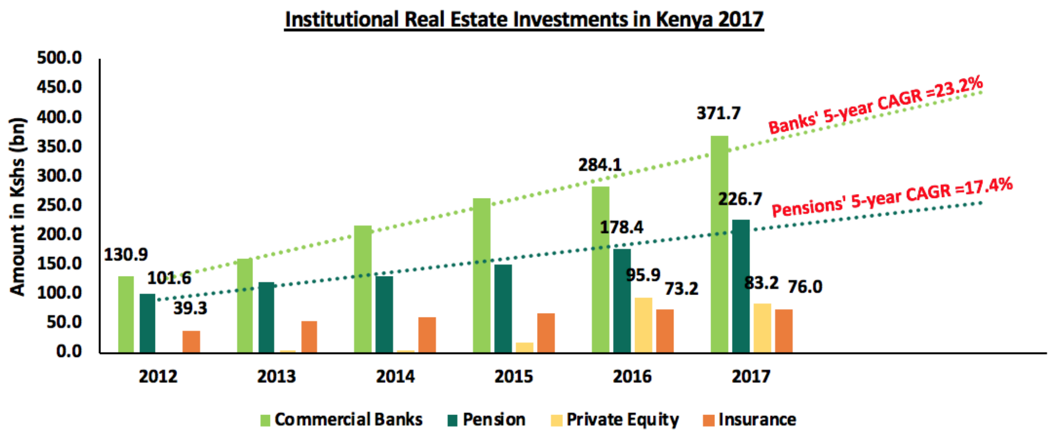
Cytonn Corporate Governance Report - 2018, & Cytonn Weekly #39/2018

Real Estate

I. **Industry Reports**

During the week, the Central Bank of Kenya released its 2018 Financial Stability Report, which tracks the local economy and financial sector in Kenya. Key take-outs from the report were:

i. Commercial banks and pension funds remained as the leading sources of credit for real estate developers and homebuyers alike. Bank credit to real estate increased by 30.8% to Kshs 371.7 bn in 2017, from Kshs 284.1 bn in 2016. This is despite the decline in private sector credit growth that stood at 4.3% as at August 2018 compared to a 5-year average of 14.3%. Pensions funds' portfolio allocated to real estate increased by 27.1% to Kshs 226.7 bn in 2017, from Kshs 178.4 bn in 2016,
ii. Private equity funding to real estate reduced by 13.3% to Kshs 83.2 bn, from Kshs 95.9 bn over the same period in 2017. This is in comparison to a growth of 412.5% between 2015 and 2016, and,
iii. Insurance funds retained the least portfolio of Kshs 76.0 bn, having grown by 3.8% in 2017, from Kshs 73.2 bn in 2016. This, however, made up 20.9% of the assets under management, which is 8.1% short of the 30.0% limit allocation for property investments by the Retirements Benefits Authority (RBA).



Source: Central Bank of Kenya 2018

In our view, the decline in private equity investments in 2017 is attributable to:

i. Political tension in 2017 causing investor wariness,
ii. The deteriorating financial services sector due to the Bank Amendment Act of 2015, and,
iii. The decline in the performance of the commercial real estate sector, where most private equity

funds tend to focus, due to an oversupply of office and retail supply, especially in Nairobi.

The continued investment by commercial banks and pension funds, on the other hand, is supported by:

i. High long-term returns with a five-year average total return to investors of 24.3% compared to traditional asset classes' average of 13.2%,
ii. Sustained demand for housing with the nation's deficit at 2.0 mn units, and,
iii. The expansion of the middle class creating demand for real estate.

We are, however, of the view that there is still need for increased sources of finances for real estate given the huge housing deficit in the market. Case in point, with a cumulative demand of 2 mn units and assuming a cost of Kshs 2 mn per unit, Kenya has a real estate market size worth at least Kshs 4 tn against a total funding of Kshs 757.6 bn as at 2017 from banks, pension funds, insurance firms and private equity investors. The pension industry, for instance, has the potential to unlock funds for real estate development with assets worth Kshs 963.1 bn as at the end of June 2017 and growing at a CAGR of 13.5% from Kshs 396.7 bn in June 2010, with the current property investment allocation standing at 21.3% only. Other alternative sources of funding that could be explored include the capital markets through structured products such as REIT's, commercial papers and project notes.

II. **Hospitality Sector**

During the week, global hotelier, Radisson Hotel Group, announced plans to open its first residence in Nairobi's Arboretum neighborhood in Q2'2019. The property, which shall be under the Radisson Blu brand as Radisson Blu Hotel and Apartments, will have approximately 123 rooms and will add onto its current operational portfolio consisting of the 140-room Park Inn Hotel in Westlands, which opened in April 2017, and the 271-room Radisson Blu Hotel in Upperhill, which opened in November 2015. The international hotel group also plans to introduce three more of its brands, that is, Radisson RED, Radisson Collection, and Radisson (timelines undisclosed), raising its total brand portfolio in Kenya to 5. The heightened appetite for Kenya from international hotel brands attests to the growth and viability of Kenya's hospitality scene. Some of the other notable international hotel brands in Nairobi include:

International Hotel Brands Operating in Nairobi and Hotels in the Pipeline

No	Hotel Group	Current Portfolio	No Of Rooms	Under Construction	No Of Rooms	Estimated Completion Year
1.	Dusit Thani Group	DusitD2, Westlands	101	-		
2.	Hilton	Hilton Nairobi, CBD Hilton Garden Inn, Msa Rd Double Tree, Hurlingham	287 171 109	Pinnacle, Upperhill	255	2020
3.	Radisson Hotel Group	Park Inn, Westlands Radisson Blu, Upperhill	140 271	Radisson Blu Hotel & Apartments, Arboretum	123	2019
4.	Kempinski	Villa Rosa Kempinski, Westlands	200	-		

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No	**Hotel Group**	**Current Portfolio**	**No Of Rooms**	**Under Construction**	**No Of Rooms**	**Estimated Completion Year**
5.	Intercontinental Hotel Group	Crowne Plaza, Upperhill InterContinental Nairobi, CBD Crowne Plaza, Msa Rd	206 326	-		
6.	Marriot International	Four Points by Sheraton, Kilimani Four Points by Sheraton, JKIA	96 172	JW Marriot, Westlands Protea, Mombasa Road	365 250	2020 2021
7.	Best Western	Best Western Plus Meridian, CBD Executive Residency, Riverside	128 48	Best Western, Westlands	100	2019
8.	Louvre Hotel Group	Royal Tulip Canaan, Kilimani Golden Tulip, Westlands	94 94	-		
9.	Accor Hotels	Movenpick Hotel, Westlands Fairmont The Norfolk Hotel, CBDIbis Styles, Westlands	223 170	Pullman Westlands	340	2019
10.	Sarova	Lazizi Premier, Msa Road Heron Portico, Kilimani Portico the Zehneria, Westlands	144 108 56			
*****Other international brands planning to come into the market include Wyndham, City Blue, and Swiss International **The incoming supply of hotel keys is estimated to be at least 2,945 keys***						

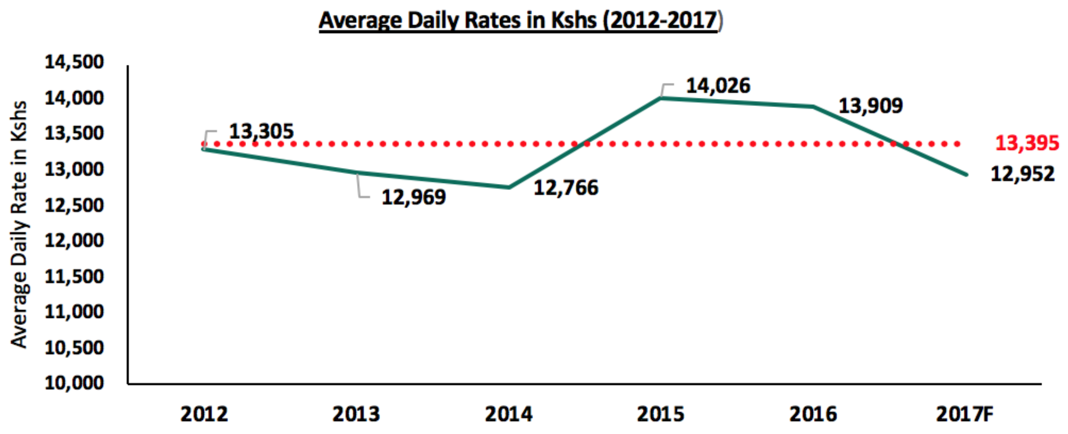
Source: Cytonn Research

We attribute the robust expansion drive by international hoteliers to:

i. Improved infrastructure such as airport renovations at the Jomo Kenyatta International Airport (JKIA), and Moi International Airport (MIA), and roads such as the Standard Gauge Railway,
ii. Availability of express flights such as Nairobi-New York, Rwanda-Mombasa, Italy-Malindi, Paris-Nairobi, Qatar-Mombasa, among others, which have improved the convenience in transport for both business and leisure travelers,
iii. Aggressive marketing by the Kenya Tourism Board, aided especially by the global recognition awards and positive reviews from travel agencies such as Trip Advisor,
iv. Reduced visa restrictions and visa on arrival for African nationalities, which was introduced in 2017,
v. Nairobi's regional status as a business hub, thus it is a key destination for business travelers to the Eastern Africa Region, and,

vi. Increased demand for luxurious hotel accommodation services especially from the international tourists.

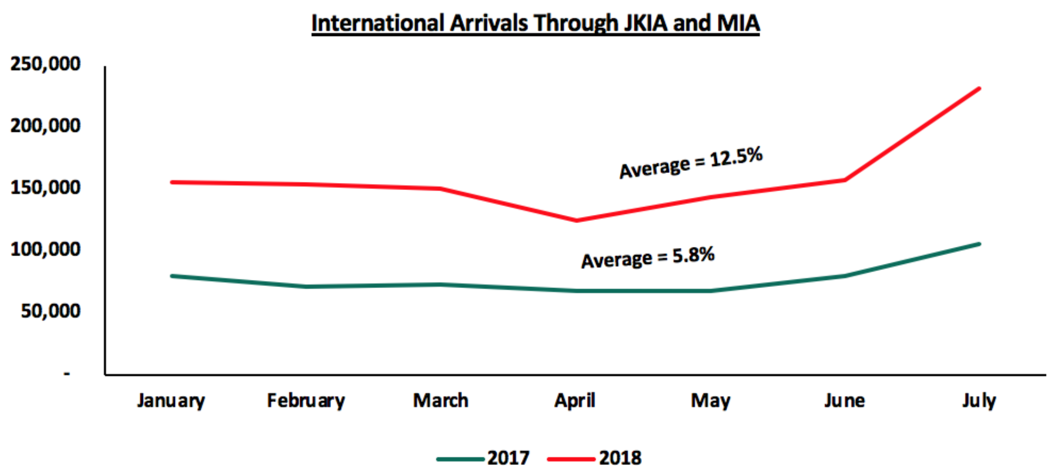
Hotels performance has been boosted by increased demand for premium hotel services from both leisure and business travelers. In 2015 and 2016, the sector showed signs of recovery with an Average Daily Rate of Kshs 14,026 and Kshs 13,909, respectively, 4.7% and 3.8% higher than the 5-year average of Kshs 13,395, where lower rates were recorded between 2011 and 2014, on account of insecurity caused by terrorist activities in Kenya. According to Cytonn Hospitality Report 2017, the Average Daily Rate decreased in 2017 due to the protracted electioneering period that caused security concerns.



Source: Cytonn Hospitality Report 2017

The sector's performance has been on a recovery path in 2018 supported by a stable macroeconomic environment, the return of political calm, and increased international tourist arrivals.

Over the January to July period, 2018 recorded an average increase in international arrivals, through the Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) of 12.5%, compared to 5.8% over a similar period in 2017, as shown below:



Source: KNBS Leading Economic Indicators

The increase in international hotel brands is bound to boost the Meetings, Incentives, Conferences, and Exhibitions (MICE) industry by availing international quality conferencing facilities, which are a key pull factor for global conferences. Additionally, presence of well-known brands is an attraction for international tourists, due to brand loyalty, and thus is likely to encourage longer or frequent stays leading to increased sector earnings.

Also during the week, Kenya's tourism and hospitality sector received global accolades during the World Travel Awards (WTA) recently held in Durban, South Africa. The various awards are as shown below:

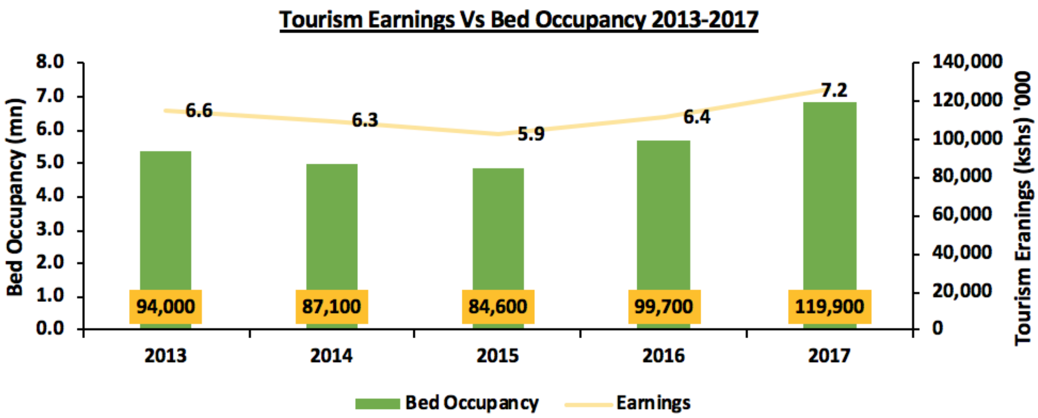
Kenya World Travel Awards 2018

Facility	**Award**
Maasai Mara	Leading National Park
Diani Beach	Leading Beach Destination
Diani Reef	Leading Beach Resort
Kenya Airways	Leading Airline - Business and Economy Class
Aberdare Country Club	Leading Green Hotel
Palacina Residences and Suites	Leading Hotel Residences
Villa Rosa Kempinski	Leading Luxury Hotel

Other facilities that bagged awards include: Ol pejeta Conservancy, Fairmont Mount Kenya Safari Club, Manda Bay, Finch Hattons, Olare Mara Kempinski

Source: Online Sources

The awards facilitate the performance of the sector and of key to note is that, the Maasai Mara and Diani Beach have won the respective accolades six and five times in a row, respectively, demonstrating Kenya's position as a global leader in the industry. This is also evidenced by the continued improvement of our hospitality industry, where according to KNBS Economic Survey 2018, tourism earnings increased by 20.3% in 2017 to Kshs 119.9 bn from Kshs 99.7 bn in 2016, whereas hotel occupancy increased by 11.3% to 7.2 mn bed nights in 2017 from 6.4 mn bed nights in 2016, thus indicating sustained demand for hotel beds.



Source: KNBS 2018

We, therefore, expect the hospitality sector to remain on its upward trajectory supported by increased international tourist arrivals, support from the government in the form of international marketing, increased entry of international hotel brands, and enhanced security within the country.

III. **Retail Sector**

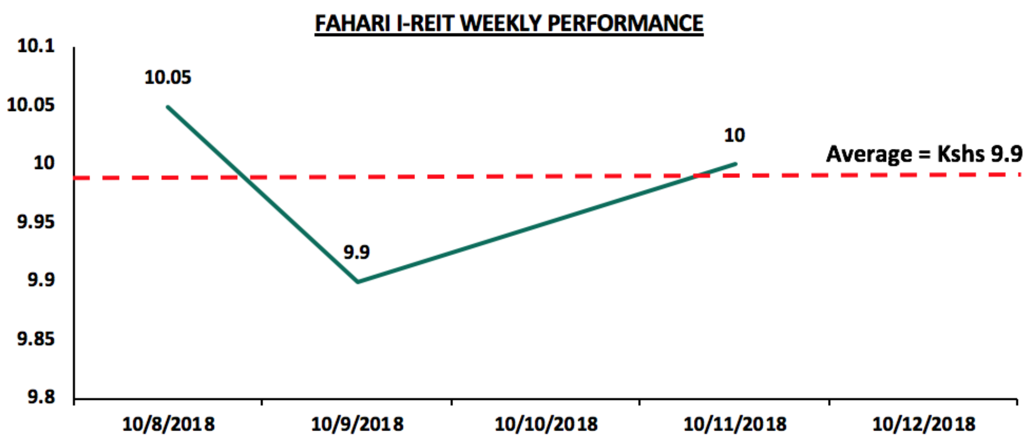
Local retailer, Naivas, announced plans of shutting down its Kitengela Mall branch, which was opened in June earlier this year. The retailer will relocate its store merchandise to its recently launched branch at Freedom Heights Mall in Lang'ata where it took up 18,000 SQFT of space. Naivas Supermarkets, one of the leading retail chains in Kenya, has been undertaking a national expansion drive, which has seen its store count rise to 46 countrywide, and 24 in Nairobi. This recent development, however, will see the number of stores reduce to 45 nationwide, and 1 in Kitengela. In our view, this could be due to a challenging business environment at its Kitengela Mall branch, attributable to the stiff competition from the informal retailers in Kitengela, as well as the presence of other formal retailers such as Tuskys and Eastmatt. Previously, we have witnessed local retailers under distress due to financial constraints arising from overambitious expansion drives. Therefore, this is a prudent move by Naivas to avoid bearing unnecessary losses considering the Kitengela Mall branch was only operational for four months.

Other Highlights

A. **Infrastructure:** The Kenyan Government allocated Kshs 10 bn to Kenyan Sub-Counties in a bid to ease communication across counties as well as improve government service delivery to the citizens through the National Optic Fiber Backbone Infrastructure, which will be an extension from the Kenyan Counties to the Sub-Counties. The project is set to take 3-5 years in institutions such as schools, hospitals, and police stations. This in turn is expected to improve monitoring of security, traffic snarl ups, and thus increasing investment opportunities, especially for residential real estate investments,
B. **Industrial:** Electronics manufacturer Toshiba has invested Kshs 500 mn to open its first regional warehouse in Nairobi's Karen in a bid to serve its East African market more efficiently. Currently, the brand has been operating within the continent from its South African branch.

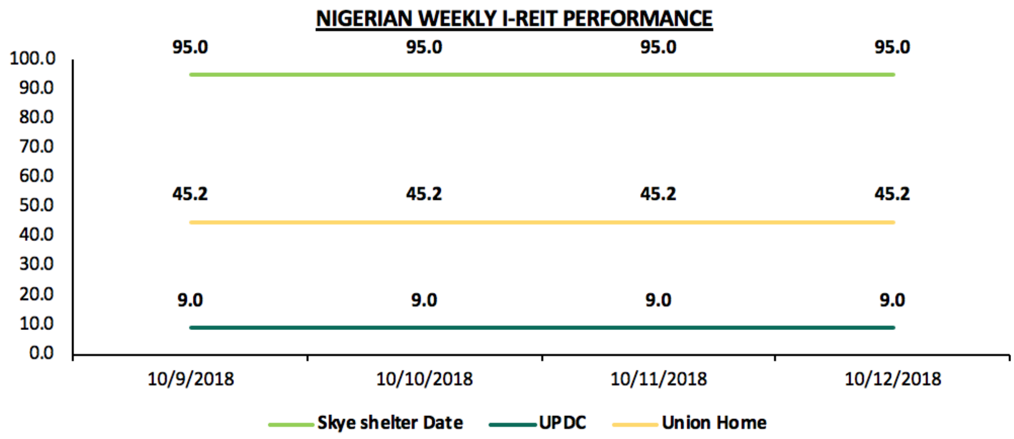
Listed Real Estate

The Fahari I-REIT remained unchanged closing the week at Kshs 10.0 per share (as of Thursday), which was the same as last week's closing price. Additionally, during the week, it recorded an average price of Kshs 9.9 per share, 2.9% decline from last weeks' average of Kshs 10.2. 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 the Fusion D-REIT (FRED), which failed to raise the minimum capital required to list on the NSE, (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.



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 remain optimistic about the real estate sector, with its performance boosted by improving macroeconomic environment, increase in tourism and hospitality earnings and increase in infrastructural improvements.
