Kenya's Attractiveness as an Investment Destination, & Cytonn Weekly #49/2018

Real Estate

I. **Retail Sector**

Kenya's retail sector has been vibrant over the past few years, attracting interest from renowned international retailers as well as the robust expansion of local retailers. The trend continues, and during the week, a leading coffee restaurant, Java House, opened its 62nd branch at Engen service station in Parklands. This is the second branch that Java House has opened in December 2018, following the opening of Lavington branch at Shell service station in Lavington. In our view, the Java House expansion in Kenya is supported by;

i. Increased disposable income because of an expanding middle class thus creating demand for high-end restaurants and casual dining areas. According to KNBS Economic Survey 2018, private consumption expenditure recorded the highest growth, since 2013 when it recorded 8.4%, in 2017 by 7.0%, compared to 4.7% in 2016, 5.2% in 2015, and 4.3% in 2014,
ii. A positive demographic dividend, with a population growth rate of approximately 2.6% p.a. and a rapid urbanization rate of 4.3%, in comparison to the global 1.2% and 2.1%, respectively, hence an increase in demand for restaurants, and,
iii. Stable economic growth, with Kenya's GDP growth averaging at 5.1% over the last five-years, and set to come in at 5.7% in 2018, according to Cytonn Research, thus, creating an enabling environment for the retailers to make desirable profits.

In our view, the Parklands area presents a viable opportunity for the business as (i) it hosts a large expatriate population who create demand for high-end restaurants, (ii) it is in close proximity to Westlands, a prime commercial hub, with several firms that regularly seek premises for business meetings, and (iii) it hosts high to middle income earners with high purchasing power, creating the restaurant's target market. The continued expansion of Java House and other restaurants such as Mugg & Beans and Burger King in Nairobi will result in increased uptake of retail real estate developments thus improving the overall performance of the sector. For investors in retail real estate, with an average rent of Kshs 218.8 per SQFT, retail space in Parklands and Westlands records a high average rental yield of 12.4% and average occupancy rates of 90.2% compared to the market average rental yield of 9.4% and an occupancy rate of 83.7%, according to Cytonn Kenya retail sector report 2018. This therefore portrays Parklands as a viable investment destination for both retailers and retail real estate developers.

II. **Residential**

During the week, three developers, namely Laser Freight, Trio Properties and Salsabil Heights, presented plans to the National Environmental Management Authority (NEMA) for approval to develop 481 studio houses in Nairobi in South C, Parklands and Langata, respectively. The three developers are seeking approval to develop the following concepts:

- Laser Freight seeks to develop a 12-level block hosting 143 studio apartments with 15 parking bays, a lap pool, a gym and laundry mats at Nairobi's South C Estate,
- Trio Properties intends to develop 176 studio apartments in Langata, Nairobi on a 11-floor block, and,
- Salsabil Heights seeks to develop 162 serviced studio apartments in Parklands on a 12 floors block. (*unit sizes and prices undisclosed*).

The above areas are attractive to investors mainly driven by proximity to Nairobi's main commercial business hubs, availability of social amenities, good infrastructure and relatively high demand as they host middle-income earners especially young adults seeking affordability and convenience. According to Cytonn Residential Report 2018, the target locations Langata, South C and Parklands, recorded a rental yield of 5.3%, 5.6% and 7.3%, respectively compared to the market average at 5.4%. Therefore, investors in these projects are likely to get the same returns once the projects are complete based on market trends, in addition to development return, which averages about 20% over the 3-year development period. The following table shows the performance of the above-named locations;

Residential Market Performance – Apartments 2018

Location	Average Price Per SQM	Average Rent Per SQM	Average Annual Sales	Average Rental Yield	Average Price Appreciation	Average Total Returns
South B & C	107,819	510	26.5%	5.7%	4.4%	**10.1%**
Parklands	113,908	641	25.8%	7.3%	(1.3%)	**5.9%**
Langata	107,374	462	23.2%	5.3%	0.3%	**5.6%**
Avg Market Performance	99,052	463	**23.9%**	**5.8%**	**2.9%**	**8.8%**

· South B& C records the highest total return among the three areas, attributable to its proximity to key business nodes, thus, attracting demand especially from the young and working population in general

· Parklands offers the highest rental yields at 7.3% due to relatively high rental rates, compared to the market average at 5.8%, however, it recorded a decline in price appreciation attributable to an increase in supply of apartments as investors move out of Westlands which is increasingly being commercialized

Source: Cytonn Research 2018

In terms of serviced apartments, the Westlands & Parklands area recorded a rental yield of 10.6%, compared to a market average of 7.4% according to Nairobi Metropolitan Area Serviced Apartments Report 2018. Studio serviced apartments record the highest monthly charges at Kshs 3,965 per SQM with average occupancy rates of 82% and a rental yield of 13.5% compared to market average monthly charges of Kshs. 2,768 per SQM, occupancy rates at 75% and a rental yield of 9.5%, hence they are an attractive investment opportunity. We expect to see increased investment in residential property with investors targeting areas with demand for low to middle income housing units and with high returns in order to maximize on investors returns.

III. **Statutory Reviews**

The Employment and Labor Relations Court Justice Hellen Wasilwa issued an interim order suspending the 1.5% levy that was to be deducted from the wages of formal industry workers with a similar amount remitted by their employers to create the National Housing Development Fund. This order holds until the hearing and determination of the application made by the Central Organization of Trade Unions (COTU). COTU had raised the application on grounds that there was no public participation in its introduction and no guarantee of transparency in its implementation. The levy, which was to take effect as from 1st January 2019, would have seen the government raise up to Kshs. 24.0 bn annually from the employees, with an additional Kshs. 24.0 bn from the employers, had it been effected. This figure is based on the Kenya National Bureau of Statistics, 2017 Statistical Index, which indicates the country's wage bill in 2016 was Kshs 1.6 trillion. This ruling may be a setback to the government as the National Housing Development Fund (NHDF) is meant to help the government realize its goal of delivering 500,000 affordable housing units in the next four years. In our view, the National Housing Development Fund is a good initiative towards facilitating the achievement of the affordable housing initiative. Therefore, we recommend that the government should lay clear and transparent guidelines on management of the fund as well educate the public on its importance and functionality in order to win public trust. The government may also consider representation of the workers on the NHDF board to ensure proper usage of the funds. The government should also explore other avenues of funding such as the public markets and a review of the Public Private Partnerships (PPP) framework to facilitate the approvals process and to aid in establishment of Special Purpose Vehicles, thus encourage the involvement of the private sector, in order to achieve the affordable housing initiative.

In other real estate highlights, the Head of Public Service, Joseph Kinyua, suspended the demolitions of property, including those built on road reserves and riparian land buildings across the country, indefinitely. The directive comes in after a sequence of real estate property such as South End Mall along Langata road, Ukay Centre in Westlands and AirGate Mall along Outer Ring Road, among others, have been demolished in a bid to reclaim public and riparian land. In our view, while the reclamation of the public land is a prudent move, there has been lack of clarity on land earmarked as riparian land and the issuance of regulatory permits, hence there's need for these to be aligned in order to enable developers conduct due diligence and adhere to set guidelines and approval processes. We hope that the suspension will create time for the government and other regulatory bodies to align with developers and create clarity to prevent a slowdown in the real estate sector where investors have adopted a wait and see attitude due to uncertainty of land ownership papers and regulatory permits during the sale of property.

We expect continued increase in activities in the real estate sector, particularly in the residential sector, supported by; (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) legal reforms in support of real estate, and (iii) government incentives and initiatives such as focus on affordable housing.