Performance by Retirement Benefits Schemes in Kenya & Cytonn Weekly #10_2019

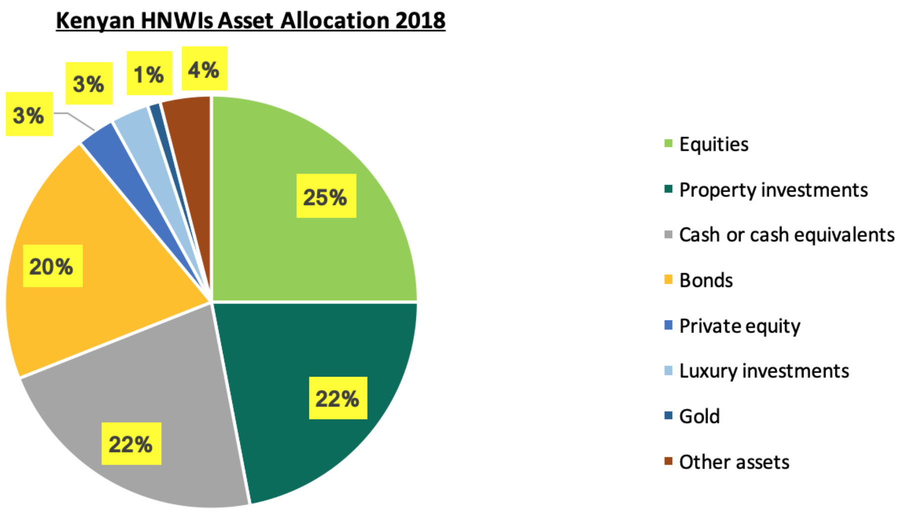
Real Estate

1. **Industry Reports**

During the week, Knight Frank released a report titled 'The Wealth Report 2019' highlighting investment trends of High Net Worth Individuals (HNWIs) in 2018, the appeal of emerging cities to the wealthy and the performance of luxury properties in 100 cities through the Prime International Residential Index (PIRI 100). Knight Frank defines High Net-Worth Individuals (HNWIs) as individuals with a net worth of at least USD 1.0 mn (approx. Kshs 100 mn) excluding their primary residences. Major take-outs from the report include:

- According to the Prime International Residential Index (PIRI 100), Nairobi dropped 17 positions to #92 from #75 last year as prime residential property prices dropped by 4.5% in 2018, 3.6% points higher than the 0.9% decline in 2017, due to an oversupply in the high-end market segment, tighter liquidity and a general market correction in pricing,
- Kenya had 9,482 High Net Worth Individuals in 2018, a 3.3% growth from 9,176 individuals in 2017, with the number projected to grow to 11,584 by 2023,
- Wealthy Kenyans owned an average of 2.7 homes per person in 2018, a 42.1% increase from 1.9 homes per person in 2017. 19% of the wealthy had second homes outside the country, with 7.0% looking to buy outside the country in 2019/2020, and,

Kenyan high net-worth individuals allocated about 22.0% of their investment portfolios to investment properties in 2018, other investments being mostly in equities, cash or cash equivalents and bonds, at 25.0%, 22.0%, and 20.0%, respectively, as shown below:



Source: Knight Frank Wealth Report 2019

The report highlights the sustained interest by High Net-worth Individuals in property investments reinforcing demand for luxury housing units. We attribute this to benefits such as (i) stable rental incomes, (ii) preservation of capital by hedging against inflation, and (iii) prestige factors. According to our research, however, increased supply in the high-end market has outpaced the growth in effective demand and thus we expect occupancy and uptake rates to stagnate in the near future. According to the Cytonn Annual Review 2018, prices in the high-end market segment grew by 2.9% in 2018, 1.3% points lower than the residential market average of 4.2%, with average occupancy at 72.8%, compared to the residential market average of 81.0%. We expect investors in the high-end segment to focus on better performing locations such as Kitisuru and Karen that recorded total returns of 8.9% and 8.8%, respectively, compared to the high-end market average of 6.4% in 2018.

2. **Residential Sector**

During the week, Actis, a private equity firm with a key focus on Africa, and Shapoorji Pallonji Real Estate (SPRE), an Indian real estate firm, announced plans to undertake a Kshs 12.0 bn joint venture to develop affordable and middle-income homes in Sub-Saharan Africa, starting with Kenya (specific location details undisclosed). The partnership aims to capitalize on the housing demand in Kenya estimated at 2.0 mn units and growing by approximately 200,000 annually according to the National Housing Corporation, driven by rapid population growth and urbanization at 2.5% and 1.2%, respectively, against slow housing production estimated at 50,000 units annually by the Ministry of Housing. The move will supplement the Kenyan Government's agenda to deliver 500,000 affordable housing units by 2020. We attribute the increased interest by private investors to the various incentives and policies put in place by the government including:

i. A 15.0% tax rate relief for developers who provide at least 100 low–cost housing units p.a.,
ii. Scrapping off of NEMA and NCA levies, encouraging developers to construct more units, due to the reduction in costs,
iii. 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, and,
iv. Partnerships with developers through availing of public land for development.

To further supplement its quest to deliver 500,000 units by 2020, the Ministry of Housing, through its Principal Secretary, Charles Hinga, this week announced the drafting of a bill that would have real estate developers compelled to allocate 30% of their developments to affordable housing. Usually, such a policy is pegged on the size of the development, where only mass housing projects exceeding a set threshold are required to adhere. In our view, the bill is likely to meet opposition from private developers, as it will result in lower profits for investors, not to mention questions whether it would withstand litigation on its constitutionality. We recommend provision of density bonuses, which is an increase in the number of allowable units beyond existing zoning regulations, in order to incentivize private developers in the production of affordable units. Additionally, tax incentives and making it easy to raise funds for affordable housing through capital markets would increase funding for affordable housing.

3. **Retail Sector**

During the week, Swiss-owned shoemaker, Bata Shoe Company, opened its latest outlet at The Hub Mall, in Karen. The store will adopt a red concept, and contemporary retail design focusing on red and white branding, visual merchandising, and digital walls among other features, in order to attract more customers. We continue to see the expansion of retailers, supported by the rising middle class and the provision of high-quality spaces in affluent neighborhoods, leading to increased space uptake and thus higher returns for developers and property managers in retail developments. In 2018, Karen's retail sector recorded an average rental yield of 11.0%, 2.0% points higher than the market average of 9.0%, with an average occupancy rate of 88.8% compared to the market average at 79.4%. This is mainly attributed to the attractiveness of Karen to retailers as it hosts an affluent population with relatively high purchasing power and thus investors are willing to pay higher rents for retail space in the area. The table below shows a summary of the Nairobi retail market performance in Nairobi:

Summary of Nairobi's Retail Market Performance 2018

Location	Rent Kshs/SQFT 2018	Occupancy Rate 2018	Rental Yield 2018
Westlands	219.2	88.2%	12.2%
Karen	224.9	88.8%	11.0%
Kilimani	167.1	97.0%	10.7%
Ngong Road	175.4	88.8%	9.7%
Thika road	177.3	75.5%	8.3%
Kiambu Road	182.8	69.5%	8.1%
Mombasa road	161.5	72.4%	7.9%
Eastland's	153.3	64.8%	6.8%
Satellite Towns	142.1	73.7%	6.7%
Average	**178.2**	**79.8%**	**9.0%**

All Values in Kshs unless Stated Otherwise

Source: Cytonn Research 2018

During the week, the Lake Basin Mall in Kisumu opened to the public, following a two-year delay caused by a probe by the Ethics and Anti-Corruption Commission (EACC) into irregularities on the development's construction costs. The Kshs 4.2 bn Mall owned by Lake Basin Development Authority (LBDA), is located along the Kisumu-Kakamega Road and will bring to the Kisumu market 60,000 SQFT of retail space. The five-floor complex will consist of 140 shops, a three-star hotel and 335 parking bays. Key tenants that booked space last year, according to the dailies include Bata Shoe Company, Best Western Hotel and Communications Authority of Kenya. As per Cytonn Retail Sector Report 2018, Kisumu was among the best performing regions in Kenya recording rental yields of 9.7%, 1.1% points above the Kenyan market average of 8.6% driven by high occupancy rates of 88.0%, 2.0% above the market average of 86.0%, attributable to increased retail business to serve the fast-growing urban population at 52.0% of the population compared to country's average at 26.5%.

The below table shows Kisumu's retail market performance in comparison to other regions in Kenya:

Summary of Retail Market Performance in Key Urban Cities in Kenya 2018

Region	Rent 2018 per SQFT per Month	Occupancy Rate 2018	Rental yield 2018
Mt Kenya	141.3	84.5%	9.9%

Summary of Retail Market Performance in Key Urban Cities in Kenya 2018

Region	Rent 2018 per SQFT per Month	Occupancy Rate 2018	Rental yield 2018
Kisumu	148.2	88.0%	9.7%
Nairobi	178.9	83.7%	9.4%
Mombasa	103.7	96.3%	8.3%
Eldoret	137.5	78.5%	7.6%
Nakuru	83.3	85.0%	6.9%
Average	**132.1**	**86.0%**	**8.6%**

- **Mt. Kenya and Kisumu were the best performing regions, with average rental yields of 9.9% and 9.7%, respectively. This is attributable to high occupancy rates of 84.5% and 88.0%, respectively, above the market average of 86.0%**

All Values in Kshs unless Stated Otherwise

We expect the real estate sector to continue recording increased activities fueled by the focus on the provision of affordable housing, expansion of retailers in the Kenyan market and more developer activity in undersupplied segments such as low-cost housing and selected markets with relatively high returns.