Consolidation in Kenya's Banking Sector to Continue, & Cytonn Weekly #06/2019

Real Estate

I. **Industry Reports**

During the week, Broll Kenya, a property services company, released their Nairobi Retail Report H2'2018, which highlighted a slowdown in the retail market performance. The report noted that landlords embarked on offering rent concessions aimed at drawing tenants to their vacant spaces in addition to taking a cautionary approach by leasing smaller spaces to more than one anchor tenant, following the fall of local giant, Nakumatt Holdings, which was a sole anchor tenant in several retail spaces.

The key take-outs from the report include:

i. The market recorded a 5.0% increase in supply of retail space to 5.7 mn SQFT as at H2'2018, from 5.4 mn SQFT recorded in H1'2018, attributed to the opening of spaces such as The Well in Karen, which brought into the market 77,371 SQFT of space,
ii. The sector recorded a 6.0% points y/y increase in occupancy rates in H2'2018, and this was mainly attributed to the take-up of space that was previously occupied by Nakumatt Supermarkets, in addition to the entry of new international retailers primarily from Europe, across the fashion, sportswear and hypermarket categories,
iii. In terms of the market share of supermarkets within Nairobi, Tuskys Supermarket had the highest percentage of market share of approximately 23.0%, while Naivas and Foodplus Supermarkets came in second and third with a market share of approximately 20.0% and 11.0% in H2'2018, respectively, and,
iv. On average the monthly rent for anchor tenants came in at between Kshs 55.0 per SQFT and Kshs 100.0 per SQFT, while that of line shops ranged between Kshs 120.0 and Kshs 340.0 per SQFT. In addition, the monthly service charge for small regional centers registered the highest average rate of Kshs 52.7 per SQFT, while that of neighborhood centers came in at Kshs 33.5 per SQFT.

According to the report, the retail sector recorded a slight improvement in performance in H2'2018, with the 6.0% points y/y increase in occupancy rates, amidst the growing supply. On the contrary, Cytonn Annual Markets Review 2018, noted that the performance softened as a result of increased supply of retail space, and the tough operating environment characterized by low private sector credit growth, resulting in a 0.6% points decline in rental yields to 9.0% in 2018 from 9.6% in 2017. For 2019, we expect a slowdown in performance with returns expected to soften as a result of the current retail oversupply at 2.0 mn SQFT, while occupancy rates are expected to decline by 2.9% points to 76.9% from 79.8% in 2018 leading to reduced yields of 8.7% from 9.0% in 2018. However, we expect the continued entry of international retailers and expansion of local retailers to cushion the market. For more information, see our Cytonn 2019 Markets Outlook.

II. **Master-planned Developments**

During the week, property developer Tilisi Developments announced that it had opened the sale of Phase 2 of its 400-acre mixed-use development, which is located in Limuru. This follows the completion of Phase 1 of infrastructure for its 85-acre logistics park, which according to the CEO, Kavit Shah, is 65.0% sold. In addition, an initial sale of approximately 120-acres of Phase 2 was made to Chigwell Holdings, a Nairobi- based property development firm. The firm plans to develop 300 residential units on a 47-acre parcel of land, and this will be the developer's fourth project, with others being 127 residential units at a development knows as Sidai Village in Athi River, the 343-unit Phenom Estate in Lang'ata, and an ongoing Phenom Park in the same area. The Tilisi project highlights the rise of master-planned communities in Kenya, which encompass mixed-use developments built in a rural or undeveloped area aimed at shifting urban development from cities. They integrate themes such as residential, retail, industrial, education facilities etc., and are thus mainly located in Satellite Towns where large tracts of land are available at lower prices compared to those in major urban centers.

III. **Residential Sector**

In the residential sector, Sprinter Real Estate Investment, an American investor, and Third Eye Management and Associates, a US based firm, are set to construct 300 houses in Ndenderu, Kiambu County. The 300-unit project, dubbed Fanisi Tigoni View, will sit on 8-acres of land and comprises of 2- and 3-bedroom apartments of 84 SQM and 115 SQM, selling at Kshs 5.2 mn and Kshs 5.9 mn, respectively, which translates to an average of Kshs 56,604 per SQM. The Ndenderu area benefits from good infrastructure with access from Limuru Road, Northern Bypass and the Western Bypass, which is under construction, and its proximity to fast growing neighboring markets such as Ruaka. As with other Satellite Towns, we expect to continue recording increased activities fueled by the relatively affordable land prices, availability of land in bulk, the improving infrastructure and the continued focus on the government's Big Four Agenda on provision of affordable housing by both the private sector and the government.

IV. **Retail Sector**

During the week, Ebrahim Supermarkets, a local retailer, closed its outlet situated at Wazir House, at the Junction of Moi Avenue and Kenyatta Avenue, reasons undisclosed. Established in 1944, Ebrahim Supermarket is among of the oldest retail stores in the country and the move will see the retailer remain with only one electronics and computer distribution unit situated along Kimathi Street, in Nairobi, having previously closed other stores in Kisumu, Nakuru and Mombasa. In addition, Ukwala Supermarkets, having already sold 75.0% of their stake to Botswana retailer Choppies as at March 2016, which includes most of their assets, at the time of sale being 10 out of 14 stores, applied for voluntary liquidation after revealing that it had been unable to pay off its debts, which included amongst others, creditors' claims and the Kenya Revenue Authority (KRA) debt amounting to Kshs 930 mn and Kshs 840 mn, respectively. The above is a move towards winding up of the parent company, with the judgement on the application expected on March 14th. This comes at a time when we have seen other retail giants such as Nakumatt Holdings and Uchumi struggling, leading to the closure of several of their stores across the country. We attribute these to:

i. Financial constraints, which have forced retailers to embark on restructuring e.g. Ukwala and Uchumi Supermarkets,
ii. Poor supply chain management and governance practices in the case of family-owned Nakumatt Holdings,
iii. Increased competition from dominant local retailers such as Tuskys and Naivas, that has diminished the market share of smaller-scale retailers such as Ebrahim thus affecting returns, and
iv. Limited in-store products owing to the small size of the outlets compared to competitors and failure to adapt to market trends mainly on product differentiation, in the case of Ebrahim Supermarkets, thus not able to meet clients' ever-changing preferences fueled by the

growing purchasing power of the expanding middle class.

Other highlights during the week:

Mauritius Duty Free Paradise, a company that operates duty free retail for travelers, announced plans to venture into the Kenyan market through a yet to be revealed local partner in the next three-years. The company, which sells products such as perfumes, cosmetics, alcohol, cigars and Swarovski crystals, aims to have the outlet serve as a base for expanding into East Africa, as it aims to focus on Kenya, Zambia, Rwanda and Madagascar. Other duty-free shop operators already in the market include Maya Duty Free at the Jomo Kenyatta International Airport (JKIA), Moi International Airport and Wilson Airport, and Siamanda Duty Free Limited at JKIA. We expect the entry of the retailer to result in demand for retail space at the Kenyan airports.

We expect the real estate sector to continue recording increased activities fueled by the focus on the provision of affordable housing, availability of development class land and entry and expansion of retailers in the Kenyan market.
