Nairobi Metropolitan Area Infrastructure Report 2018, & Cytonn Weekly #41/2018

Real Estate

I. **Residential Sector**

The affordable housing initiative by the Kenyan Government under the Big 4 Agenda continues to witness increased support of its implementation from both private investors and the government. During the week, H.E President Uhuru Kenyatta signed into law the Supplementary Appropriation Bill No. 2 of 2018, with the housing department receiving Kshs 21.0bn, which is 44.7% of the Kshs 47.3 bn supplementary budget and a 223.1% increment from the Kshs 6.5 bn allocated in Kenya National Budget 2018/19, in support of the affordable housing initiative. The additional funding shows the government's commitment to delivering 500,000 affordable housing units by 2022, an initiative expected to cost a total of Kshs 2.3 tn. This comes just after the Cabinet approved the guidelines for the implementation of the initiative in terms of projects' financing, cost, design, quality and affordability last week. This far, the government has made advancements by putting in place various policies and strategies to support both developers and homebuyers, some of which include:

Measures to Support Home Buyers:

1. 15% tax relief, for buyers of units developed under the affordable housing scheme up to a maximum of Kshs 108,000 p.a, or Kshs 9,000 p.m,
2. Exemption from stamp duty tax, normally set at 2.0% - 4.0% of the property value, for first time home buyers of units under the affordable housing initiative, and,
3. 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. So far, the KMRC has already received pledges for seed funding from the World Bank worth Kshs 15.1 bn, The National Treasury pledging Kshs 1.5 bn and banks such as the Cooperative Bank pledging Kshs 0.2 bn. For more information, please see our note on KMRC here.

Measures to Support Developers:

1. 15% corporate tax rate for developers who provide at least 100 low – cost housing units p.a,
2. Scrapping off of NEMA and NCA levies, encouraging developers to construct more units, due to the reduction in costs,
3. Establishment of the National Housing Development Fund (NHDF), with the Kenyan President approving the Finance Bill 2018, which includes a 1.5% levy on employee's basic salaries up to Kshs. 5,000 p.m. and the employer expected to match the same amount that will be channeled into the fund,
4. Partnerships with developers through availing of public land for development, and,
5. Establishment of a land bank whereby unutilized prime government land will be gathered

together and availed for use by both local and foreign investors for affordable housing projects.

These advancements, as well as the increased funding, are commendable and a proof to the Kenyan Government's commitment to delivering the affordable homes to Kenyans, and we anticipate the launch of various projects in coming months especially in Nairobi, with the Urban Housing Renewal Development LLP and Technofin, a developer, unveiling the house plans for Pangani Housing Project. However, we expect the affordable housing initiative to face impediments such as inadequacies in public-private partnership (PPP) package for private developers due to the persistent challenges that hinder the success of PPPs in Kenya such as (i) persistent red tape during government approval processes, (ii) equivocal profit-sharing strategies for the private partners, and (iii) long and extended time-frames that tend to characterize PPP projects, thus making them unattractive to private developers and inadequate infrastructure in several parts of the country, which will increase the construction cost, hence compromising the affordability.

During the week, Urithi Housing Co-operative Society Limited, a Co-operative that is registered by the Ministry of Trade, Industry and Co-operatives in Kenya, launched a development of 5,000 low-cost housing units on 100-acres at Birmingham Woodlands Estate in Mang'u Area, off Thika Road. The development will consist of 130 SQM bungalows, 105 SQM maisonettes, and 80 SQM & 60 SQM 3 & 2-bed apartments, selling at an average price of Kshs 6.45 mn, Kshs 4.95 mn, Kshs 3.95 mn, and Kshs 2.95 mn, respectively, translating to an average selling price per SQM of Kshs 48,815. We attribute the increased focus by developers on affordable housing to i) the large housing deficit mainly for the low income and lower-middle segment of the market, with a cumulative demand of 2 mn units growing by 200,000 units per year, according to National Housing Corporation, ii) the government affordable housing initiative and incentives, and iii) the high returns in the real estate sector, averaging at 24.3% over the last 5-years. According to Nairobi Metropolitan Area Residential Report 2018, satellite towns recorded a rental yield of 5.9%, 0.5% points higher than the market average at 5.4% thus attracting investors. On the other hand, with an average selling price of Kshs 74,759 per SQM, which is 37.6% lower than the market average at Kshs 119,827 per SQM, satellite towns attracting home buyers who are looking for affordability. We therefore, expect to see increased developments in satellite towns such as Thika and Juja that are recording higher rental yields of 6.1%. For developers, these areas are attractive given the affordability of land for development, with satellite towns average price being Kshs 21.0 mn, compared to Nairobi Suburbs-Low Rise Residential Areas at Kshs 92.0 mn and Nairobi Suburbs-High Rise Residential Areas at Kshs 220.3 mn, hence are able to save on costs thus providing more affordable housing. However, these areas lack the requisite infrastructure for development, such as proper access roads, power and sewerage services, hence developers are forced to incur these costs, which are then passed on to the end buyer, compromising on affordability. We therefore recommend increased focus on infrastructural development in satellite towns in order to enable developers achieve affordable units according to government affordable housing guidelines.

II. **Commercial Office Sector**

In the commercial office sector, Ushuru Sacco office block along Wood Avenue in Kilimani, owned by Ushuru Co-op Savings and Credit Society Limited, is scheduled for opening in November 2018 (size and other details undisclosed). According to Cytonn Q3'2018 Markets Review, Kilimani, classified as a high-rise commercial office zone, recorded a yield of 9.6% in Q3'2018, 0.2% points increase from 9.4% in Q2'2018, while occupancy increased by 1.9% points from 85.4% in Q2' 2018 to 87.3% in Q3'2018, and rent remained flat at Kshs 101 per SQFT. The increase in occupancy rates was because of the availability of Grade A offices that are attracting tenants due to the state-of-the-art technical services provided such as high-quality elevators, fittings and automation systems and ample parking at a minimum ratio of 3:1000 (3 parking slots for every 1000 SQFT) which lack in Grade B and C offices. Overall, the Nairobi Office Market had an average rental yield of 9.5% at an average occupancy rate of 87.3%, recording 0.2% and 3.1% points increase in rental yield and occupancy rates, respectively from Q2’2018 despite the total oversupply of 4.7 mn SQFT as at 2017.

The table below shows the performance of the commercial office sector in Nairobi in Q3’2018:

(All values in Kshs unless otherwise stated)											
Nairobi Commercial Office Performance by Nodes Q3’2018											
Nodes	**Price Kshs / SQFT Q3' 2018**	**Rent Kshs/SQFT Q3 2018**	**Occupancy (%) Q3 2018**	**Rental Yield (%) Q3 2018**	**Price Kshs / SQFT Q2 2018**	**Rent Kshs/SQFT Q2 2018**	**Occupancy (%) Q2 2018**	**Rental Yield (%) Q2 2018**	**Q/Q Δ in Rents (%)**	**Q/Q Δ in Yields (%)**	**Q/Q Δ in Occupancy (%)**
Karen	12,888	117	89.0%	**10.8%**	13,776	118	87.2%	10.2%	**(0.7%)**	**0.6%**	**1.8%**
Westlands	10,667	111	89.0%	**10.0%**	12,567	109	84.7%	9.7%	**2.0%**	**0.3%**	**4.3%**
Parklands	12,208	103	86.0%	**9.8%**	12,433	103	85.6%	9.8%	**0.0%**	**0.0%**	**0.4%**
Kilimani	13,031	101	87.3%	**9.6%**	12,694	101	85.4%	9.4%	**0.0%**	**0.2%**	**1.9%**
Nbi CBD	11,333	88	92.1%	**9.1%**	11,750	87	92.1%	8.7%	**1.3%**	**0.4%**	**0.0%**
UpperHill	13,386	100	90.1%	**9.0%**	12,708	101	85.7%	9.0%	**(1.0%)**	**0.0%**	**4.4%**
Msa Road	11,750	82	71.0%	**8.7%**	11,770	83	68.0%	8.6%	**(1.0%)**	**0.1%**	**3.0%**
Thika Road	11,750	85	89.0%	**8.7%**	11,500	85	80.0%	8.7%	**0.0%**	**0.0%**	**9.0%**
Grand Average	**12,202**	**102**	**87.3%**	**9.5%**	**12,527**	**102**	**84.6%**	**9.3%**	**0.1%**	**0.2%**	**3.1%**

Source: Cytonn Research

We attribute the growth to; i) a stable macro-economic environment in 2018 making it conducive for business operations, and ii) growth of SMEs and multinational firms, which have created demand for quality offices. Despite the improved performance, we retain a neutral outlook on the office market and recommend investments in differentiated concepts such as serviced offices, which have low supply with a market share of just 0.35% and high returns with average rental yields of 13.4% compared to a market average of 9.5% and mixed-use developments with an average rental yield of 11.0%.

We expect continued increase in activities in the real estate sector, particularly in the residential sector, supported by government initiatives and commitment to delivering the affordable homes to Kenyans.