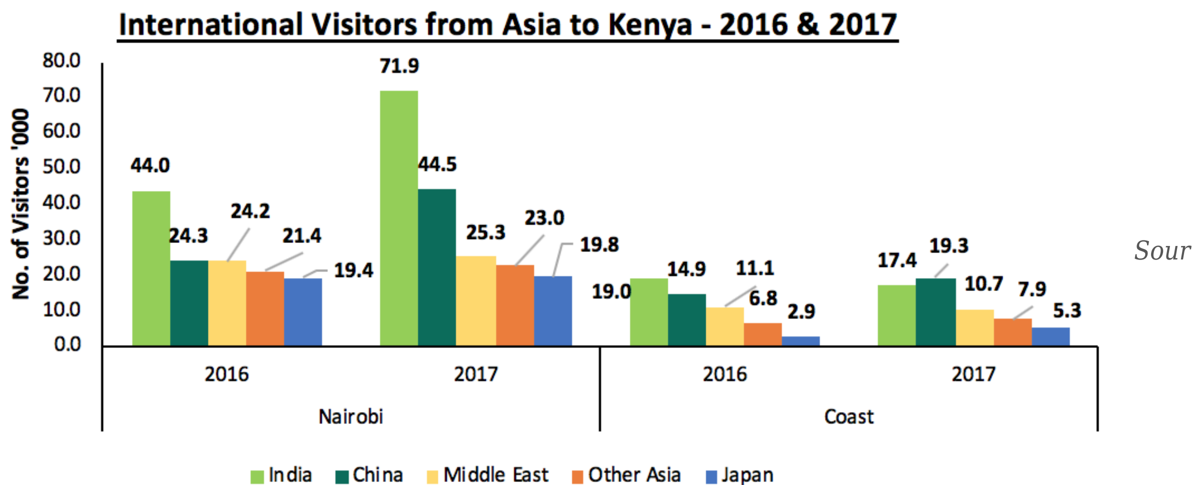
The IMF Precautionary Credit Facility 2018, & Cytonn Weekly #35/2018

Real Estate

Hospitality

During the week, Qatar Airways announced plans to launch direct flights to Mombasa starting December 2018, a move that will see four flights between Doha, Qatar, and Mombasa, Kenya, per week. This will be Qatar Airways' second Kenyan destination, after Nairobi. In our view, the move will aid further in the recovery of tourism at the Kenyan Coast, where according to the Kenya National Bureau of Standards (KNBS), hotel occupancy in the region registered a growth of 19.2% in 2017 to 2.9 mn, from 2.5 mn in 2016, in comparison to Nairobi's increment of 10.0% to 1.7 mn from 1.5 mn in the same period. Currently, countries like India, China, and the Middle East region, which consists of countries like Qatar, United Arab Emirates, Egypt, Yemen, and Saudi Arabia, among others, are the leading sources of Asian visitors to Kenya. In 2017, the number of visitors from Asia to the Kenyan Coast saw an increase of 10.8% to 60,600 in 2017 from 54,700 in 2016, in comparison to a 38.4% increase in Nairobi to 184,500 in 2017, from 133,300 in 2016, as shown below:



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ce: KNBS

Other international airlines that operate flights to Mombasa include Ethiopian Airlines, Turkish Airlines, and RwandAir; while local jet airlines include Fly Sax, Fly540, and Fast Jet. Thus, this new addition underlines the return of consumer confidence from a place of security concerns following the incidences of insecurity in between 2012 and 2015, which saw several countries, including the USA and France, impose travel advisories on the Kenyan Coast. The recovery has been as a result of the government's aggressive marketing of Kenya's tourism industry in international markets, enhanced security, infrastructural improvements in the Coastal Region such as the construction of the Standard Gauge Railway, the Port Reitz Road, Moi International Airport Access Road, and the Dongo Kundu Bypass, among others. We expect the increase in local and international flights, to

boost the local tourism industry in general especially following recovery of the economy from the effects of the double election in 2017, with the Tourism Board projecting a 16.0% growth in international arrivals in 2018, which in our view will be made possible by the open-air policy, and the on-arrival visa policy for African visitors.

Also during the week, the owners of Sentrim Hotels and Lodges, the hotel chain that owns the Sentrim Hotels brand, put up the business for sale, consisting of a portfolio of eight hotels located in prime hospitality nodes across Kenya, at a price of Kshs 5.2 bn.

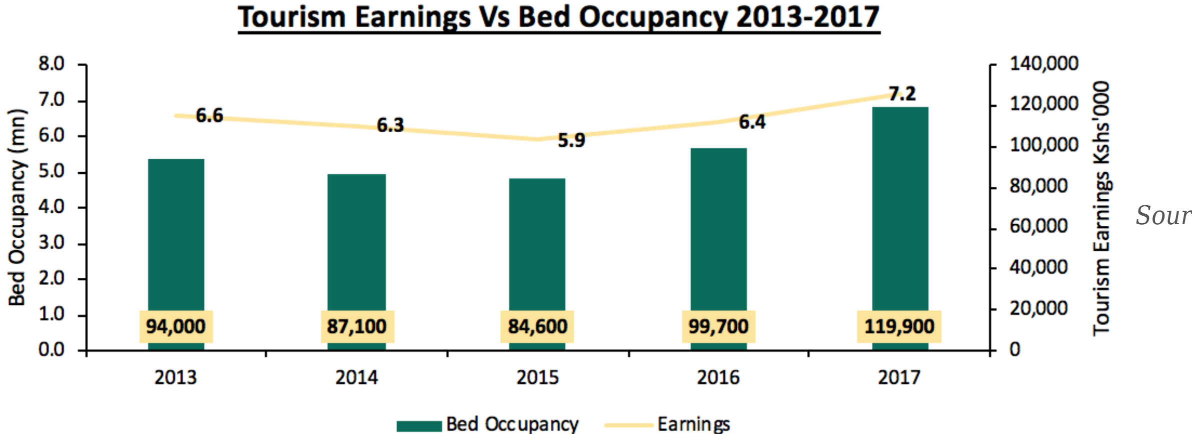
The Sentrim portfolio is as shown below:

Sentrim Hotels & Lodges Portfolio

Name of Development	Acreage	Location	Keys
680 Hotel	0.7	Nairobi CBD	240
Hotel Boulevard	4.2	Nairobi CBD	72
Royal Castle Hotel		Mombasa	68
Sentrim Elementaita		Nakuru	84 keys; 58 cottages
Sentrim Amboseli	58	Amboseli Park	60
Sentrim Mara	91.3	Maasai Mara	31
Sentrim Samburu	15	Samburu National Reserve	21
Sentrim Tsavo	21.3	Tsavo East National Park	21

Source: Knight Frank, Online Sources

In our view, the move to sell the establishments is bound to benefit the purchasers in that, the business is relatively established in Kenya with over four decades of operations, thus, a solid customer base and goodwill, in addition to the land, which is over 190-acres. Moreover, the Kenyan hospitality industry has been on a recovery path, recording a 20.3% increase in earnings in 2017 to Kshs 119.9 bn from Kshs 99.7 bn in 2016, as per KNBS Economic Survey, 2018 whereas, hotel bed-nights occupancy increased by 11.3% to 7.2 mn in 2017 from 6.4 mn in 2016, thus, sustaining demand for hotel beds.



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Also during the week, STR Global released hotels performance across African Cities for H1’2018. As

per the report, Nairobi's bed-occupancy rates fell by 0.6% points to 49.3% in H1'2018, from 49.9% as Q4'2017, while Average Daily Rates (ADR) declined by 6.5%. The decline in performance, in our view, is attributable to the continued increased supply of hotel rooms and serviced apartments, especially with the continued entry of international hoteliers such as Marriott International, Movenpick, Carlson Rezidor, and Hilton, among others with a pipeline of 4,675 hotel rooms and 1,260 serviced apartments, per our Cytonn Hospitality Report 2017, hence a decline in occupancy rates. In addition, the protracted electioneering period saw various western countries such as the United States issue temporary travel alerts, thus, affecting visitors' confidence. As per the STR Data, the best hotel market in Africa is Marrakech, Morocco, which posted a 40.7% increase in ADR to USD 195, from USD 115.8 as Q4' 2017, and a 12.3% points increase in occupancy rates.

Residential

During the week, Capitaland East Africa, an East Africa based commercial and residential real estate, investment and project management syndication company, announced plans to set up a Mixed-Use Development (MUD) in Mang'u, Juja. The project, named Artstone Valley, will be on 25-acres of land, off the Nairobi-Thika Highway, and will comprise of a residential component consisting of 960 3-bedroom units, 480 2-bedroom units, and 60 1-bedroom apartment units; and social facilities including a hospital, primary and nursery schools, as well as a mall.

The project, which is set to be completed within the next 40-months, is a joint venture between Capitaland, UAE-based real estate firms Abu Dhabi Investment and Housing and Emirate Homes Group; and investment firm, Royal Investment Group. These firms join the list of multinationals investing in the Kenyan real estate sector, with others include UK-based Kiloran-All Design consortium, who plan to develop The Beacon Mall in Nairobi; Aviation Industry Corporation of China (AVIC), which has invested in projects such as Two Rivers Mall; Taaleri, a Finnish Fund invested in Cytonn Investments and Fusion Capital; and Tata Group from India planning to venture into the local residential market, among others. The multinationals are attracted to Kenya, and the real estate sector in particular, by;

i. Ongoing infrastructural developments such as the Standard Gauge Railway, construction of roads such as Eastern, Southern and Northern Bypasses, among others,
ii. High demand as a result of a demographic dividend that has continued to grow by 2.6% per annum, and a growing middle class,
iii. Attractive returns in the real estate sector, which has recorded returns of on average 24.3% p.a. over the last 5 years, compared to traditional asset classes' 5-year returns, which have averaged at 13.2% per annum,
iv. Favorable legal and operating environment, such as the scrapping of land title search fees, NCA & NEMA levies, 15.0% corporate tax for developers of a 100 low cost units p.a., and digitization of the lands ministry, all of which saw Kenya's rank in Ease of doing Business improve to 80 in 2017, from 92 in 2016, and,
v. Nairobi's status as a leading regional hub that have seen multinational firms continue to set up regional headquarters, thus sustaining demand for upper mid-end and high-end dwellings with a live-work-play concept.

Juja's investment opportunity is enhanced by (i) good location along a major highway, that is, the Thika Superhighway, (ii) relatively affordable land prices, with an average price per acre of Kshs 9.6 mn, 111.5% lower than the average of Kshs 20.3 mn per acre for satellite towns in Nairobi, and (iii) the prevalent young population, especially from institutions such as Jomo Kenyatta International University, as well as the young working class from key business nodes such as the CBD, Thika Road, Ruiru, and Thika. As at H1' 2018, average total returns in Juja increased by 0.5% points to 6.1%, from 5.6% in 2017, with average annual uptake rates increasing by 8.4% points to 23.7%, from 15.3% as at September 2017. Despite the increase in returns in 2018, key to note is that among the 11 Satellite Towns in our universe of coverage, Juja has the lowest returns, with price appreciation

and total returns of 0.0% and 6.1%, respectively, in comparison to the satellite market averages of 2.7%, and 8.6%, respectively. This is as the area's population structure, which mostly constitutes of the young population are mainly renters, thus, constraining investor returns.

(All Prices in 'Kshs' Unless Stated Otherwise)

Satellite Towns Residential Performance 2017/ 2018 - Apartments

Location	Average of Price Per SQM	Average of Rent per SQM	Average of Annual Sales (%)	Average of Rental Yield	Average of Price Appreciation	Average of Total Return 2018	Average Total Returns 2017	Change in Total Returns (Points)
Thindigua	92,603	454	28.2%	5.9%	5.3%	11.2%	19.3%	(8.1%)
Ruaka	101,163	440	25.6%	5.3%	5.8%	11.1%	11.8%	(0.7%)
Ruiru	89,918	469	20.6%	6.3%	3.7%	9.9%	8.4%	1.5%
Athi River	63,395	351	25.4%	6.3%	2.4%	8.7%	7.4%	1.3%
Rongai	70,983	338	23.7%	5.9%	2.8%	8.7%	5.4%	3.3%
Lower Kabete	86,026	415	24.3%	5.8%	2.6%	8.4%	7.8%	0.6%
Kitengela	67,018	327	19.4%	6.4%	1.8%	8.2%	11.8%	(3.6%)
Kikuyu	76,046	336	22.3%	5.3%	2.7%	8.1%	10.7%	(2.6%)
Syokimau/Mlolongo	75,313	299	22.0%	5.0%	1.8%	6.8%	-	
Thika	49,155	284	25.0%	6.1%	0.3%	6.4%	9.1%	(2.7%)
Juja	50,728	259	23.7%	6.1%	0.0%	6.1%	5.6%	0.5%
Average	**74,759**	**361**	**23.7%**	**5.9%**	**2.7%**	**8.6%**	**9.5%**	

Source: Cytonn Research

Infrastructure

Residents of Kitengela are set to construct their own sewer line, that will service over 100-homes and approximately 20,000 persons. The 45-Km sewer line, will be funded by residents who are expected to raise a total of Kshs 39.0 mn towards the project. However, in our view the project will need other investors to actualize, as based on previous government projects, the average construction cost per Km for a sewerage project is Kshs 31.8 mn, including the construction of sewerage plants and other contingencies. With our estimates, the Kitengela sewer line should have a total cost of approximately Kshs 1.4 bn. Previously, the government has partnered with such institutions as African Development Bank (AfDB) and World Bank, for local sewerage projects, with the estimated costs of some of the projects as shown below:

(All Prices in 'Kshs' Unless Stated Otherwise)

Government of Kenya Sewerage Improvement Projects

Sewerage Project	Length (Km)	Project Funding	Project Cost	Cost per Km
Kiambu Sewerage project	30.3	GoK, AfDB	995,750,000	32,863,036
Kikuyu Sewerage Project	25.0	GoK, AfDB	537,000,000	21,480,000
Ol Kalou Project	14.3	GoK, AfDB	416,157,240	29,101,905
Ruiru Sewerage Project	57	GoK, World Bank	2,400,000,000	42,105,263
Average				**31,387,551**

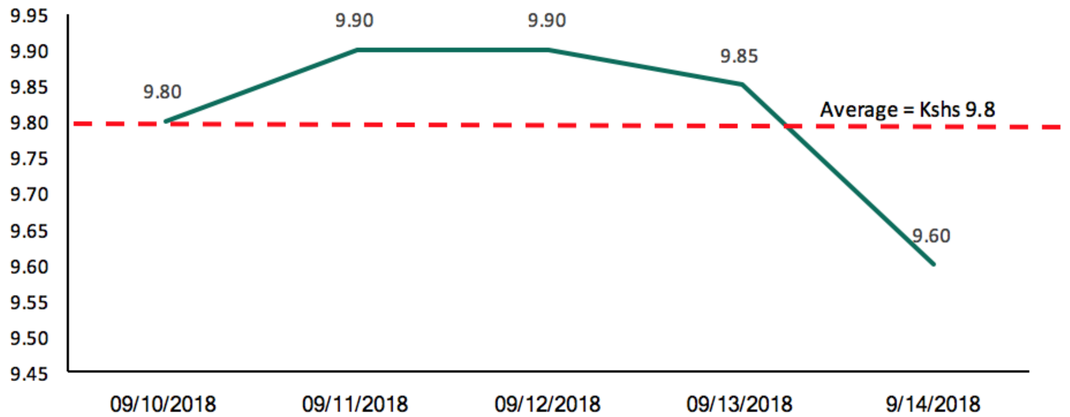
Source: NEMA, Athi Water Services Board

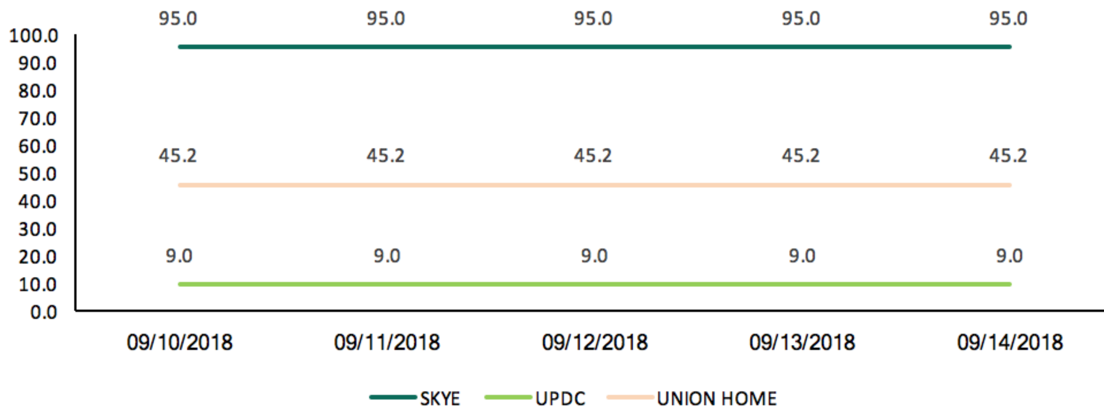
The Kitengela sewer line will adjoin the Exports Processing Zone's (EPZ) Athi River Sewerage

system in the neighboring Machakos County. Currently, Kitengela has a population of approximately 71,426 persons. The town has been one of the notable real estate investment nodes in Kajiado County, and the Nairobi Metropolitan Area in general, mainly on account of availability of affordable land for development with an average price per acre Kshs 11.3 mn, compared to the Nairobi Metropolitan average of Kshs 140.9 mn. In the residential sector, as at H1'2018, Kitengela had average total returns of 9.6%, as per the Cytonn Nairobi Metropolitan Residential Report 2018. However, this was a 3.3% points decline from the 12.9% recorded in H1' 2017, whereas annual uptake declined by 3.5% y/y points to an average of 21.0% from 24.5% in 2017. The connection to the main sewer line, as well as other infrastructural developments aimed at decongesting the town, such as the Kshs 100.0 mn upgrading of the Athi River-Namanga Highway, and other Kitengela slip roads by the Kenya National Highways Authority (KeNHA), which commenced in 2017, are likely to lead to an increase in real estate development activities, uptake and real estate performance in the town. This is as infrastructural services lead to better quality of life in towns, thus boosting demand for real estate in the towns. For instance, in 2017, following the announcement that Ruiru would be connected to the sewer, the town recorded a relatively high capital appreciation in Nairobi Metropolitan Area of 3.7%, 1.0% points higher than the market average of 2.7%, and 1.8% points higher than 1.9% recorded in 2016. Also, since 2012, with the completion of the Northern Bypass, Ruaka has recorded an increase in development activity, with developments such as The Alma, and Taraji by Cytonn Investments, and others such as Glenwood Apartments, coming up. As of 2016, the town recorded attractive returns with average rental yields of 5.1%, price appreciation of 16.1%, resulting in total returns of 21.2%; while in 2018, the town recorded the highest capital appreciation in the satellites market, with an average of 5.8% p.a., 3.1% higher than the market average of 2.7% (as seen in the table above).

Listed Real Estate

The Fahari I-REIT closed the week at Kshs 9.6, 2.0% lower than the week's opening price of Kshs 9.8. During the week, it recorded an average price of Kshs 9.8, which is a decline of 15.5% from the average trading price same time last year, of Kshs 11.6. The continued poor 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, noted during the release of the H1'2018 results, thus resulting to low trade volumes, 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 the real estate sector to continue on an upward performance trajectory boosted by: (i) increased local and international investor interest, (ii) continued investment in infrastructure, (iii) an expanding middle class, (iv)the huge housing deficit of 2.0 mn units, which is growing by 200,000 houses p.a, and (v) relatively high real estate returns which have averaged at 24.3% p.a. over the last 5 years.