii) financing the development and seeing their construction through, and (iii) selling or exiting of the projects. In our view, the government should employ transparency in the programme so as to ensure accountability of all parties involved. The developments should also be closely monitored, and progress tracked, to facilitate timely delivery.

During the week, The Kenya Mortgage Refinancing Company (KMRC) continued to gain much-needed financial support with Co-operative Bank announcing that it will invest Kshs 200.0 mn worth of share capital in support of the facility. The facility is also expected to receive Kshs 15.1 bn seed funding from the World Bank, and Kshs 1.5 bn from the National Treasury, with the state retaining maximum ownership of 20.0%. KMRC, a mortgage liquidity facility established earlier in 2018, was created with a target of supporting Kenya's mortgage industry by creating sustained liquidity for mortgage lenders. This will enable end users to access mortgages at lower interest rates and with longer tenors of up to 30 years. Access to mortgages

in Kenya remains low, mainly due to (i) low-income levels that cannot service a mortgage, (ii) soaring property prices, (iii) high-interest rates and deposit requirements, which lock out many borrowers, (iv) exclusion of employees in the informal sector due to insufficient credit risk information, and (v) lack of capital markets funding towards real estate purchases for end buyers. According to Central Bank of Kenya, there were only 24,085 mortgages in Kenya as at December 2016, out of a total adult population of approximately 23.0 mn persons, with the mortgage to GDP ratio standing at 2.7%, compared to countries such as South Africa and USA, which have a ratio of above 30.0% and 70.0%, respectively. The Mortgage Refinancing Company is tipped to increase the number of active mortgages in Kenya by about 100.0% to at least 50,000 by 2022. However, despite the financial support, as stated in our April 2018 topical, other factors that are necessary to actualize KMRC's operations and goals include;

i. Transparency and effective regulation of the facility by an independent regulatory body to avoid fraud,

ii. Governance rules designed to ensure its efficiency, especially given that the government is the largest shareholder,
iii. A clear and efficient land titling process,
iv. Sufficient support from the private sector, especially in regards to bond issuance, and
v. Provision of affordable homes.

Co-operative Bank's move is commendable as it sets the path for other private institutions and investors while also validating the facility, which is bound to attract more private sector investment.

Commercial:

The retail industry saw a flurry of activity during the week, with renowned German engineering and electronics firm, Bosch, launching its first store in Central and East Africa in Westlands, at The Oval. The retailer intends to have Nairobi as its main regional hub before further expansion in the Central and East African market. The retailer also has offices in Egypt, Morocco, Nigeria, Angola and Mozambique, and a production plant in South Africa.

Also, fast-food chain Subway, announced plans to open 4 more branches in Nairobi. The food chain, which is looking to occupy spaces of 400-1,200 SQFT within the CBD, Upperhill, Lavington, and Mombasa Road, currently has 9 outlets in Kenya, and operations in 110 countries. Similarly, Chicken Inn parent group, Innscor, based in Zimbabwe announced plans to expand its footprint within the Kenyan market, in a USD 4.3 mn investment that is also aimed at increasing its operations in Zimbabwe and Mauritius. The fast-food chain has 121 local outlets, including its other chains such as Bakers' Inn, Pizza Inn, and Creamy Inn. This reaffirms Nairobi's attractiveness as a regional hub for investment, which is a positive sign especially for real estate investments. (*A detailed analysis of the entry of international retailers in Kenya is covered in a note below*)

Hospitality:

Regional airline, Jambojet announced plans to increase the frequency of its Nairobi-Kisumu flights by 20.0%, to 24 flights from the current 20 per week. Jambo Jet is the latest airline to increase flight frequency in Kenya, following increments by notable airlines such as;

?. Air France, which increased their flight frequency between Paris and Nairobi by 66.7% from 3 per week to 5,
i. Ethiopian Airline, which doubled its Mombasa flights from Addis Ababa, and,
ii. Local jet airline Silverstone, which has recently launched daily flights to Mombasa and the Maasai Mara.

The increase in the frequency of flights indicates a gain in popularity of air travel, which we attribute to;

?. An increase in holiday travels, as well as an increase in MICE conferences; with local conferences held rising by 2.4% to 3,844 in 2017 from 3,755 in 2016, as per the KNBS Economic Survey,
i. Improved infrastructure, such as upgrading airports to international status, such as in Kisumu, and Isiolo, as well as construction of another terminal at the Jomo Kenyatta International Airport (JKIA),
ii. A rise in living standards as the middle-income class grows, and,
iii. Competitive fares as a result of a rapidly growing air travel industry, for instance, Jambojet's one-way ticket from Nairobi to Kisumu costs as low as Kshs 3,500, 133.3% higher than a one-way ticket for a bus; yet, a flight reduces the trip time by 966.7%, to 45 minutes from 8 hours by a bus.

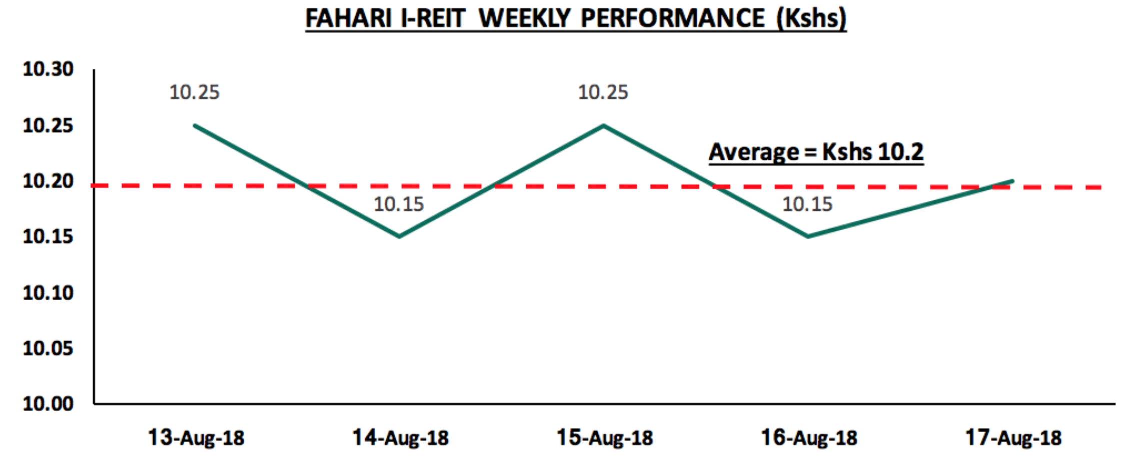
Driven by the above factors, we to continue witnessing an increase in air travel locally that will necessitate further improvement of infrastructure, thus opening up new areas for real estate investments. Kisumu County also attracts a significant number of visitors with sites such as Kisumu Museum attracting the third highest number of visitors in Kenya p.a., after Nairobi National Park and Fort Jesus, as per The KNBS Economic Survey 2018. Additionally, the county has seen an improvement in its accommodation sector with 4-star hotels such as Acacia coming to the market in the last two years. Infrastructural developments in recent years have also improved ease of access to the city, further boosting its hospitality and tourism sectors. These developments include; upgrading of the airport to international status, and development of roads such as the Nyamasaria and Kisumu-Kisian Highway.

Other highlights of the week include:

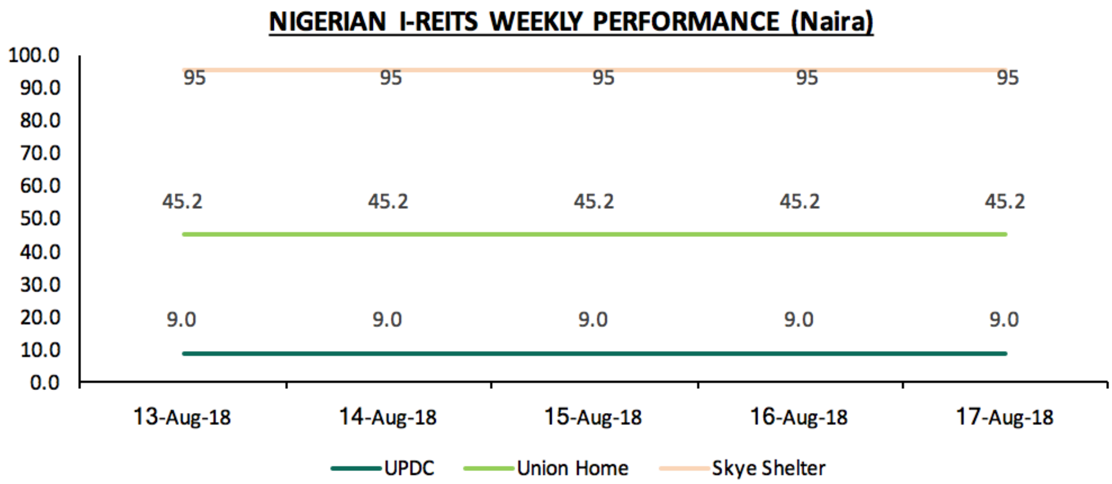
- Superior Homes, the master-planned developer where Cytonn holds a strategic stake, completed the construction of its Nakuru (Lake Elementaita) holiday homes facility, seated on a 12-acre development named Lake Elementaita Mountain Lodge, consisting of 33 standard villas, 13 villa suites, and four executive villas, as well as a recreation and conference facility. The Kshs 800.0 mn project, is situated along Nairobi-Nakuru highway. According to Cytonn Hospitality Report 2016, Nakuru recorded an Average Daily Rate (ADR) of Kshs 218, compared to the national average of Kshs 212, indicating an opportunity for investors; while it came in fourth, in terms of investment opportunity, after Maasai Mara region, Nairobi, and Mt Kenya regions,
- In Kisumu, developers Victoria Housing Ltd unveiled a 12-acre project that will see the delivery of 55 units comprising of 2–bedroom apartments, and 3 & 4-bedroom detached units with price points of Kshs 10.0 mn, Kshs 17.0 mn and Kshs 20.0 mn, respectively, in the Kanyakwar Suburb. As per Cytonn Kisumu Investment Opportunity Report, the residential sector in Kisumu had average rental yields of 5.1%. Apartments outperformed detached units, recording average rental yields of 8.5%, and relatively high uptake of 23.4%, compared to detached units' 3.8% and 16.1% for rental yields and uptake, respectively,
- Kenya's Deputy President William Ruto, launched the construction of the 70 Km long Ngong-Suswa Road. The project, which is expected to take 2 years, is estimated to cost Kshs 4.0 bn. This is bound to enhance accessibility in the county, especially in the parts of Kajiado County where the road traverses, thus, opening up areas for real estate investments.

Listed Real Estate:

The Fahari I-REIT closed the week at Kshs 10.2, which was the same last week's average, and a marginal decline from the week's opening price of Kshs 10.25. During the week, it recorded an average of Kshs 10.2, which is a decline of 19.1% from last year's trade price of Kshs 12.61 during the same period. This is as their H1'2018 earnings results registered a 16.3% y/y decline in earnings to Kshs 0.36 per unit from Kshs 0.43 per unit in H1'2017. The decline in performance is attributed to a temporary increase in vacancies, coupled with some tenants bargaining for reduced rentals upon the renewal of leases, leading to a reduction in rental income, thus resulting to low trade volumes, as an indication of low investor appetite.



Source: Bloomberg



Source: Bloomberg

The Nigerian I-REIT market remained unchanged, with Union Homes, Skye Shelter, and UPDC, retaining a price per share of N45.2, N95 and N9, respectively, throughout the week. This is as a result of inadequate investor knowledge about the market hence low investor interest in the instrument, and poor valuation of the market, which leads to lower levels of demand by potential investors.

We expect to continue attracting international investors, on the back of continued infrastructural improvements, expanding middle class and sustained by the relatively high real estate returns, which have a 5-year average of 24.3% p.a.

International Retailers Mini Note

Kenya's retail sector has been vibrant over the past few years, and we have witnessed the sector revolutionize from a predominantly informal sector to having the second highest penetration of formal retail in Africa with a 30.0% penetration of formal retail after South Africa with 60.0%. The growth of the sector has in turn, attracted global interest from renowned international retailers such as Carrefour, fast food restaurants such as Yum! Brands – the parent company of KFC and Pizza Hut, as well as select luxury

brand stores such as Swarovski, a crystal jewelry store; and luxury car brands such as Porsche and Bentley, just to name a few.

In this mini note, we look at:

A. Notable international retailers who have penetrated the Kenyan market within the last 6-years,

B. Factors that are driving these global giants' growing interest in Kenya, and,
C. Conclusion on the impact this is bound to have on the local market.
D. The table below shows some of the notable shops and brands that have set up shop in Kenya within the last 6 years:

Select International Retailers in Kenya

Outlet	Parent Company	Origin Country	Year of Commencement	No. of Local Outlets	Number of Global outlets
Food Chains					
Mugg & Beans	Famous Brands	South Africa	2017	1	220
Burger King	Restaurants Brand International	United States	2017	4	16,859
Pizza Hut	Yum! Brands	United States	2016	2	16,796
Dominos	Bain Capital, Inc.	United States	2014	3	15,000
Coldstone	Kahala Brands	United States	2014	8	1,100
Chicken Inn/Pizza Inn/Bakers' Inn/Creamy Inn	Innscor Africa	Zimbabwe	2013	121	398
KFC	Yum! Brands	United States	2012	19	20,404
Subway	Doctor's Associates, Inc.	United States	2011	8	44,834
Hypermarkets					
Miniso	Miniso	Japan	2017	6	>2,600
Choppies	Choppies Enterprises Limited	Botswana	2017	12	212
Carrefour	Majid Al Futtaim Holding	France	2016	6	12,300
Game	Massmart	South Africa	2016	1	424
Other Stores					
LC Waikiki	LC Waikiki Retailing Ltd	Turkey	2017	2	881
Swarovski	Swarovski Group	Austria	2017	1	2,800
Bosch	Robert Bosch Stiftung GmbH	Germany	2018	1	>440
Woolworths	Woolworths Holdings Ltd	South Africa	2012	12	1,400
Incoming Retailers					

Select International Retailers in Kenya

Outlet	Parent Company	Origin Country	Year of Commencement	No. of Local Outlets	Number of Global outlets
Shoprite	Shoprite Holdings Ltd	South Africa	*		>500

Source: Online, Wikipedia

** Shoprite is expected to enter the Kenyan market this year; taking up space in Garden City and Westgate malls*

B. Factors driving the continued entry of these international retailers to Kenya are:

Increased Disposable Income: This has been as a result of an expanding middle class. According to KNBS Economic Survey 2018, private consumption expenditure recorded the highest growth, since 2013 when it recorded 8.4%, in 2017 by 7.0%, compared to 4.7% in 2016, 5.2% in 2015, and 4.3% in 2014,

a. **Stable Economic Growth:** In addition to being a diversified economy, the grip on the nation's inflation rates, interest rates and prices has been relatively stable, compared to other countries, thus creating an enabling environment for the retailers to make desirable profits,
b. **Positive Demographic Dividend**: The country's population has been steadily growing at approximately 2.6% p.a. with a rapid urbanization rate of 4.3%, in comparison to the global 1.2% and 2.1%, respectively. This has led to a demand for retail outlets especially in growing urban regions,
c. **Provision of high-quality spaces** in line with international standards as well as infrastructure,
d. **Rise in Dollar Millionaires and Ultra-Wealthy Individuals:** According to Knight Frank's Wealth Report 2018, Kenya's ultra-high net-worth individuals (UHNWI), worth USD 50.0 mn, excluding their primary residence in Kenya, increased by 13.0% to 90 in 2017 from 80 in 2016, while high net-worth individuals (HNWI) increased by 16.2% to 1,290 from 1,110, during the same period, with the number of wealthy Kenyans expected to increase by 58.3% on average by 2022. This specifically leads to an increase in demand for luxury brands,
e. **Increased Demand for International Brands:** This is due to consumer's change in tastes and preferences,
f. **Insufficient Competition Due to Struggling Local Retailers:** Such as Nakumatt and Uchumi, creating an easy gap for the international retailer's expansion, Carrefour, has taken up 4 of the 9 malls vacated by Nakumatt within Nairobi.

C. The entries have **impacted** the local sector in the following ways

- Developers are now keen to develop high-quality retail spaces that conform to international standards so as to attract multinational firms,
- Intense competition for footfall between local retailers and the international retailers,
- High retail sector yields as multinationals are willing to pay a premium for good space; with the retail real estate theme recording average retail yields of 9.7% in H1'2018, compared to 5.4% for residential and 9.3% for commercial office, and
- Consequently, this has led to an increase in retail construction activity both by local and international investors, with Nairobi's mall space growing by an 8-year CAGR of 15.9% to approx. 6.5 mn SQFT as at 2018, from 2.0 mn SQFT in 2010. Other counties such as Kiambu, and Mombasa, also continue to attract foreign retailers evidenced by Choppies' superstore in Kiambu, and LC Waikiki's plan to expand to Mombasa. Kiambu and Mombasa are estimated to have a mall

space of 0.9 mn SQFT, and 1.4 mn SQFT, respectively.

In our view, these entries reaffirm Kenya's position as one of the leading regional hubs for investments in the continent. We therefore expect to see continued interest from foreign players and investors on the back of, (i) continued infrastructural improvements, (ii) attractive returns, and (iii) expanding middle-class, and hence growing disposable incomes

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