Ruaka Real Estate Investment Opportunity, & Cytonn Weekly #11_2019

Real Estate

I. **Industry Reports**

During the week, Kenya National Bureau of Statistics (KNBS) released its December 2018 issue of Leading Economic Indicators (LEI), highlighting an overall drop in construction activities in 2018, and growth in the tourism sector. According to the report:

i. The value of building plan approvals by the Nairobi City County declined by 12.9% to Kshs 210.3 bn in 2018, from Kshs 240.7 bn in 2017, indicating a slow-down in developer activity during the year. We attribute this mainly to;
   a. The credit crunch since the implementation of the Banking Amendment Act (2016) that has led to a reduction in private sector credit to 3.3% in 2018, compared to a 5-year (2013-2018) average of 11.8%, as banks prefer to lend to lower risk entities such as the government,
   b. A reduction in effective demand amid the growing supply in the commercial sector and in the upper-end residential market, that has led to a surplus of 2.0 mn and 5.3 mn square feet of space in the retail and commercial office sectors, respectively, and 3.0% points decline in average occupancy rates in the residential sector to 81.0% in 2018, from 84.0% in 2017, according to Cytonn Research. Developers are therefore holding back on new projects as they await to sell out the existing stock, and,
   c. Uncertainty over building approvals following demolitions of allegedly legally approved buildings in 2018.

Source: Kenya Bureau of Statistics (KNBS)

ii. The quantity of cement consumed recorded a 5.0% decline to 5.5 mn metric tonnes in 2018, from 5.8mn metric tonnes in 2017, while production decreased by 8.5% to 5.6 mn metric tonnes from 6.2 mn metric tonnes in 2018 and 2017, respectively. The reduction in consumption and production of cement illustrates reduced activities in the construction sector during the year. In addition to the decrease in real estate development activities highlighted above, this can also be attributed to lower infrastructural development such as the slowdown of the Standard Gauge Railway Phase 2A.

Source: Kenya Bureau of Statistics (KNBS)

iii. In the tourism sector, the number of tourist arrivals at the Jomo Kenyatta International Airport (JKIA) and the Moi International Airport increased by 13.0% from 858,432 for the period between January and November 2017 to 969,854 during the same period in 2018. We attribute this to the improved security and political stability, which have continued to boost tourists' confidence in the country and thus making it a preferred travel destination for both business and holiday travelers.

**The numbers are for the period between January and November every year*

Source: Kenya National Bureau of Statistics (KNBS)'

Supported by the above statistics, we retain a **Neutral** outlook for the real estate sector, as we expect the surplus supply in the retail, commercial office, and high-end residential sectors to result in decreased activities in the respective sectors. However, we have a positive outlook for the hospitality sector and mid-end and low-end residential sector, as we expect improved performance boosted by the demand for hospitality services and the continued focus on the provision of affordable housing, respectively.

II. **Residential Sector**

During the week, Erdemann Property Limited, a Kenyan-based real estate developer, broke ground on a Kshs 7.0 bn affordable housing project, dubbed The River Estate in Ngara, Nairobi set to deliver approximately 2,720 units. The project, which will be jointly financed jointly the National Government and the Nairobi County Government, will be done in 2 phases, with Phase 1 set for completion in December 2020 and Phase 2 in December 2021. It will comprise of 1-bedroom, 2-bedroom Type A and 2-bedroom Type B residential units selling at an introductory cash price of Kshs 2.9 mn, Kshs 3.9 mn and Kshs 3.5 mn, respectively. Some of the unique features in the development will include cabro paved roads, 2 basement parking spaces, 3 elevators per tower and commercial units, among others. The project is part of the national government's pledged affordable housing projects under the Big Four Agenda, with other planned projects in areas such as Mavoko, Makongeni and Shauri Moyo in Nairobi. These efforts have been in a bid to meet the existing housing deficit in Kenya of approximately 2.0 mn houses according to the National Housing Corporation. Some of the initiatives and incentives introduced by the government to drive the agenda include:

a. Introduction of partnerships with private developers by availing public land for development,
b. Waiving of building approval fees for all affordable housing projects in Nairobi City County,
c. Setting up of the Kenya Mortgage Refinancing Company (KMRC) to enable longer-term mortgages at affordable rates,
d. Setting up the National Housing Development Fund (NHDF) aimed at enabling potential home-buyers to save towards home-ownership and consequently offer offtake for housing developments, and
e. Introduction of the 15.0% corporate tax on the resulting profits, instead of the normal 30.0% for developers who put up at least 100 low-cost housing units.

We expect these measures to enhance the development of affordable housing units in the country by both the private and public sectors. However, we are of the view that, in order to facilitate the achievement of the agenda, other issues that need to be addressed to include; i) the current high cost of construction, ii) infrastructural development especially in satellite towns, iii) private sector funding which could be facilitated by the deepening of capital markets, and iv) legislative reviews such as the amendment of laws to allow people to use their pension to guarantee house purchases.

III. **Land Sector**

This week, the Ministry of Lands announced that the Lands Information Management System (LIMS) is expected to go live on 1st April 2019. The system is expected to shorten the lands registration process by 61-days, to 12-days, from 73-days required by the manual system. Currently, property registration consists of nine processes namely, title search, land rent clearance, land rate clearance, requisition of file valuation, site visits and reporting, registration of title, payment of stamp duty and endorsement and assessment of the deal. With the Lands Information Management System (LIMS), three of those processes, that is, land rent clearance, land rate clearance and requisition of file valuation will be completely moved online, five of them which include title search, consent to transfer, title registration, payment of stamp duty, and assessment and endorsement of the deal will be partially digitized, while the rest will be retained as manual processes. The Lands Ministry had announced the plans to digitize the processes on the Lands Information Management System in early 2018 in order to speed up the registration processes. We expect the digitization of the processes to enhance time saving, cost reduction and transparency in the registration of land and thus encourage property development.

IV. **Infrastructure**

China Road and Bridge Corporation (CRBC), a Chinese engineering and construction firm, is set to secure a Kshs 2.5 bn contract to refurbish the Nairobi commuter railway network. According to the Ministry of Transport, Cabinet Secretary, Hon James Macharia, the firm should not be subjected to competitive bidding as it already has the required technical capacity and pre- requisite railway experience. Other projects undertaken by the firm in Kenya include; the completed Mombasa-Nairobi Standard Gauge Railway (Phase 1) and the ongoing Phase 2A from Nairobi to Naivasha. The Nairobi commuter railway track is part of the Kshs 10 bn fund set aside to ease traffic congestion in Nairobi, and is aimed at facilitating the operation of 11 second hand locomotives, 20 halts, the refurbishment of mini stations in the city such as the Kitengela Railway Station, upgrading of the Ruiru, Kikuyu, Syokimau and Embakasi lines and the Nairobi Central Station. On completion, we expect the railway network to improve ease of access to satellite towns such as Kitengela, Ruiru, Kikuyu, Embakasi, and Syokimau, thus result in increased economic activities, and demand for property. Currently, the average price of land in satellite towns stands at Kshs 23.0 mn and has been growing with a 7- year CAGR of 14.1% from an average of Kshs 9.0 mn in 2011 boosted by improving infrastructure and the growing demand for development class land. We thus expect the refurbishment of the railway network to result in an increase in the land value in the areas it will serve.

We expect the real estate sector to continue recording increase activities driven by; i) the improving infrastructure, digitalization of the land registration process and the continued focus on the provision of affordable housing by both the private sector players and the government.