Status of Rate Cap Review in Finance Bill, 2018, & Cytonn Weekly #32/2018

Real Estate

During the week, Double Win Company Limited, a real estate firm, announced plans to put up a residential complex, along Argwings Kodhek Road. The project will comprise of two blocks of 14 storeys each, and will have 168-apartments; 2 and 3 bedroom units. According to Cytonn Nairobi Metropolitan Area Residential Report 2017/2018, Kilimani area had average total returns of 13.9%, 5.7% points higher than the market average of 8.2%. The attractive returns are as a result of Kilimani's proximity to key business districts and nodes such as CBD, Upperhill and Westlands, and its vast supply of social amenities such as malls including Yaya Centre, and continued infrastructural development as seen through the upgrading of Ngong' Road.

Below is a table showing the performance of apartments in the upper- mid end market;

(all figures in Kshs unless stated otherwise)

Nairobi Metropolitan Area Apartments Performance 2017/2018 - Upper Mid-End Performance

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales (%)	Average Rental Yield (%)	Average Price Appreciation (%)	Average Total Returns (%)
Kilimani	131,594	621	25.6%	6.1%	7.8%	13.9%
Riverside	121,295	508	21.7%	5.4%	3.8%	9.3%
Spring Valley	144,169	647	24.1%	5.9%	3.1%	9.0%
Loresho	109,426	558	23.2%	6.0%	2.7%	8.7%
Upperhill	141,905	593	23.7%	5.2%	3.4%	8.6%
Westlands	132,128	636	26.1%	6.0%	2.3%	8.3%
Kileleshwa	124,549	629	23.6%	6.0%	1.0%	7.0%
Parklands	113,908	641	25.8%	7.3%	(1.3%)	5.9%
Average	**127,372**	**604**	**24.2%**	**6.0%**	**2.9%**	**8.9%**

- ***Kilimani had the highest returns at 13.9% owing to its proximity to key business districts and nodes such as CBD, Upperhill, and Westlands, and also its vast supply of social amenities such as neighborhood malls and good infrastructure and incoming infrastructure such as the upgrade of Ngong' Road,***

Source: Cytonn Research

We expect continued investments in the residential sector driven by; (i) the rapid population growth at an average of 3.3% in Nairobi, compared to the national average of 2.6%, (ii) the introduction of innovative financial credit solutions such as the Kenya Mortgage Refinancing Company(KMRC) and National Housing Development Fund(NHDF), which are expected to create a better credit financing environment for developers and end buyers, (iii) continued infrastructural development activities including, revamping of old roads such as the Ngong' Road whose Phase 2 is currently undergoing expansion, thus opening up new areas for investment, and (iv) the relatively high urbanization rate in Kenya at 4.4% compared to the global average of 2.1%, necessitating the need for adequate housing in the urban areas.

During the week, Central Bank of Kenya (CBK) released the Bank Supervision Annual Report 2017, which included a residential mortgage market survey. The survey gave updates on the size of mortgage portfolio, mortgage loan characteristics, mortgage risk characteristics and the obstacles to the development of the mortgage market.

The main take-outs from the survey include;

i. The value of mortgage loan assets outstanding increased by 1.5% from Kshs 219.9 bn in December 2016, to Kshs 223.2 bn in December 2017, attributable to the increased appetite for home ownership as opposed to rentals;
ii. The number of mortgage loan accounts increased by 8.8%, from 24,059 accounts in December 2016 to 26,187 accounts in December 2017. This is also attributable to the increased appetite for home ownership as opposed to rentals;
iii. On the mortgage loan characteristics, the interest rate charged on mortgages averaged at 13.6% in 2017, compared to 18.7% in 2016, excluding bank and other charges. This decrease is attributable to the interest rate capping effected in September 2016. The capping has resulted in increased appetite for mortgages as more borrowers perceived home loans to be more affordable;
iv. The maximum loan as a percentage of property value, also referred to as the loan to value, remained constant at 90.0%, for majority of the banks both in 2016 and 2017;
v. The main factors considered by institutions before approving mortgage loans for households were as follows: (i) sustainability of the borrower income, depending on the terms of payment, (ii) the credit history of the borrower, (iii) property location and ease of sale in the case of default, (iv) the ability and willingness of the buyer to repay the loan, and (v) legitimacy of the property;
vi. On lending to businesses, the survey indicated that the main risk factors examined by institutions include: (i) the profitability of the business owner, (ii) the economic stability of the business, (iii) the experience of the management in the running of the particular business, (iv) the length of the business operation, (v) the business's ability to pay the loan from its cash flows, and (vi) the business's credit history and the status of existing debts;
vii. The main obstacles facing the mortgage market in 2017 included: (i) the high cost of housing units, (ii) the high cost of land for construction, high incidental cost, and (iii) difficulties with property registration, unlike in 2016 where low-income levels were cited as the major impediment;
viii. The financial institutions highlighted several measures which on implementation, are expected to result in the improvement of the mortgage market. These include: (i) government incentives for low cost housing solutions, (ii) availability of affordable long term loans, (iii) reduction of stamp duty for first time owners, and (iv) the availability of low cost housing solutions; and;
ix. In 2018, the mortgage market is expected to record increased activities, driven by: (i) the political calm following the conclusion of the prolonged electioneering period, and (ii) the Kenyan Government's affordable housing agenda.

This information is summarized in the table below;

6 year Mortgage KPI Trends in Kenya

Year	2011	2012	2013	2014	2015	2016	2017	6 Year CAGR
Outstanding Mortgages (Kshs)	90.4 bn	119.6 bn	138.1 bn	164.0 bn	203.3 bn	219.9 bn	223.2 bn	16.3%
Non- performing Mortgages (Kshs)	3.0 bn	6.8 bn	8.5 bn	10.8 bn	11.7 bn	22.0 bn	27.3 bn	44.5%
Average Mortgage Size (Kshs)	5.6 mn	6.4 mn	6.9 mn	7.5 mn	8.3 mn	9.1 mn	10.9 mn	11.7%
Number of Mortgages	16,029	18,587	19,879	22,013	24,458	24,058	26,187	8.5%
Annual Change in No. of mortgages		16.0%	7.0%	10.7%	11.1%	(1.6%)	8.8%	

· ***The number of mortgage loan accounts increased by 8.8%, from 24,059 accounts in December 2016 to 26,187 accounts in December 2017, attributable to the increased appetite for home ownership as opposed to rentals***
· ***The value of outstanding mortgages recorded a 6 year CAGR of 16.3%, from 2011 to 2017***

Source: Central Bank Report

The mortgage market bucked the effect of the Banking Amendment Act, 2016 that constrained performance in the financial services and real estate sectors leading to a decline in:

i. Private sector credit growth, which declined by 21.9% points from 25.8% in June 2014 to 3.9% as at December 2017 , and
ii. Returns in the real estate sector which declined by 3.2% points from 12.6% in 2016 to 9.4% in 2017.

In 2016, the Banking Amendment Act 2016, negatively affected the mortgage market, with the number of mortgages declining by 1.6% from 24,458 accounts in 2015 to 24,058 accounts in 2016. This is attributable to the strict lending by banks to borrowers (private sector) whom they considered riskier, and instead focused on lending to the government. This resurgence is evidence of the high demand for residential real estate developments.

Going forward, we expect the sector to continue on an upward trajectory driven by: (i) the housing deficit that currently stands at 2.0 mn units according to the National Housing Corporation (NHC), (ii) positive demographics such as a high population growth rate of 2.6% recorded in 2017 1.4% point higher than global averages of 1.2%, and (iii) the relatively high urbanization rate in Kenya at 4.4% recorded in 2017 compared to the global average of 2.1%, necessitating the need for adequate housing in the urban area.

Infrastructure Sector

Transport and Infrastructure Cabinet Secretary, James Macharia, during the Architectural Association of Kenya Annual Convention at Pride Inn Hotel, Nairobi, announced that the Kenyan Government is set to sign a contract next month with China Communications Construction Company (CCCC), for the construction of the 262 Kilometre phase 2B of the Standard Gauge Railway (SGR), which is set to cost Kshs 380.0 bn, and will run from Naivasha to Kisumu. He also noted that the entire SGR (both Phase 1 & 2) budget stands at Kshs 800.0 bn. On completion, we expect that the railway line will open up areas such as Narok, Bomet, Kericho and Kisumu.

Below is a summary of the areas traversed by, distance in kilometres and costs of the various phases of the SGR:

Kenya's Standard Gauge Railway

Phases		Length (Km)	County	Project Cost (Kshs)	Contractor	Status
Phase 1		472	Mombasa and Nairobi	Kshs 327 bn	China Road and Bridge Corporation (CRBC)	Completed and Opened in May 2017
Phase 2	A	120	Nairobi, Kajiado, Nakuru, Kiambu, Naivasha and Narok	Kshs 150 bn	China Road and Bridge Corporation (CRBC)	Commenced in March 2018
	B	262	Naivasha, Narok, Bomet, Nyamira and Kisumu	Kshs 380 bn	China Communications Construction Company (CCCC)	Contract with the contractor to be signed in September, 2018
	C	107	Kisumu, Busia and Malaba	Pending		

Source: Cytonn Research, 2018

According to the Cytonn's H'1 2018 Market Review, the construction of the SGR, in addition to other state's infrastructural initiatives, will boost the growth of the country's macro-economic variables such as the Gross Domestic Product (GDP), through revenue generation, creation of employment, and ease of doing business. Infrastructure opens up areas for real estate development, through increasing accessibility and access to essential services such as water, electricity and a sewerage system. This attracts more investors to venture into the real estate sector as evidenced by the increased traction of economic activities in areas such as Thika following the completion of the Thika Superhighway in 2012, which has resulted in the development of malls such as Garden City Mall, Thika Road Mall, and master planned developments such as Tatu City and Riverrun Estates.

We expect continued investment activities in the infrastructural sector by the government, as it intensifies efforts to improve infrastructure in the country in a bid to address the huge deficit in infrastructure including rail, roads and ports. This is evidenced by the significant 2017/2018 national budget allocation of Kshs 134.9 bn, which is 22.2% of the budget, to infrastructural development.

Other highlights of the week include;

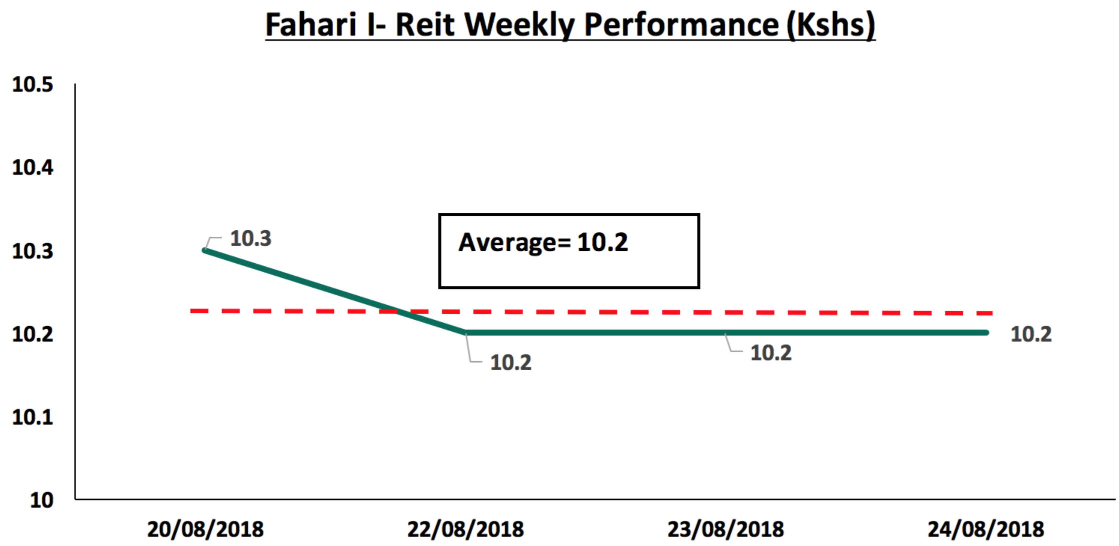
i. Kilifi County Government signed an agreement with the Kenyan National Government, cementing a partnership that will see the construction of at least 2,000 housing units within the next year, in support of the affordable housing initiative of the government's Big Four Agenda. According to the Housing Permanent Secretary, Charles Hinga, the projects will be undertaken in; Kilifi, Mtwapa and Malindi, where development land has already been identified. In addition, the project will be funded by the government through the Kenya Urban Support Programme;
ii. Java House Group, a local restaurant chain, announced plans to open 3 stores in Kigali, Rwanda,

which will bring the total number of stores in Rwanda to four, in the next 6-months. According to the Chief Executive Officer, Paul Smith, the move is line with its expansion strategy, with the main target countries being Nigeria, Uganda and South Africa. In Uganda, the restaurant chain aims to increase the number of its branches to approximately 15, in the next 3-years, from the current 6 branches. It also targets to open an undisclosed number of branches in Nigeria and establishment of a franchise model approach in South Africa;

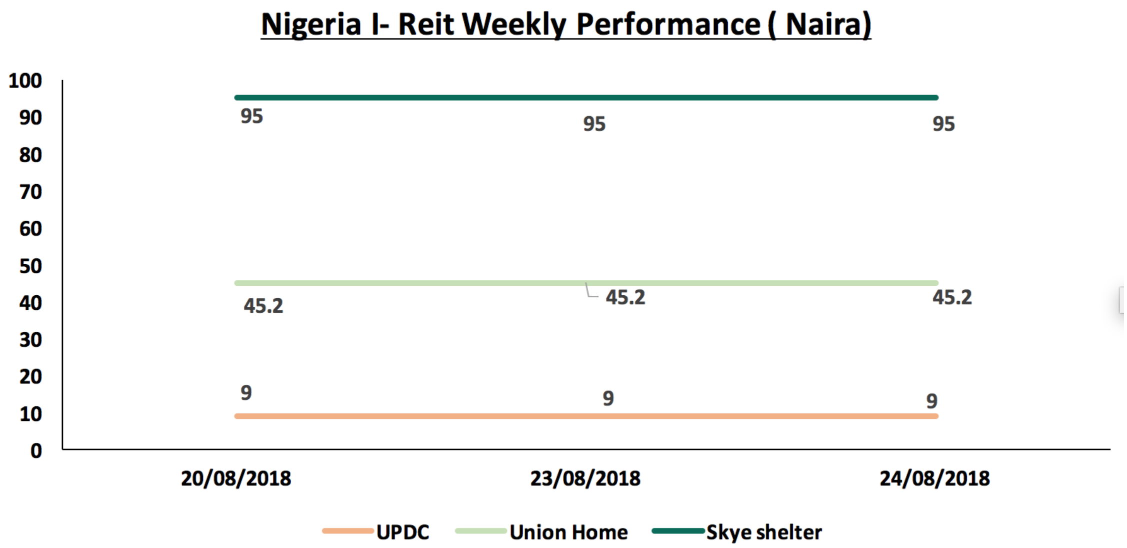
iii. French retailer Carrefour received exclusive occupancy rights for its branch situated at The Hub Mall, Karen, over a lease period of 5-years. The move will lock out other supermarkets both local and international, from setting shop in the shopping complex. The retailer currently has 6 branches in Nairobi- at Two Rivers Mall along Kiambu Road, The Junction Mall and Galleria Mall along Ngong Road, The Hub in Karen, Sarit Centre in Westlands, and Thika Road Mall along the Thika Superhighway. The retailer is also set to open its 7th branch at the Village Market later this year.

Listed Real Estate

The Fahari I-REIT closed the week at Kshs 10.2, similar to last week's average price, and a marginal decline from the week's opening price of Kshs 10.3. During the week, it recorded an average price 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.



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. We attribute to the 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 continued increase in activities in the real estate sector driven by; (i) continued infrastructural development, (ii) the housing deficit that currently stands at 2.0 mn units according to the National Housing Corporation (NHC), (iii) positive demographics such as a high population growth rate of 2.6%. 1.4% point higher than global averages of 1.2%, and (iv) the relatively high urbanization rate in Kenya at 4.4% compared to the global average of 2.1%, necessitating the need for adequate housing in the urban areas.
