Nyeri Real Estate Investment Opportunity 2019, & Cytonn Weekly #08/2019

Real Estate

I. Industry Reports

During the week, Kenya Bankers' Association released their Q4'2018 issue of the KBA-House Pricing Index (HPI), which tracks house price movements in the Nairobi Metropolitan Area. The key take-outs from the report are as below:

i. Overall residential prices rose by 1.5% in Q4'2018, a 0.1% points q/q rise compared to 1.4% in Q3'2018. As per the report, this is attributable to stabilizing supply and demand dynamics with supply reducing notably due to credit constraints on the developers' side, while demand has continued to be boosted by buyers' preference for new buildings, driving selling prices up for new stock,
ii. Apartments accounted for 76.3% of the total transaction volumes over the last quarter of 2018, followed by bungalows and maisonettes with 12.1% and 11.6%, respectively. This was a notable difference from Q3'2018, which had transaction volumes of 27.0%, 37.8%, and 35.1% for apartments, bungalows, and maisonettes, respectively. The rapid shift in typology uptake is attributable to the affordability of apartments given that they have relatively lower construction costs per unit,
iii. Key factors that continue to shape homebuyers' preference are (i) unit plinth area, (ii) number of bathrooms, and, (iii) most importantly, the number of bedrooms, with amenities such as a gym, master en-suite and wooden floors having a marginal effect on housing prices.

According to the KBA-HPI Index Report, homebuyers showed preference for properties in high-end and upper mid-end markets. This is in line with our findings as per Cytonn Annual Markets Review 2018, where the upper mid-end sector registered the highest annual uptake with 26.6% in comparison to the overall residential market uptake average of 22.8%. On the Cytonn outlook, supply is expected to remain modest with credit to the private sector expected to remain low, thus stalling additional stock. However, the current housing shortage, which stands at 2.0 mn units, is set to continue driving demand, thereby sustaining units' uptake in the middle-income and low-end segments.

Knight Frank also released the Kenya's Market Update for the second half of 2018. The report tracks the high-end and upper mid-end real estate markets in Kenya. The key take-outs from the report are:

i. High-end residential prices declined by 4.5% in 2018, 3.6% points more compared to 0.9% in 2017. The report attributes this to a general oversupply in the upper spectrums of the market, which have rendered the market a buyer's market, thus driving prices down as a way of price correction,
ii. Residential rents also decreased, albeit at a slower rate of 1.3% in 2018, compared to 2.8% in

2017. This is as expatriates and mid to high income-earners sustained demand for temporary-stay properties in high-end markets,

iii. In the office sector, asking rents in Nairobi stagnated over the second half of 2018 at Kshs 130 per SQFT, a result of the market's oversupply. The report, however, notes that absorption of Grade A office space increased by 63.0% during the second half compared to the first half of 2018. This is as a result of the attractive locations of the various Grade A offices delivered to the market,
iv. In the retail sector, monthly rents for prime nodes remained flat in the second half of 2018 attributable to the retail market adjusting to continued oversupply in certain locations, making it a tenant's market. However, occupancy for established malls remained relatively high at over 90.0% with new malls registering lower occupancies of 45-75%.

The report is in line with our findings, whereby, the high-end residential market registered a 0.8%-points decline in price appreciation to 2.9% in 2018, from 3.7% in 2017, due to available supply that is not commensurate with actual effective demand for the same. As per Cytonn Annual Markets Review 2018, the office sector registered only a marginal increase in performance cushioned by a slight uptick in occupancy to 83.3% in 2018 from 82.6% in 2017, whereas the retail sector registered a decline in occupancy rates to 79.8% from 80.3%, over the same period. This, consequently, has driven developers to lower asking rents in order to retain clientele and encourage occupancy. As per the Cytonn report, commercial sector performance is set to stagnate as the oversupply persists for the next 3-5 years. Differentiated concepts, however, such as mixed-used developments and serviced offices are expected to perform well due to their low market share of 0.4% as well as continued demand from affluent individuals and expatriates on short business stints.

II. Hospitality Sector

During the week, Tourism Cabinet Secretary Najib Balala announced plans to rehabilitate Kisumu's Sunset Hotel into a conference center. The center, set to be complete by 2021, will have a 10,000-capacity with an estimated cost of Kshs 300.0 mn. As per KNBS Economic Survey 2018, local conferences and delegates increased by 2.4% and 17.1%, respectively, in 2017, partly on account of numerous political strategy activities held, thus, creating an opportunity for conferencing centers especially away from Nairobi. Thus, Kisumu being one of Kenya's political activities hotspots, we expect this to boost the county's tourism earnings especially in the wake of the next election period of 2022. In our view, therefore, this is bound to benefit Kisumu's tourism industry as conference tourism continues to shape Kenya's hospitality sector's performance and earnings coupled with infrastructural developments. In Kisumu, these include upgrading of the Kisumu airport to international status and development of roads such as the Nyamasaria - Magadi- Manyatta Road and Kisumu - Kisian Highway.

III. Infrastructure

During the week, Kiambu County's Senator Paul Wamatangi announced plans to revamp Kiambu Road to a dual carriageway from Muthaiga to Githunguri Town. The road, set to be complete by 2022, will also connect to the Uplands- Githunguri - Ruiru Road, which is currently under reconstruction and connects Thika Superhighway and Nairobi - Nakuru Highway. Kiambu Road serves various real estate investment hotspots such as Ridgeways, Runda, Runda Mumwe, and Thindigua. Over recent years, estates along the road have experienced a rapid change in landscape from being largely agricultural to becoming a real estate investment hub. This is attributable to;

i. Close proximity to commercial hubs such as the Central Business District and Westlands,
ii. Availability of amenities including shopping facilities such as Ridgeways mall, Two Rivers mall along the Northern Bypass, and the recently completed Ciata City and Kiambu Malls, and,
iii. Infrastructural developments with the Northern Bypass completed in 2016 creating an easy access route to other areas such as Ruaka, Ruiru and Thika Road.

The planned improvement will lead to better accessibility and reduce traffic congestion that is usually rampant during peak hours. Consequently, we expect this to result in increased demand for property in the area thus driving prices upwards.

Other Highlights

- SACCOs Societies Regulatory Authority (SASRA) released a report on SACCO’s sectoral lending in Kenya for the period ending December 2016. According to the report, land and housing sectors received the largest proportion of the credit facilities over the period, accounting for 36.2% of the total loans amounting to Kshs 328.4 bn. Building construction and land purchases took the bulk of the total loan value extended to land and housing sectors with 46.5% and 46.0%, respectively, with a paltry of the loan amounts going towards renovations and land processes such as valuation and surveying. This confirms the critical role played by SACCOs in housing provision in Kenya, especially in the wake of the financial crunch resulting from low private sector credit growth by banks. SACCO loans are characterized by favorable interest rates, flexible collateralization and customized to specific low-income groups,
- Cabinet approved a bill on sectional property, which seeks to simplify the registration of sectional property titles in Kenya. Currently, the process is dictated by Sectional Properties Act No. 21 of 1987, which has often been touted as cumbersome. Common practice, therefore, among developers is setting up a corporation, which owns the freehold to the property or the main lease, and sub-leases are then offered to homebuyers together with a share in the corporation, which gives them rights to the common areas. However, this method restricts the rights of the property owners to the terms of the sub-lease, which may also be unacceptable as collateral for bank loans. Therefore, the new bill, if signed into law, will allow high-rise property owners to own sectional titles, which can be collateralized, thus, improving real estate transactions, as clients also tend to shy away from purchasing flats/apartments due to the unclear law around ownership in such shared projects

Our outlook for the real estate performance remains neutral with a bias to positive owing to various saturated markets across all themes. However, we expect select nodes coupled with differentiated concepts such as affordable housing, Grade A and serviced offices, and infrastructural improvements, to continue boosting its performance and opening up new areas for investors.