Cytonn Monthly - May 2019

Real Estate

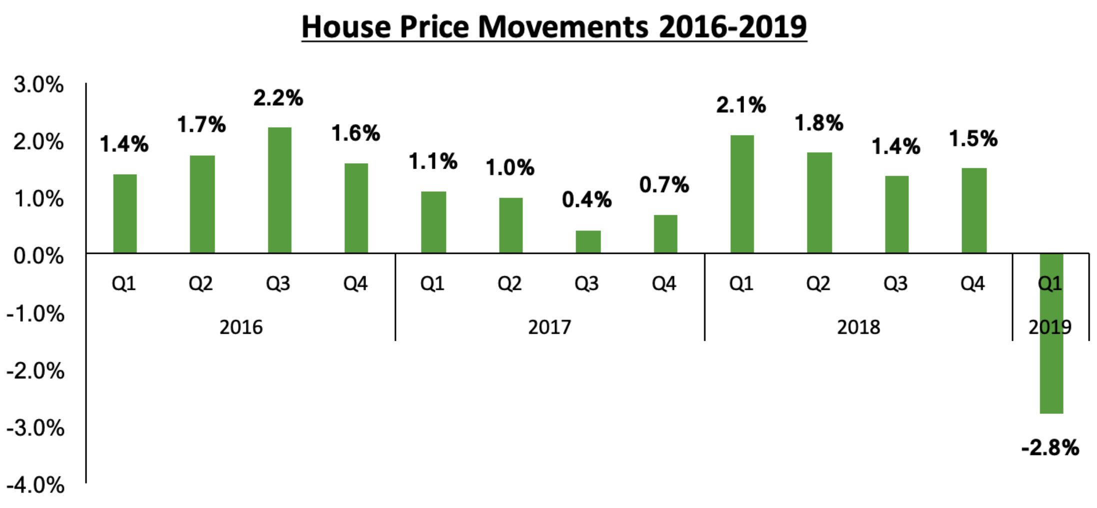
During the month, real estate saw overall increased activity in the residential sector, while the commercial office and hospitality sectors remained sluggish.

I. **Industry Reports**

During the month, two real estate sector reports were released, namely the KBA-Housing Price Index Q1’2019 and Hotel Development Pipeline in Africa 2019, whose key take outs are as outlined below;

i. Kenya Bankers’ Association released the Q1’2019 KBA-Housing Price Index, which tracks house price movements in the Nairobi Metropolitan Area. The key take outs from the report were;

- Overall house price growth registered the deepest decline since 2013 of 2.8% in Q1’ 2019, a 4.3% points q/q decline compared to 1.5% price appreciation recorded in Q4’2018 attributable to supply and demand imbalances. As per the report, on the supply side, the building and construction sector’s recorded slow credit growth which led to housing supply constraints. On the demand side, homebuyers main challenge was the prevailing economic conditions, which have resulted in tight household budgets, and further exacerbated by reluctance from lending institutions to offer loans to the private sector, hence decline in effective demand,



- In terms of market uptake, apartments accounted for 62.6% of all residential market’s uptake in Q1’2019, followed by maisonettes and bungalows at 23.4% and 12.0%, respectively. Apartments, however, recorded a 13.7% points decline from 76.3% in Q4’2018, a sign of subdued market activity. The dominance of apartments is an indication that the housing market is predominantly in the middle-income segment of the population, and,
- Buyers’ housing preferences were largely influenced by number of bedrooms and bathrooms, with location being a key determinant in pricing.

In line with our Cytonn Q1'2019 Markets Review, we expect the residential market to continue recording modest performance due to factors such as off-take financing, which continues to be elusive for home buyers, as well as insufficient credit advancement to developers. However, we expect the lower mid-end markets to continue experiencing increased demand and uptake as homebuyers seek affordability.

ii. W Hospitality Group also released the Hotel Chain Development Pipelines in Africa 2019 Report, which tracks key planned hotel development activities across Africa. The following were the key take outs:

    i. Hotel deal pipeline in Africa was recorded at 75,000 rooms, a total of 41 hotels and nearly 70.0% of the hotels are upscale and upper upscale chains, indicating the growing need for quality and luxury hotel facilities across the continent,
    ii. Marriott and Accor are the biggest hotel brands making up Africa's hotel deal pipeline with 81 and 57 hotels, respectively, and,
    iii. Egypt and Nigeria account for the largest share of the hotel deal pipeline with 51 and 49 hotels, respectively while overall West Africa and East Africa account for the largest shares of the deal pipeline in comparison to North and South Africa.

Focusing on the Kenyan market:

i. Kenya is ranked #5 among African countries with the highest hotel room pipeline with a deal pipeline of 27 hotels and 4,232 keys in total, as at 2019, ranking it behind Egypt, Nigeria, Morocco and Ethiopia. Kenya's deal pipeline notably increased by 22.9% from the 3,444 rooms pipeline recorded in 2018,
ii. Nairobi accounts for 75% of the pipeline with 3,167 rooms. According to the report, almost 80% of the deal pipeline across the continent are set to take place in urban centers, and,
iii. Key hotel operators that form the deal pipeline include Marriott, Best Western, Radisson Group, Accor, Hyatt, among others.

The report reaffirms recent hospitality sector performance in Kenya, which has been on an upward growth trajectory and we expect this trend to continue supported by:

i. A vibrant tourism sector with the number of international visitors reported in 2018 increasing by 14.0% to 2.0 mn from 1.8 mn in 2017,
ii. Enhanced security in spite of setbacks such as the DusitD2 Terrorist attack, and,
iii. The Meeting, Incentives, Conferences and Exhibitions (MICE) initiative, which has led to growth of business tourism.

II. **Residential Sector**

During the month, we saw more progress on the affordable housing initiative marked by launching the Kenya Mortgage Refinancing Company (KMRC) and various affordable housing projects, as detailed below:

i. The National Treasury launched the much-awaited Kenya Mortgage Refinancing Company (KMRC) after successfully mobilizing capital from its shareholders made up of local commercial banks, SACCOs, and a microfinance institution. This is also after global and Pan-African financiers, namely World Bank and AfDB approved funding of Kshs 25 bn and 10 bn, respectively, to the Kenya Affordable Housing Financing Program, geared towards enhancing overall access to affordable housing finance, strengthening the KMRC balance sheet and supporting its issuance of bonds. The liquidity facility, which is set to begin operations by June 2019 is expected to boost the Kenyan mortgage market by enabling mortgage lenders to offer longer mortgage tenures which will ultimately lead to mortgage affordability and increase home ownership. For more analysis, read our KMRC Topical,
ii. Shelter Afrique, a Pan-African Development Finance Institution owned by 44 African governments and Africa Development Bank (AfDB), also announced plans to invest Kshs 200.0 mn in KMRC.

The liquidity facility is also set to receive more funding from other global financiers such as International Finance Corporation (IFC); For more, see Cytonn Weekly #19,

iii. Leading mortgage financier in Kenya, Housing Finance (HF) announced plans to reduce its current average mortgage size by 50.0% in a bid to tap into the growing demand for home loans from the lower mid-income class. The housing finance institution also aims to double its mortgage portfolio from the current 6,000 mortgages to 12,000 in the next two-years by offering mortgages averaging at Kshs 4.5 mn. According to Central Bank of Kenya, Kenya's average mortgage size was Kshs 10.9 mn as at 2017, which has locked out many potential homebuyers from accessing mortgages due to unaffordability. Therefore, the move by HF is a key step towards increasing mortgage penetration in the country and it will complement government's efforts to increase home ownership through KMRC,
iv. United Nations' Habitat Housing Cooperative Society Limited and Singapore-based consortium Afra Holdings, via their subsidiary Singapura Developers, announced plans to put up a mass housing project of 8,888 units in Kenya, in support of the affordable housing program. The project, dubbed Habitat Heights, will be on 78-acres of land in Mavoko Sub-County and will comprise of 576 studios of 22 and 28 SQM; 972 one-bedrooms of 44 SQM; 2,912 two-bedrooms of 75 SQM; and 4,368 three-bedroom units of 95 SQM. The agreement between the two companies is yet to be signed, but Habitat Housing Society is set to provide an offtake guarantee to the developers of the project. In terms of pricing, the units have price points of Kshs 3.5 mn, 4.8 mn, and 5.8 mn, for one, two and three-bedroom units, respectively, which translates to an average price per SQM of Kshs 68,199 (with separate pricing for infrastructure on a long term repayment). The project is expected to be delivered in the next 3-5 years with the official groundbreaking set for July this year,
v. Kings Developers Limited (KDL), the development affiliate under Royal Group of Companies, announced their plan to develop a 720-unit, 10-block residential apartment in Ongata Rongai, Kajiado County. The project dubbed, 'Kings Serenity' is set on eight-acres and will comprise of 93 SQM 2-bed units selling at Kshs 3.2 mn each translating to a price per SQM of Kshs 34,409 per SQM. For more, see Cytonn Weekly #21,
vi. The Ministry of Housing, under the Civil Servants Housing Scheme Fund (CSHSF), proposed the reduction of mortgage deposits for public servants from 10.0% to 5.0% of the property value, and, an allowance to pay mortgage loans up to 5-years after the retirement age of 60-years. This is to increase uptake by encouraging more public servants to take up housing units, given the reduced burden of the deposit amount and the increased period of repayment. For more, see Cytonn Weekly #20, and,
vii. Also, the government unveiled the number of units to be developed in its Ngong Road affordable housing project, which is currently awaiting approval from the National Environmental Management Authority (NEMA). According to Housing Principal Secretary, Hon. Charles Hinga, the project, which is to be located 8km from the Central Business District, will comprise of 34-storey blocks with 285 one bedroom, 1,768 two bedroom, and 1,007 three bedroom units. For analysis, see Cytonn Weekly #21.

In our view, the residential sector will continue to be shaped by the ongoing focus on affordable housing, in the short to medium term, and therefore, we expect upcoming activity to revolve around the initiative especially as Government of Kenya plans to effect other supporting reforms such as the Housing Fund, and launch of projects such as Ngong Road, Pangani, Shauri Moyo, among others across the country.

III. **Commercial Sector**

- The commercial office sector recorded minimal activity largely attributable to the tough economic environment especially as developers continue to experience constrained access to credit, evidenced by relatively low private sector lending which currently stands at 4.9%, and the office space oversupply which came in at 5.2 mn SQFT in 2019 according to Cytonn's Nairobi

Metropolitan Area Office Report 2019, resulting in declined building activity. However, during the month, Japanese multinational firm, Toshiba, launched its first office in Nairobi at Regus Office Park Westlands. This marks its second branch in Africa, after South Africa, reaffirming Kenya's attractiveness and as a regional hub, a factor that has been attracting multinational firms keen on accessing the Eastern and Central Africa markets.
- The retail sector also remained largely dormant but for international food chain Burger King's newly opened branch in Lavington at Shell Petrol Station, indicating foreign retailers' interest in growing their local footprint in a bid to tap into the Country's growing middle class.

We expect the commercial sector to remain sluggish particularly in regards to construction activity, owing to reduced business activity in terms of expansion plans, across the country largely due to tight economic conditions and the ongoing oversupply. However, the sector's performance will be cushioned by the continued interest from foreign players.

IV. **Hospitality Sector**

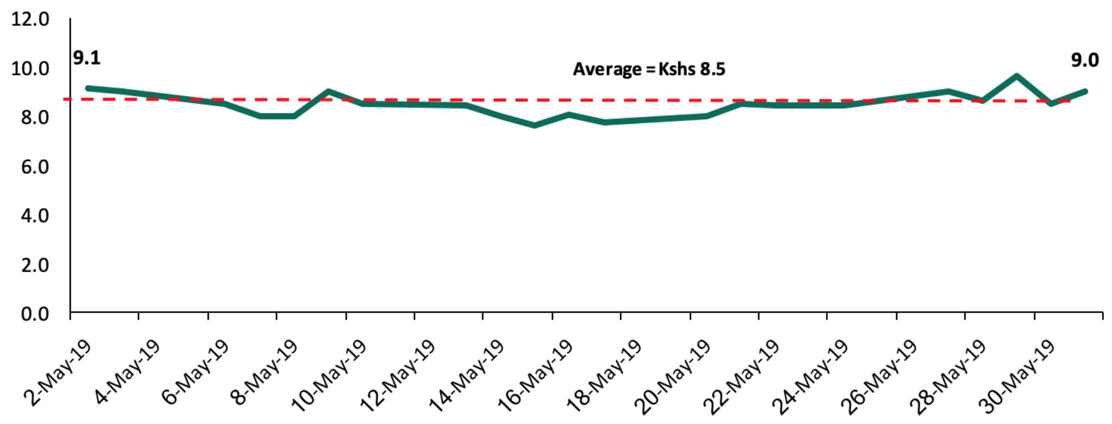
During the month, Autograph Collection Hotels, one of Marriott International's brand of luxury hotels, added Nairobi's Sankara Hotel located in Westlands to its portfolio, as a franchise. The move increases Marriott's local portfolio to three hotel facilities, after Four Points by Sheraton Nairobi Airport, opened in October 2017, and Four Points by Sheraton Hurlingham, which was converted in April 2017. Sankara Hotel, which had 168 keys was in the process renovated to suit the Autograph Collection's brand gaining an additional 11 suites, bringing its total number of keys to 179. For analysis, see Cytonn Weekly #21.

With the increasing interest in Kenyan hospitality market from international hotel operators and growth in meetings, conferences and exhibitions, we expect the hospitality sector to remain vibrant.

V. **Listed Real Estate**

The Stanlib Fahari Income-REIT closed the month at Kshs 9.0 per share, which was a slight drop of 1.1% from the month's opening price of Kshs 9.1. However, the instrument dropped by 16.3% in comparison to the price per share at the beginning of the year, which was at Kshs 10.75, and 56.6% from its issue price of Kshs 20.75. The REIT has been performing poorly mainly due to minimal acceptance by real estate investors and a general poor institutional framework inhibiting its growth.

Fahari I-REIT Performance May 2019



We expect real estate to continue recording increased activity in residential sector, with a key focus on the affordable housing segment, as well as the hospitality sector. Key factors that will support the industry's overall performance include i) continued improvements on infrastructure, ii) friendly business environment, especially to foreign firms, as evidenced by Kenya's move up the rank on the Ease of Doing Business Index to position 61 in 2018 from 80 in 2017, and iii) an increasingly expanding economy as signaled by 2018's GDP

growth rate, which came in at 6.3%.

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