Kenya Retail Sector Report 2018, & Cytonn Monthly – August 2018

Real Estate

During the month of August, the real estate sector recorded an increase in activities driven by: i) intensified government efforts to bridge the housing deficit in the country, which stands at 2.0 mn units according to National Housing Corporation, ii) positive demographics such as a high population growth rate of 2.5%, 1.3% points higher than the global average of 1.2% and a high rate of urbanization of 4.2%, compared to the global average of 2.0% as at 2017 as per the World Bank, which have created sustained demand for housing and commercial real estate across the country, iii) a stable macroeconomic environment with GDP growth averaging at 5.5% over the last 5-years, and we expect growth to come in at 5.5% in 2018, and iv) continued infrastructural improvements evidenced by the significant 2017/2018 national budget allocation of Kshs 134.9 bn, which is 22.2% of the total budget, to infrastructural development that will open up areas for investment.

In this report, we have highlighted industry reports that were released during the month, then delved into the review of the residential, commercial, hospitality, infrastructure and listed real estate sectors and concluded with statutory actions that happened during the month.

I. **Industry Reports:**

Two reports released during the month of August underlined the performance of the real estate sector as explained in the table below:

Industrial Reports Released in August

Report	**Key Take Outs**
CBK - Bank Supervision Annual Report 2017	• 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, • The number of mortgage loan accounts increased by 8.8%, from 24,059 accounts in December 2016 to 26,187 accounts in December 2017, • The growth is an indication of sustained demand for home ownership and likely to be an effect of perceived affordability of mortgages given the interest rate capping at 13.5% in 2017, • For more information, please see Cytonn Weekly #32/2018
KNBS – Leading Economic Indicators June 2018	• The value of building approvals at the Nairobi City Council in H1'2018 came in at Kshs. 100.8 bn, 21.7% lower than the total value of approvals recorded in H1'2017 of Kshs 128.7 bn, • The value of approvals for commercial developments declined at a significantly higher rate of 35.5% to Kshs 37.6 bn from Kshs 58.3 bn in H1'2017 in comparison to the 10.2% drop for residential developments to Kshs 63.2 bn from Kshs 70.4 bn in H1'2017, • The slowdown in commercial developments is attribute partly to increased competition especially in the office market with an oversupply of 4.7 mn SQFT as at 2017, therefore giving buyers a bargaining power and leading to lower returns for developers, • For more information, please see Cytonn Weekly #30/2018

Source: Cytonn Research

II. **Residential Sector:**

Activities in the residential sector during the month were mostly focused on the affordable housing initiative by the Central Government under the Big 4 Agenda;

1. The Kenya Mortgage Refinancing Company (KMRC) continued to gain much-needed financial support with the 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. For more information, please see Cytonn Weekly #31/2018,
2. The UN – Habitat advised the Kenyan Government to intervene through policies to ensure that the 23,000 Savings and Credit Co-operative Organizations (SACCOs), who have close to Kshs 1 trillion in savings, have access to serviced land, professional expertise, and reduced tax on building materials that would facilitate provision of mass affordable housing to low income earners. If implemented, these policies will create an enabling environment for SACCOs and other players on the supply side to produce low-income housing and thus contribute towards the achievement of the Jubilee Government's Big 4 Agenda. For more information, please see Cytonn Weekly #30/2018,
3. Partnership between the National Government and Nairobi County Government has led to an acquisition of land parcels in areas such as Kibera, Mariguni, Parkroad, Starehe, Shauro Moyo and Makongeni to be used for provision of affordable housing. For more information, please see Cytonn Weekly #30/2018, and,
4. Nairobi Lands, Urban Renewal and Housing County Executive, Mr. Charles Kerich, announced that the implementation of the Nairobi Urban Regeneration Plan will start in September 2018 in Pangani Estate, where a developer known as Technofin will break ground. The Regeneration Plan, which aims at providing new homes while renovating old ones, will be a partnership between Nairobi County and various developers, whereby the county provides free land while the developers finance and construct the houses. For more information, please see Cytonn Weekly #31/2018.

The above are testament to the government's commitment towards delivery of at least 500,000 affordable units by 2022. During the month, however, the proposal by the Treasury to levy a 0.5% deduction of the gross pay per month to workers in the formal sector was turned down by Members of Parliament as they deemed it a burden to both the workers and the companies. The funds were initially meant to partly finance the low-cost housing projects and thus the government has to consider alternative options to raise finance. To encourage the involvement of the private sector, there is need for consideration of policies that will save on development costs with the key areas that require attention being i) construction costs as they contribute to approximately 50%-70% of development costs, ii) provision of offsite infrastructure and serviced land so that developers save on costs that would have otherwise been incurred, and iii) access to finance through advocacy for alternative sources of development funding such as structured products and REITs.

In the middle and high-end market segments, developers continue to invest in real estate attracted by the high returns and increased demand for institutional grade developments. During the month, Double Win Company Limited, a real estate firm, announced plans to put up a residential complex along Argwings Kodhek Road in Kilimani. The project will comprise of two blocks of 14 storeys each, and will have 168-apartments; 2 and 3 bedroom units. According to our research in July 2018, apartments in Kilimani are a lucrative investment opportunity bearing average total returns of 13.9%, 5.7% points higher than the market average of 8.2%, which is attributable to good infrastructure and to its proximity to key business districts and nodes such as CBD, Upperhill and Westlands. For more information, please see Cytonn Weekly #32/2018.

Centum, an investment firm in Kenya, announced plans to break ground on Riverbank Apartments within their Two Rivers Mixed Use Development based in Runda, whereby the residential development will consist of 196 – units of 1-bedroom, 2-bedroom and 3-bedroom typologies measuring 87 SQM, 128 SQM and 185 SQM, respectively. With investments in other sectors such as financial services, power generation, education, healthcare and agribusiness, Centum has diversified into real estate with a view of generating attractive returns. Other real estate projects by Centum in the offing include i) the 180 – acre industrial park in Vipingo at the Coast, ii) the 30 – acre Awali Estate in Kilifi comprising of 62 maisonettes of 210 SQM and 90 bungalows of 155 SQM, and iii) the 1,255 Palm Ridge Homes in Kilifi consisting of 1, 2 and 3-bedroom units for a price Kshs 2.0 mn, Kshs 3.0 mn and 4.0 mn, respectively. The investment firm, however, noted a decline in profits in 2017 from Kshs 6.45 bn to Kshs 4.18 bn on account of a difficult operating environment in 2017 with reduced access to credit and the heated political environment. This is in line with our Cytonn Nairobi Metropolitan Residential Report that showed a 1.2% points drop in returns from 9.4% in 2016/17 to 8.2% in 2017/18. In our view, the setbacks in 2017 were temporary and we expect recovery of the market in 2018 on the back of an attractive demographic profile, infrastructural development, and political stability. However, given the increased supply and competition in the market, we recommend that investors ought to conduct proper research to identify niches in the market before investing.

III. **Commercial Sector:**

In the commercial office sector, Prism Towers, a 33–storey building of 133m in height, developed by Kings Developers Ltd officially opened for occupation. The building, situated in Upperhill, and whose construction began in 2014 brings to the market a total of 250,000 SQFT of lettable office space. According to Cytonn Nairobi Commercial Office Report 2018, yields in the office sector in Upperhill have stagnated at an average of 9.0% in 2016 and 2017 with occupancy rates dropping by 7.8% points from 89.8% in 2016 to 82.0% in 2017 attributable to the increased supply of office space in the node with no adequate demand to take it up. In light of this, we retain a negative outlook for the commercial office sector in Nairobi. For more information, please see Cytonn Weekly #30/2018

In the retail sector, we saw increased uptake of retail space with several global and local retailers expanding or announcing plans to expand. In our view, the expansion of retailers is on the account of (i) high economic growth rates with the GDP growth rate averaging above 5.0% p.a over the last 5-years thus boosting disposable incomes, and increasing purchasing power, (ii) Kenya's growing position as a regional and continental hub, hence witnessing an increase in multinationals operating in the country, and (iii) the huge opportunity, with Kenya having a formal retail penetration of 35% according to Oxford Business Group, compared to markets like South Africa with a penetration of 60%. The table below shows the various stores and their announced expansion plans;

Table Showing Retailers and Their Expansion During The Month

Name	Country of Origin	Type of Store	Stores opened or announced during the month	No of Stores in Kenya	Location of Stores in Kenya
Bosch	German	Electronics	1 Opened at The Oval	1	The Oval, Westlands
Subway	United States	Fast Food	4 planned at CBD, Upperhill, Lavington, and Mombasa Road	9	Junction Mall, Nairobi CBD, Thika Road Mall (TRM), Timau Plaza (Opp Yaya Center), Amee Arcade (in Parklands), Westgate mall, University way, Village Market and The Hub (in Karen)

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Burger King	United States	Fast Food	1 opened at Thika Road Mall (TRM)	4	Thika Road Mall, Two Rivers mall, Nextgen Mall and The Hub
LC Waikiki	Turkey	Clothing	1 planned for opening at Thika Road Mall (TRM)	3	Two Rivers mall, The Hub and Mombasa City mall
Java Group	Kenya	Restaurant	3 planned in Kigali, Rwanda	64	Uniafirc, Bufallo Mall, JKIA, Thika Road, Kileleshwa, Kimathi Street, Orbit Place, Capital Center, Parklands, Upper hill, Mama Ngina, Kileleshwa, Hurlingham, Sarit Center, Embassy House, Westlands Square, Waiyaki Way, City Hall, Adam Arcade, Prestige Plaza,

Source: Cytonn Research

The expansion of retailers into various malls has enhanced footfall as consumers increasingly seek to shop in formal retail stores due to the wide variety of products and new brands from both local and international retailers. In addition, the growth of retailers has a positive impact on real estate through the increased uptake of retail space leading to an improvement in performance in the retail sector. According to Cytonn Kenya Retail Sector Report 2018, occupancy rates increased by 3.4% points to 83.7% in 2018 from 80.3% in 2017 indicating increased retail uptake. However, rental yields declined by 0.2% points to 9.4% in 2018 from 9.6% in 2017 as a result of increased supply of retail space forcing developers to reduce rental charges to remain competitive.

In the industrial sector, Tilisi Research released a report dubbed 'The Warehousing Market in Kenya' highlighting the demand and supply of warehousing space in Kenya sector, the key demand drivers and the main challenges facing the sector. The key take-outs from the report were;

- Kenyan warehousing is primarily made up of small-scale go-downs of between 1,076 to 3,200 SQFT, which is lower than the international standards, for example the average size of warehouses in the US warehousing market is 184,693 SQFT. This was attributed to the fact that Kenyan operations are serving a much smaller market as opposed to most international operations,
- The report indicated an acute shortage of warehouse spaces as demand overlaps supply with the findings from their survey showing that 16% of respondents had sought new warehousing facilities in 2017/18, compared with 9% in 2016/17, and 6% in 2015/16 showing the increasing demand mainly from the Pharmaceutical, Logistics and FMCG industries,
- The factors that have led to the rise of demand in warehouse spaces are; i) rising of E-commerce in the region with increasing online retail sites such as Jumia, Kilimall International, Masoko, Aladin and PigiaMe creating the need for easily accessible warehouses, ii) improved infrastructure with the new Standard Gauge Railway establishing an in Inland Container Depot (ICD) in Embakasi-Nairobi that can handle 1,232 twenty-foot equivalent units daily leading to increase in warehouse spaces around the area, and iii) growth of the retail industry,
- The survey found that 75% of the warehouse renting companies pay below the price of Kshs. 45 per SQFT and that rents have been rising by 11.5% between 2015 and 2017 due to increase

demand,

- Respondents in the survey highlighted various challenges in terms of warehousing needs including i) accessibility ii) location, iii) warehousing quality, and iv) affordability. The report concludes that infrastructure is key to the sector and noted that areas along Northern, Eastern and Southern Bypasses have attracted companies to set up warehouses as companies are able to save up to 30% on its logistics costs by reducing the cycle time to 2-days from 3 to 4-days, initially. On pricing, while 13% of the respondents cited affordability as an issue, it is important to note that 61% of respondents stated that they would be willing to pay more for warehousing in a well-located logistics park with Grade A facilities as they have the potential to reduce operational costs by up to 35%.

The report highlights the opportunity in investment in high quality warehousing space supported by the high demand. We anticipate further growth given the intensified focus on manufacturing as one of the 4 Pillars of focus by the government for the next 4-years and the increased investment in infrastructure that is likely to improve business in trade and logistics and also open up new fronts for warehouse development. As per Cytonn H1' 2018 Markets Review, the industrial sector recorded improved performance in 2018 with rental yields increasing by 0.7% points from 5.4% as at H1'2017 to 6.1% in H1'2018, while occupancy levels increased by 11.8% from 77.3% recorded in 2017. The increase in yields was as a result of an 11.8% increase in occupancy levels driven by an increase in demand attributable to: i) the renewal of investor confidence following the conclusion of the prolonged electioneering period, and ii) the increased focus on manufacturing, among the governments Big 4 Agenda.

IV. **The Hospitality Sector:**

During the month of August, the Kenya National Bureau of Statistics released their June issue of Leading Economic Indicators showing that international arrivals recorded a 0.9% increase coming in at 443,950 in H1'2018 compared to 439,807 H1'2017. This growth is largely attributed to i) restoration of political calm, ii) the revision of negative travel advisories, warning international citizens, e.g. from the United States against visiting Kenya, iii) 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, iv) positive reviews from travel advisories such as Trip Advisor who ranked Nairobi as the 3rd best place to visit in 2018, and v) promotions from various campaign projects such as the British Euro-Afro Vocals Kenya campaign project that aims to market Kenya's cultural tourism and material culture in the United Kingdom. In light of this, we are still confident of our forecast of an 11.0% increase in international arrivals from 1.45 mn in 2017 to 1.61 mn arrivals in 2018 as per the Cytonn Annual Market Outlook 2018, which will result in high occupancies and revenues in the hotel sector.

V. **Infrastructure:**

In the infrastructure sector, the government continues to increase its investments in order to boost the country's economic growth through; i) revenue generation, ii) increased employment opportunities, iii) betterment of services and facilities, and iv) improving the ease of doing business in Kenya. Below is a table highlighting infrastructural projects across the country that were announced during the month;

Announced Infrastructural Projects during the month

Name	Type	Length	County	Project Value (Kshs.)
Miritini Terminus – Mombasa CBD	Railway	22km	Mombasa	200 mn

Announced Infrastructural Projects during the month

Name	Type	Length	County	Project Value (Kshs.)
Garissa Road – Thika Super Highway Bypass	Roads	10km	Kiambu	1.5 bn
Garissa Road – Kenyatta Highway	Roads	15km	Kiambu	1.5 bn
Nairobi Satellite Towns Water and Sanitation Development Programme Project	Water	*	Kiambu – (Ruiru – Juja) & Kajiado (Kiserian – Ongata)	3.6 bn
Standard Gauge Railway (SGR) Phase 2B	Railway	262km	Nakuru & Kisumu	380 bn

Source: Local Dailies, Cytonn Research 2018

The increased activities in the infrastructural sector by the government intensifies in a bid to address the huge deficit in infrastructure including rail, roads and ports and 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. In our view, the increased investment in infrastructure is an indication that the government is committed to its developmental agenda and such infrastructural initiatives will help open up more areas for real estate development, increasing accessibility and access to essential services such as water, electricity and a sewerage system.

VI. **Listed Real Estate:**

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

During the month, Stanlib's Fahari I-REIT saw a decrease of 12.1%, closing at Kshs 10.2 per share from Kshs 11.6 per share at the end of July 2018. On average, the REIT traded at an average of Kshs 10.2 per share, a 4.7% drop from an average of Kshs 10.7 per share last month and 2.9% below its opening price of Kshs 10.5 per share at the beginning of 2018. Moreover, the highest price per share attained during the month came in at Kshs 10.3 per share, 11.2% lower than the month of July, which recorded a high of Kshs 11.6 per share. The prices for the instrument have remained low largely due to: i) Fahari I – REIT performing poorly with a dividend yield of 5.7% as opposed to brick and mortar retail and office in Nairobi with 9.4% and 9.3%, respectively, ii) inadequate investor knowledge, and iii) lack of institutional support for REIT's. We expect the REIT to continue trading at low prices and in low volumes.

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

REIT's in the Nigerian market however continued to plateau with the three REITS i.e. Union Home, Skye Shelter and UPDC attaining a constant price per share of N45.2, N95.0 and N9.0, respectively, throughout the month. The performance is an indication of stalled demand for the instrument attributable to shallow investor knowledge and, we expect the performance to continue on this trend for the long term.

VII. **Statutory Reviews and Actions:**

During the month, several stakeholders in the real estate sector were affected by operations by the Nairobi River Regeneration Committee led by the National Environment Management Authority

(NEMA) in plans that seek to alleviate the encroachment on riparian land. The move has seen demolition of developments that restrict flow of rivers and thus cause flooding. In addition, an in-house audit conducted by the National Construction Authority (NCA) found that 16.0% i.e. 800 of the 5,000 developments in Nairobi were unsafe for living. 18.3%, 146 of the 800 buildings, required structural adjustments to meet required standards while, 81.7%, 654 buildings did not obtain statutory approvals and had thus been earmarked for demolition. In our view, these challenges are consequences of (i) inadequate due diligence by developers, (ii) corruption in the Lands Ministry that has led to the issuance of public land to private real estate stakeholders, and (iii) lack of clear guidelines within the existing laws on the protection of riparian land i.e. Water Act, 2002, Water Resource Management Act 2007, Environment Management and Coordination Regulations of 2006. For instance, the Environment Management Coordination Regulations of 2006 puts the recommended riparian distance at a minimum of 6-metres and a maximum of 30-metres from the highest water mark while the Agriculture Act puts it at a minimum of 2-metres. We recommend proper due diligence by both the developers and the government officials before handing out approvals for construction and establishment of clear and consistent guidelines on the law of riparian land protection.

On the legal front, Members of Parliament (MPs) repealed the solar water heater law, which imposed a fine of Kshs 1.0 mn or a 1- year jail sentence to developers who fail to install solar water heating systems in their developments. Nullification of such laws will be a benefit to developers and the end user as they are in line to reduce development cost. Additionally, such statutory reviews are commended as such a law would be a hindrance in the achievement of the affordable housing initiative by the government by increasing the cost of development.

We expect the real estate sector in Kenya to continue on an upward trajectory given (i) continued improvement in infrastructure by the central government, (ii) expansion by global retailers into the country, (iii) expanding middle-class, and hence growing disposable incomes, and (iv) the relatively high urbanization rate in Kenya at 4.2% compared to the global average of 2.0%, necessitating the need for adequate housing in the urban areas.
