Cytonn Monthly - April 2019

Real Estate

I. Industry Reports

Six real estate sector reports were released during the month of April, highlighting the sector's performance as shown below:

Industry Reports Released in April 2019

Coverage	Report	Key Take-outs
Real Estate & Infrastructure	Economic Survey 2019, by Kenya National Bureau of Statistics (KNBS)	.The real estate sector's contribution to GDP declined marginally by 0.1% points to 7.0% in 2018, from 7.1% in 2017, and recorded a slowdown in terms of growth rate, having grown by 4.1%, compared to 6.1% in 2017. The slower growth rate was attributed to inaccessibility and unaffordability of off-take financing, with the credit advanced to the sector recording a marginal decline of 0.5% to Kshs 368.7 bn as at end of 2018, from Kshs 370.7 bn as at the end of 2017, ·For more information, see our Cytonn Weekly #17/2019.
Residential Sector	Hass Q1'2019 Property Sales and Rental Index, by HassConsult Limited	·The Nairobi Metropolitan Area residential market registered an annual price appreciation of 3.3% as at Q1'2019, compared to a 1.7% decline recorded in Q1'2018; while q/q prices depreciated by 2.6%, compared to an appreciation of 2.4% in Q1'2018, ·Detached units and apartments recorded an average y/y price appreciation of 5.1% and 1.7%, on average, and a q/q depreciation of 1.6% and 0.6%, respectively, ·For more information, see our Cytonn Weekly #16/2019.
Commercial Office Sector	Nairobi Metropolitan Area Commercial Office Report 2019 by Cytonn Investments Management PLC	·Rental yields increased marginally to 8.1% in 2018, from 7.9% in 2017, driven by the continued positioning of Nairobi as a regional hub and an improving macroeconomic environment, ·Asking rents in 2018 increased marginally by 1.6% to an average of Kshs 103 per SQFT, from Kshs 101 per SQFT in 2017, while asking prices increased by 0.6% to Kshs 12,719 in 2018, from Kshs 12,649 in 2017, ·The sector has pockets of value in zones with low supply and high returns such as Gigiri, and in differentiated concepts such as serviced offices, which record rental yields of up to 13.5% p.a. ·For more information, see our Cytonn Weekly #14/2019.
Land Sector	Hass Land Price Index Q1'2019, by HassConsult Limited	·Land price growth in Nairobi's suburbs improved marginally, recording an annual growth rate of 1.4% and a q/q growth of 0.5%, whereas Satellite Towns recorded a 1.5% annual growth and 0.2% q/q growth in Q1'2019, 0.3% points lower than land in Nairobi suburbs, ·Well-developed suburbs such as Kilimani and Spring Valley posted land annual price declines of 1.1% and 0.6%, respectively, due to a large inflow of new supply, driving price correction while Mlolongo recorded the highest annual land price appreciation at 9.7%, boosted by a surge in demand by homebuyers owing to their relative affordability and ease of transit due to the Nairobi Railway and Standard Gauge Railway (SGR), and an improving road network, ·For more information, see our Cytonn Weekly #16/2019.

Coverage	Report	Key Take-outs
Industrial Parks Sector	'Africa Horizons: A Unique Guide To Real Estate Investment Opportunities', by Knight Frank	·Kenya acts as the logistics hub of East Africa supported by significant new investments into the sector, including the rail link between Nairobi and Mombasa, and the Kenyan Government's focus on the manufacturing sector under the Big 4 Agenda, ·There is a continued shift of industrial parks developments from the existing industrial area due to challenges such as poor infrastructure and high land costs, to satellite towns such as Ruiru supported by increased demand for centralized warehouses by retailers, ·For more information, see our Cytonn Weekly #15/2019.
Industrial Parks Sector	Kenya Logistics Market Report by Broll Property Group	·The total industrial space supply increased by 9.1% to 1.2 mn SQM in 2018 from 1.1 mn SQM in 2017 while price per acre for industrial serviced plots located in Nairobi's periphery, increased by an 11.1%, 3-year CAGR to Kshs 37.7 mn as at 2018 from Kshs 27.5 mn in 2015, ·Occupancy rates increased by 4.0% between 2017 and 2018 attributable to improving business environment and infrastructure, while average rental rates remained flat with the average monthly rent per SQFT for Grade A, B and C spaces at Kshs 65, Kshs 37 and Kshs 21, respectively in line with the general real estate sector performance, ·For more information, see our Cytonn Weekly #16/2019.

Based on the above real estate research reports, we retain our neutral outlook for the real estate sector mainly constrained by commercial real estate space surplus in the market, inaccessibility and unaffordability of off-take financing and slow credit growth at 3.4% as at February 2019, compared to a 5-year average of 12.0%. The sector, however, exhibits pockets of value in select sectors such as industrial parks, mid-end & lower-end residential sectors, zones with low supply and high returns such as Gigiri, and in differentiated concepts such as serviced offices, which record rental yields of up to 13.5% p.a.

II. Residential Sector

During the month, activity in the residential sector was mostly focused on the Affordable Housing Initiative (AHI) as shown below:

i. World Bank approved a USD 250.0 mn (Kshs 25.0 bn) loan facility to support the Kenyan Government's efforts in operationalizing the Kenya Mortgage Refinancing Company (KMRC). The KMRC was incorporated in April 2018 as part of the Affordable Housing Initiative (AHI), aimed at boosting access to affordable housing finance. Its primary function is to provide affordable long-term funding and capital market access to primary mortgage lenders (PMLs) such as banks and financial co-operatives who will then lend to the primary mortgage market at affordable monthly premiums and longer tenure. To facilitate the launch of KMRC, the entity is expected to obtain at least Kshs 1.0 bn as the minimum core capital according to CBK (Mortgage Refinance Companies) Regulations 2019. We see the loan facility as a good step towards the launch and operationalization of the Kenya Mortgage Refinancing Company in June 2019, providing access to affordable housing finance for home-buyers. For more details on KMRC, see our note Kenya Mortgage Refinancing Company (KMRC) Update,

ii. The National Treasury tabled its Kshs 2.8 tn 2019/2020 Budget Estimates to Parliament. According to the 2019 Budget Policy Statement, Kshs 10.5 bn is to be allocated towards the Affordable Housing Initiative. This is a 61.5% increase from the Kshs 6.5 bn allocated in Kenya National Budget 2018/19, which shows the National Government's commitment towards delivering affordable housing, and

iii. The Housing Ministry kick-started the Housing Fund Levy with a directive for employees and employers to remit by 9th May to the National Housing Development Fund (NHDF). The fund is structured similar to a pension scheme, such that employees will contribute a percentage of their income (1.5% of their gross earnings each month), to a maximum of Kshs 5,000, and employers will match the amounts contributed. However, following the directive, the announcement has faced huge opposition attracting a court injunction to halt taking effect until final decisions by the labour court are made. For more information, see our Cytonn Weekly #16/2019.

Also during the month, Hass Consult launched a mixed-use development situated in Riverside, Nairobi. The project dubbed, 'Riverside Square', is expected to be completed by 2021 and will comprise of 250 apartment units, Grade A offices and boutique stores with the residential development consisting of 1-bed, 2-bed, 3-bed apartments and 4-bed penthouse with starting prices of Kshs 9.5 mn, Kshs 14.3 mn, Kshs 20.2 mn, and Kshs 71.0 mn, respectively, and corresponding plinth areas of 81 SQM, 95 SQM, 140 SQM and 511 SQM, translating to a Price/SQM of Kshs 117,284, Kshs 150,526, Kshs 144,286 and Kshs 138,943, respectively. The main factors driving investment in Riverside include; (i) proximity of the area to the Nairobi Central Business District and major business nodes, (ii) presence of international organizations such as FSD Kenya and Heinrich Boll Foundation, creating a market for serviced apartments, retail and office spaces, (iii) relatively good infrastructure network and security, and (iv) positioning of the area as an affluent neighborhood hosting middle to high-income earners with relatively high purchasing power.

For investors in mixed-use developments, Riverside, which is covered under the Westlands node, recorded an average rental yield of 7.0%, 1.0% points below the mixed-use development (MUD) market average of 8.0%, according to Cytonn Annual Markets Review – 2018. This is driven by the poor performance of retail sections of the mixed-use developments in the area, which recorded a rental yield of 8.1%, 0.4% points below the market average of 8.5%. The poor performance is mainly attributed to Riverside's proximity to destination retail developments such as Sarit Centre and Westgate mall that offer a larger store variety, personalized experience and convenient parking.

All values in Kshs unless stated otherwise

Nairobi's Mixed-Use Developments Market Performance by Nodes 2018

	Development Composition %			Retail Performance				Office Performance				Residential Performance				
Location	**Retail %**	**Office %**	**Resi. %**	**Price Kshs / SQFT**	**Rent Kshs /SQFT**	**Occup. (%)**	**Rental Yield (%)**	**Price Kshs / SQFT**	**Rent Kshs/SQFT**	**Occup. %)**	**Rental Yield (%)**	**Price Kshs /SQM**	**Rent Kshs /SQM**	**Annual Uptake %**	**Rental Yield %**	**Average MUD yield**
Limuru Rd	60.0%	20.0%	19.0%	23,975	277	80.0%	11.1%	13,500	103	70.0%	6.4%	177,935	1,259	25.0%	8.5%	9.6%
Karen	51.0%	48.0%	5.0%	23,333	186	99.0%	9.4%	13,409	120	87.0%	9.3%	215,983	821	27.0%	4.6%	9.4%
Upper Hill	10.0%	90.0%		15,903	147	72.0%	7.7%	13,095	113	86.0%	8.8%					8.7%
Kilimani	25.0%	75.0%		19,571	168	87.0%	9.1%	12,875	102	82.0%	7.7%					8.6%
Thika Rd	36.0%	14.0%	50.0%	35,000	297	95.0%	9.7%	12,500	111	90.0%	9.6%	161,849	756	20.0%	5.6%	7.6%
Westlands	27.0%	58.0%	59.0%	16,399	179	65.0%	8.1%	12,845	113	76.0%	8.1%	201,274	636	31.0%	3.8%	7.0%
Msa Rd	51.0%	10.0%	39.0%	20,000	180	50.0%	5.4%	13,200	96	75.0%	6.5%	171,304	843		5.9%	5.7%
Eastland's	25.0%		75.0%	20,000	132	76.0%	6.0%					81,717	351	20.0%	5.1%	5.4%
Average	**58.1%**	**30.9%**	**41.3%**	**19,664**	**181**	**76.9%**	**8.5%**	**13,015**	**110**	**81.1%**	**8.2%**	**168,344**	**778**	**24.5%**	**5.6%**	**8.0%**

***Westlands includes Riverside and Parklands**
- ***Riverside recorded an average rental yield of 7.0%, 1.0% points below the mixed-use development market average of 8.0%***
- ***Riverside retail performance recorded rental yields of 8.1%, 0.4% points below the retail market average of 8.5%.***

Source: Cytonn Research 2018

We expect continued efforts towards the Affordable Housing Initiative, supported by the National Government's commitment and international financial institutions support towards delivering the affordable housing to Kenyans. (We shall be doing a research note on affordable housing in Kenya in the month of May.)

III. **Commercial Office**

In the commercial office sector, I&M Bank announced that they will be relocating their head office from the Nairobi CBD to 1 Park Avenue building located in Parklands, come August this year. The new age building will be part of the real estate investment portfolio of the bank's property arm, I&M Realty. The 12,358 SQM building, whose cost remains undisclosed, will be partially owner-occupied while the rest of the space will be let out. According to the Nairobi Metropolitan Area Commercial Office Report 2019, Parklands area was one of the best performing areas in the commercial sector, recording a rental yield and occupancy rate of 8.4% and 86.0%, respectively, 0.3% points and 2.7% points above the market average of 8.1% and 83.3%, respectively, in FY'2018. This was mainly attributed to increased demand for office space by multinational companies given the limited supply of quality Grade A offices in the submarket, enabling developers to charge a premium on rentals. For more information and analysis, see our Cytonn Weekly #14/2019.

In the commercial sector, we expect local and multinational companies to continue focusing on high return areas such as Parklands, Westlands, Karen and Gigiri, recording a rental yield above 8.0% with the aim of maximizing on returns in addition to leveraging on the high-quality office spaces in the areas.

IV. **Retail Sector**

During the month, we saw increased uptake of retail space by both local and international retailers as the sector experienced the following activities:

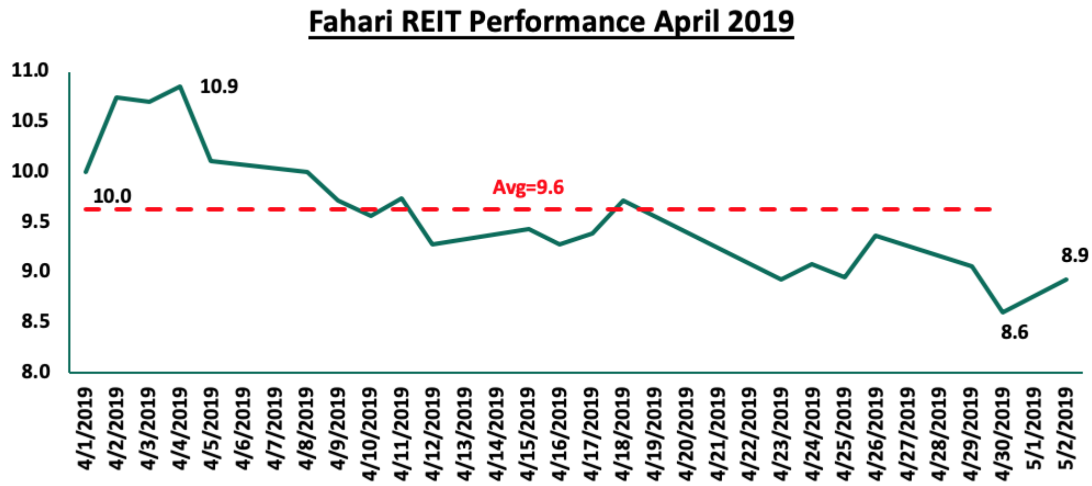
i. American pizza restaurant, Domino's Pizza, opened their seventh outlet in Kenya at Shell Petrol Station on Argwings Kodhek Road in Kilimani, Nairobi. For more information, see our Cytonn Weekly #15/2019,
ii. Tumaini Self-service, a local supermarkets store, opened two outlets: (i) Kamakis-Ruiru on the Eastern Bypass, and (ii) Kahawa Station Road in Kahawa West, bringing its total number of stores countrywide to twelve.

We expect the sector to continue attracting local and international retailers supported by; (i) increased disposable income as a result of an expanding middle class, with GDP per Capita growing at a rate of 2.3% p.a. over the last 5-years, from Kshs 89,430 in 2014 to Kshs 100,310 in 2018, (ii) a positive demographic dividend, with a population growth rate of approximately 2.5% p.a. and a high urbanization rate of 4.3%, compared to the global average of 2.1%, hence an increase in demand for restaurants, and, (iii) stable economic growth, with Kenya's GDP growth averaging at 5.6% over the last five-years and recording 6.3% growth in 2018, according to Kenya National Bureau of Statistics (KNBS) and expected to record 5.8% in 2019, thus, creating an enabling environment for the retailers to make desirable profits.

V. **Listed Real Estate**

i. The Nairobi Securities Exchange (NSE) admitted property development company, 'My Space Properties', under the Ibuka Incubator Programme, following successful vetting of the subject company. My Space Properties plans to officially list after the incubation, which will make it the second property developer to be listed in Kenya, after Home Afrika Limited, which went public on 15th July 2013. For more information and analysis, see our Cytonn Weekly #14/2019.
ii. Stanlib Fahari I-REIT announced plans to acquire more properties from pension firms and insurers who will be compensated in the form of units in the REIT. The proposed structure eliminates the need for the firm to raise large sums of new capital to buy more buildings, in addition to expanding the pool of income-generating buildings owned by the REIT and raising earnings for the expanded investor base. For more information and analysis, see our Cytonn Weekly #17/2019.

On the bourse, Stanlib Fahari I-REIT share price declined by 14.0% to close at Kshs 8.6 per share at the end of April, from Kshs 10.0 per share at the end of March. On average, the REIT traded at Kshs 9.6 per share, a 3.2% increase from an average of Kshs 9.3 per share in March 2019. The REIT closed the week at Kshs 8.9 per share. The instrument has continued to trade in low prices and volumes, constrained by negative market sentiments around REITs performance, inadequate investor knowledge and lack of institutional support for REITs.



We expect the real estate sector to continue recording increased activities in the residential, retail and listed real estate sectors supported by National and International organizations commitment towards the Affordable Housing Initiative, the continued demand for office and retail space in prime locations and increasing demand for alternative sources of capital in the real estate industry.