Kenya Listed Banks H1'2018 Report, & Cytonn Weekly #36/2018

Real Estate

Residential

In the residential sector, this week we saw activities in relation to the affordable housing initiative under the government's Big Four agenda, as the National Government invited bids from both international and local developers to build 1,500 affordable residential units at Nairobi's Park Road estate situated in Ngara for low–income earners, expected to be delivered within 36 months. This is in line with the government's plan to develop 500,000 affordable housing units by the end of their term in 2022. The government plans to achieve this through Public-Private Partnerships where the government's role is to provide the land while the developer is tasked with the role of designing, funding and constructing the units.

According to the Request For Proposals (RFPs) advertised by the government, bidders are required to pay a bid security of Kshs. 40 mn during submission of the RFP and a commitment fee of 10% of the project value within 30 days after notification of award, that will act as proof of financial capability of the developer to deliver the project. In regards to the bid security and commitment fees required to be paid, we are of the view that this will force developers to incur huge upfront costs which is a limitation, given that access to funding for developers still remains a challenge with the growth of credit to the private sector declining by 21.5% points over the last 3 years , coming in at 4.3% as at June 2018 compared to 25.8% in June 2014 as a result of introduction of capped lending rates at 4.0% points above the Central Bank Rate(CBR). In our view, the government may consider alternative ways to gauge the financial capability of developers such as requiring letters of commitment by financiers and evaluation of financial records of the firms. The government also needs to look into ways to spur the development of alternative sources of funding at competitive rates such as structured products which will reduce the overreliance on banks and provide financing for affordable housing.

Other affordable housing projects that are set to come up in Nairobi Metropolis are as shown below;

Low – Cost Housing Projects in Nairobi Metropolis

Project Name / Location	No of Units	Developer	Project Value (in Kshs)
Pangani	1,000	M/S Sovereign Group	Approx. Kshs
Ngong Road	2,520	Lordship Africa	Kshs. 24.6 bn
Jeevanjee-Bachelors	1,500	Jabavu Village Ltd	Kshs. 9.1 bn
New Ngara	1,500	KCB/ S&L	Kshs. 9.0 bn
Uhuru Road	*	Stanlib Group	Kshs. 3.5 bn

Low – Cost Housing Projects in Nairobi Metropolis

Project Name / Location	No of Units	Developer	Project Value (in Kshs)
Old Ngara	1,050	Kiewa Group	Kshs. 7.0 bn
Suna Road	1,050	Directline Assurance Limited	Kshs. 3.5bn
Shauri Moyo	5,000	Not yet Awarded	*
Makongeni	20,000	Not yet Awarded	*
Starehe	3,000	Not yet Awarded	*

To drive the affordable housing initiative, the government has already put in place various policies and strategies to support both developers and homebuyers, some of which include;

1. Measures to support home buyers;

i. 15% tax relief, for buyers of units developed under the affordable housing scheme up to a maximum of Kshs 108,000 p.a,
ii. Establishment of the National Housing Development Fund (NHDF), with the president approving the Finance Bill 2018, which includes a 1.5% levy on employee's basic salaries up to Kshs. 5000 and the employer expected to match the same amount that will be channeled into the fund. This contribution will act as a saving for employees aimed towards house purchase,
iii. Exemption from stamp duty tax for first time home buyers, and
iv. Plans to establish the Kenya Mortgage Refinancing Company (KMRC) by 2019, whose aim is to enhance mortgage affordability by enabling long-term loans at attractive market rates.

2. Measures to support developers;

i. 15.0% tax rate for developers who provide at least 100 low – cost housing units p.a,
ii. Scrapping off of NEMA and NCA levies, encouraging developers to construct more units due to the reduction in costs,
iii. National Housing Development Fund that will provide a source of finance for development of residential units although it is still not yet clear how it will be operated,
iv. Partnerships with developers through availing of public land for development, and,
v. Establishment of a land bank whereby excess land will be gathered together in a bid to address the challenges faced by investors and developers seeking to acquire land.

We applaud the steps that have been made so far towards development of affordable housing. However, it is imperative to note that in the past Private – Public Partnerships (PPPs) have proven to be ineffective as evidenced by projects such as the one in Ngara which has failed to take off due to; (i) lengthy and slow approval processes, (ii) uncertainty regarding revenue-sharing and the returns to private investors in PPPs, (iii) extended PPP time – frames that make them unattractive to private developers who prefer to exit projects in 3 – 5 years, and (iv) lack of a mechanism to transfer public land to a Special Purpose Vehicle (SPV) to facilitate access to private capital. We thus recommend a review of the PPP framework to facilitate the approvals process and to aid in establishment of Special Purpose Vehicles.

Mixed Use Developments (MUDs)

Investors are increasingly undertaking the Mixed Used Development (MUD) concept in order to; (i) reduce risk by diversification as MUDs generally offer a safe bet regardless of downturns in either of the incorporated themes, (ii) densify in more compact pacts of land thus maximizing on returns, and (iii) encourage use of resources efficiently as mostly residential and commercial tenants would occupy the same building thus utilities such as energy and sewage can be used more efficiently. One of these is a 61 storey building in Watamu, named Palm Exotjca, that is set to break ground in December 2018. The MUD, developed by Palm Exotjca Ltd and designed by Lorenzo Pagnini Architetto, an Italian architectural firm, will feature 180 serviced apartments, a 5-star hotel with 270 rooms, a commercial office space and a convention center. The project will offer amenities such as swimming pool, spa and gym, children's play area, theatre and cinema observatory, and a private beach. Interest in the coastal region is largely driven by the low supply of MUDs especially in Watamu and the area being a hub for tourist attraction due to the proximity to the Indian Ocean which will attract occupancy for the hotel and serviced apartments.

In addition, during the week, Aviation Industry Corporation of China (Avic) International Real Estate Limited, the development affiliate under the Avic group in Kenya, launched their Kshs 40.0 bn project termed 'Global Trade Center' (GTC) located in Westlands, Nairobi. The project whose construction began in 2015 and set to be completed by 2020 will comprise of a 42-storey, 485,678 SQFT office tower of 184m in height, a 35-storey luxury 5-star hotel with 365 rooms that will be operated by the JW Marriot Hotel Group, 405 residential apartments and a 124,097 SQFT mall. The concept of MUDs is growing in the country with some of the completed MUDs being Sifa Towers and Timau plaza in Kilimani and ones under construction or yet to commence construction being, The Beacon to be located off Uhuru Highway towards Bunyala Road roundabout, Le Mac in Westlands, Montave and Pinnacle Towers in Upper Hill, and Cytonn Towers in Kilimani. In our opinion, given the oversupply of office and retail space that lies at 4.7mn SQFT as at March, 2018 and 2.0mn SQFT as at September, 2018, respectively, we recommend investments in MUDs as they enable multiple channels of revenue, symbiotic nature of uses thus relatively high yields of 11.0% according to Cytonn Annual Market Outlook 2018 compared to retail, residential and office sector that attained 8.6%, 5.5% and 9.3%, respectively as at H1' 2018. This is well represented on the table below;

Rental Yields by Sector in Nairobi

Theme	Rental Yield
Mixed Use Developments (MUDs)	11.0%
Retail Sector	9.4%
Office Sector	9.3%
Residential	5.5%

Source: Cytonn Research

Retail

During the week, French retailer, Carrefour, expressed interest to take up tenancy at the Nakumatt Mega space in the wake of expiration of Nakumatt's lease at the end of the month. If the move by Carrefour materializes, it will bring their total count of outlets in the country to 7 with the rest being located at The Hub in Karen, Sarit center along Karuna Road, Westlands, Thika Road Mall along Thika Road, Junction Mall along Ngong road, Galleria Mall in Karen and Two Rivers Mall along Limuru Road. Exiting of local struggling retailers from malls as a result of poor corporate governance and financial constraints has driven the expansion of international retailers within the country as they hurry to occupy the prime spaces left behind. Additionally, the expansion into the country has also been encouraged by; (i) a stable economic environment, (ii) expanding middle-class in the country, iii) high economic growth rates with the GDP growth rate averaging at more than 5.0% p.a over the last 5 years thus boosting disposable incomes and increasing purchasing power, and (iv) Kenya's growing position as a regional and continental hub hence witnessing an increase in multinationals operating in the country. Other spaces taken up by retailers that were previously occupied by struggling local retailers are highlighted below;

Occupancy of Malls in Kenya by International Retailers

Retail Spaces	Previous Anchor Tenant	Current Anchor Tenant
Sarit Center	Uchumi	Carrefour
Thika Road Mall, Junction Mall and Galleria Mall	Nakumatt	Carrefour
Garden City, Mombasa City Mall and Westgate	Nakumatt	Shoprite

Source: Cytonn Research

The expansion of retailers who serve as anchors to these malls will result in enhanced footfall (number of people visiting the mall at a given time) as consumers increasingly seek the wide variety of products and new brands offered thus boosting uptake of retail spaces in malls by other retailers. This will improve the overall performance of the retail sector in Kenya which recorded average rental yields of 8.6% in 2018 and occupancy of 86.0% (and Nairobi with rental yield of 9.4%, occupancy of 83.7%) according to Cytonn Kenya Retail Report 2018. We have a positive outlook regardless of the oversupply in the retail sector, which stands at 2.0mn SQFT in Nairobi, as this expansion by retailers will increase uptake for retail spaces in malls thus improving performance of the sector. In our view however, developers ought to shift their focus to markets such as Mombasa and Mt. Kenya regions that have retail space demand of 0.3mn and 0.2mn SQFT, attractive yields at 8.3% and 9.9% and occupancy rates at 96.3% and 84.5%, respectively.

Hospitality

During the week, Mediview Limited, a company based in Dublin, Ireland, announced plans to set up a 200-room, 7-storey, 5-star hotel along Limuru Road on 2.5 acres pending approvals from regulatory authorities such as the National Environmental Management Authority (NEMA). The company has since invited global hotel brands such as JW Marriot Hotel, Accor Hotels and Intercontinental Hotel Group to place bids for managing the facility that will encompass amenities such as a restaurant, meeting rooms, a business center, swimming pool, a gym and spa. In our view, Limuru Road offers a good investment opportunity as; (i) it offers security with the area being blue zoned and hosting the US, Moroccan, Italian, Swedish, Turkish, Brazilian, Danish embassies and UNEP global, and (ii) it has a low supply of 5-star hotels with an 11% market share compared to nodes such a Nairobi CBD and Westlands that recorded 41% and 19%, respectively as per CytonnHospitality Report 2017. Other hotels in the area include the 137 -room Tribe Hotel and the 165 - room Trademark Hotel located along Limuru road near Village Market. We attribute the increased interest in the hospitality sector to the demand from both local and international guests with the total room nights growing at a 6-year CAGR of 4.6% from 1.5 mn room nights in 2011 to 1.9 mn room nights in 2017 according to Kenya National Bureau of Statistics Economic Survey 2018. We expect this to result in an overall improvement of accommodation and services standards in hotels so as to remain competitive in the wake of stiff competition from global brands. Other hotels that are set to come up in the Nairobi Metropolitan area are as shown below;

Hotels that are set to come up in Nairobi Metropolis

Name	Location	Rooms	Status	Year of Completion
The Alba	Westlands	83	Under Construction	2019
Global Trade Center	Westlands	365	Under construction	2020
Pinnacle	Upperhill	255	Under construction	2020

Hotels that are set to come up in Nairobi Metropolis

Name	Location	Rooms	Status	Year of Completion
Cytonn Towers	Kilimani	180	Planned	2022
Grenadier	Kiambu/Limuru Rd	200	Planned	2020
Paddock Runda	Kiambu/Limuru Rd	200	Planned	2020

Source: Cytonn Research

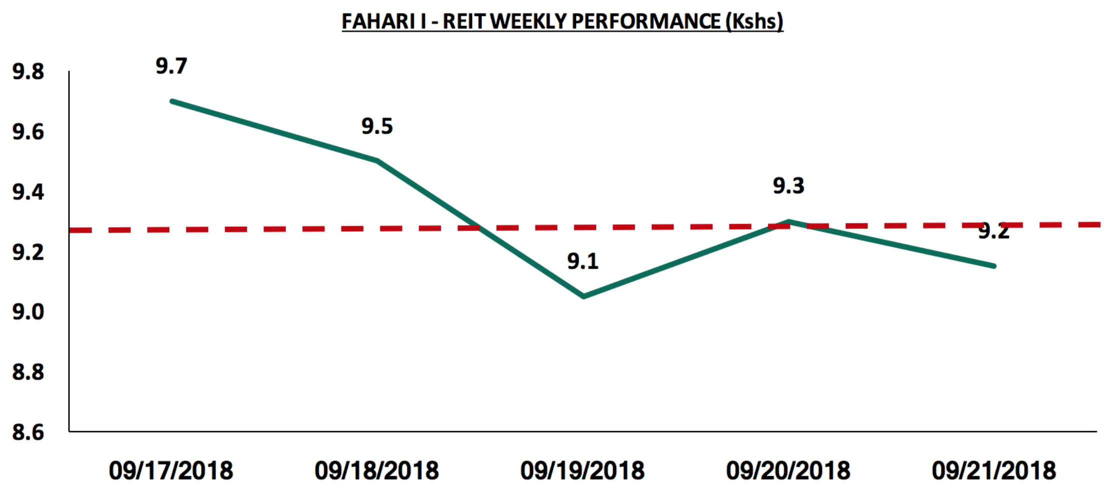
Infrastructure

Infrastructure in the country continues to be a key focus area for the national government as the Cabinet Secretary (CS) of Transport, James Macharia, announced plans aimed at reducing traffic jams in the Nairobi city through completion of four link roads i.e. the Northern Bypass, the Eastern Bypass, the Southern Bypass and the Western Bypass. The plans will majorly involve the completion of the Western Bypass, a 16.5 km expressway costing Kshs 17.3bn that will connect with the Northern Bypass at Ruaka and with the Southern Bypass at Gitaru. The Western Bypass will include features such as a 17.7 km of service lane and 2-meter wide walkways on both sides of the road. Moreover, the road will encompass interchanges and overpasses at Gitaru, Wangige, Kahara, Ndenderu, Rumingi and Ruaka, 11 traffic bridges and 7-foot bridges. The CS also announced plans to construct a 30 km bridge from Jomo Kenyatta International Airport (JKIA) to Kangemi on Waiyaki way aimed at easing movement to the airport thus providing convenience to passengers travelling to and fro the airport. The completion of these roads will result in increased demand for property and thus cause a rise in property values in the areas situated nearby. For example, after the completion of the Northern Bypass in 2014, Ruaka area recorded a 4-year Compound Annual Growth Rate (CAGR) of 18.9% in land prices from Kshs. 40mn in 2011 to Kshs. 80mn as at 2015. We thus commend the government’s efforts to improve infrastructure in the country aimed at opening up areas for development and promoting economic development through value creation for other sectors.

Listed Real Estate

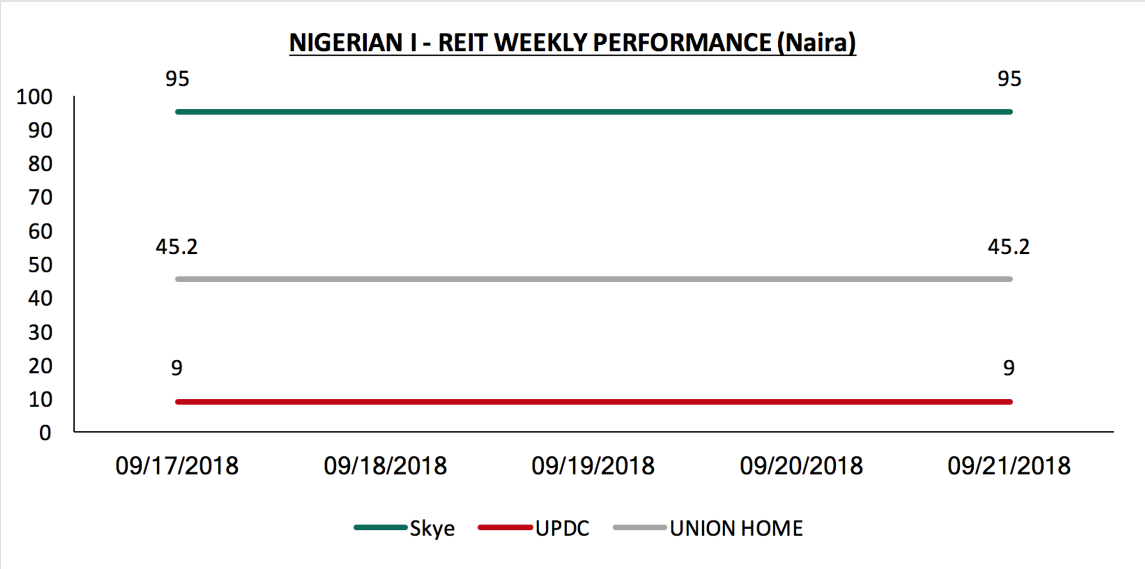
i. Fahari I - REIT

The Fahari I-REIT closed the week at Kshs 9.2, 5.2% lower than the week’s opening price of Kshs 9.7 and 4.2% lower than last week’s closing price of Kshs 9.3. Additionally, during the week, it recorded an average price of Kshs 9.3, which is a decline of 5.1% from the previous week average of Kshs 9.8. The instrument continues to trade at low prices and in low volumes largely due to: (i) the negative sentiments currently engulfing the sector given the poor performance of Fahari and Fusion REIT (FRED), (ii) inadequate investor knowledge, and (iii) the poor performance of Fahari I-REIT recording a dividend yield of 5.7% compared to brick and mortar office and retail at 9.3% and 9.7%, respectively.



ii. Nigerian I – REIT

The Nigerian I-REIT market remained unchanged during the week, with, Skye Shelter, Union Homes and UPDC, retaining a price per share of N95, N45.2, and N9, respectively. We attribute the plateaued performance to inadequate investor knowledge about the market hence low investor interest in the instrument.



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.