# Ruaka Residential Research, & Cytonn Weekly Report #8

## Cytonn Weekly

### Executive Summary

- **Fixed Income:** Yields on government securities declined for the fourth consecutive week, as a result of increased liquidity. The G20 Finance Ministers and Central Bank Governors meeting #1 is expected to address the headwinds facing the global economy;
- **Equities**: The market was on an upward trend during the week, with NASI and NSE 20 gaining by 0.4% and 1.0%, respectively, while NSE 25 declined slightly by 0.1%. Housing Finance released its FY?15 results, recording an 18.5% decline in EPS to Kshs 3.43 despite a 22.7% increase in profits as a result of the dilutive effect from their rights issue;
- **Private Equity:** Sub-Saharan Africa remains an attractive destination for global capital with increased flow of private equity funds into the region;
- **Real Estate:** Local developers turn to international markets to acquire funding for mega real estate projects as they increase the scope of their operations;
- **Focus of the Week:** Continuing with our market research on Nairobi Satellite towns, we focus on Ruaka.

# Company Updates

- Our Senior Investment Analyst, Duncan Lumwamu discussed the six listed companies at the Nairobi Securities Exchange that have accumulated massive debts. See link on CNBC Africa: Duncan Lumwamu on CNBC Africa.
- We continue to beef up the team with our on-going hires: Careers at Cytonn.

# Fixed Income

Yields on government securities continued to decline this week, with the 91-day, 182-day, and 364-day T-Bills dropping by 60 bps, 60 bps and 10 bps, respectively, to 9.3%, 11.9%, and 13.3%, from 9.9%, 12.5%, and 13.4% last week, respectively. This was on account of high liquidity levels in the money markets as a result of huge maturities on government securities of Kshs 12.7 bn during the week. Investor?s preference is still towards shorter dated paper due to the uncertainties surrounding the direction of interest rates.

This week, the government reopened both 5-year and 10-year Treasury bonds amounting to Kshs 25 bn. There was a 226.1% performance rate for the bonds, with total subscriptions at Kshs 56.5 bn, and the amount accepted at Kshs 30.3 bn. The average yields of accepted bids came in at 13.9% and 14.3% for the 5 and 10-year, respectively, against our projections of between 14.5% - 15.0% for the 5-year and 15.0 - 15.5% for the 10-year, respectively. Between January and February, yields have come down due to increased liquidity in the money markets, and the lower pressure on government to borrow in the domestic market.

Money market liquidity remained high as evidenced by the reduction in the interbank rate from 4.4% at the close of last week to 3.7% this week. This was as a result of high maturities of government securities, which was reduced slightly by repo activity of Kshs 10.0 bn. Despite the high liquidity in the money market, the Kenya Shilling remained stable against the dollar to close at 101.8. The shilling is expected to remain stable against the dollar given (i) increasing forex reserves that are currently USD 7.2 bn, equivalent to 4.6 months of import cover, (ii) a reduction in the trade balance deficit, currently at 8.9% of the GDP, due to lower oil prices that reduce the import bill.

This year?s G20 Finance Ministers and Central Bank Governors meeting #1 slated for the 26-27th February, 2016 is expected to address a variety of issues, chief among them the looming global crisis and promoting growth. Items on the agenda include:

- **Investment** - Addressing the large global infrastructural gap will have a high priority, the focus being on making long-term efforts of bridging data gaps, building capabilities, and attracting capital into investment projects to address the USD 15.0 tn infrastructural spending gap required to lift global growth. With an annual infrastructural funding deficit of USD 4.0 bn, Kenya is expected to benefit significantly from the deliberations;
- **IMF Quota and Governance Reform** - The aim this year is on minimizing European over-representation and increasing the voice of emerging markets and developing nations. An agreement to extend the IMF?s temporal bilateral resourcing and varying the formula used in calculating quota allocations is also in the pipeline for discussion. If successful, it will allow Kenya to have more voice and quota allocations for development;
- **Reforming International Tax** - The 2016 agenda is how to combat tax avoidance and evasion by multinational corporations, a vice which has been robbing governments of between USD 100 bn and USD 240 bn annually in collections;
- **Macroeconomic Policy Co-operation** - Incorporates themes such as macroeconomic stimulus, fiscal consolidation, monetary policy, the global safety net, and reducing global imbalances. Government?s role in influencing exchange rates is also to be discussed, as well as a grand currency agreement that will allow for the depreciation of the dollar.

If successful, the negotiations will allow Kenya get more IMF quotas and acquire the capabilities and resources to finance its USD 4.0 bn annual infrastructural funding gap. It will also mean reduced volatility of the Kenyan Shilling and increased taxes from multinationals. The past, however, paints a gloomy picture, as implementation of action plans has been weak. Another drawback is a collision of national and international interests leading to a failure to reach meaningful agreements that have superior international outcomes. We therefore do not expect the deliberations to have much sway on global finance, or address the looming crisis.

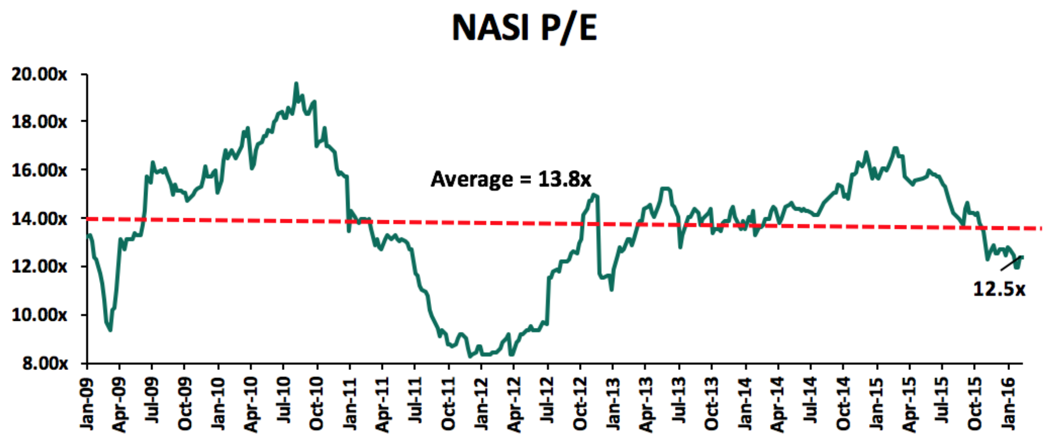
***The government remains ahead of its borrowing programme with borrowings of Kshs 202.3 bn against a target of Kshs.146 bn to date (assuming a pro-rated borrowing of the budgeted Kshs 219 bn throughout the financial year). With interest rates coming down during the week due to (i) reduced pressure on government borrowing, and (ii) high liquidity in the market, we advise investors to lock in their funds in short to medium-term paper, as the rates are higher on a risk-adjusted basis.***

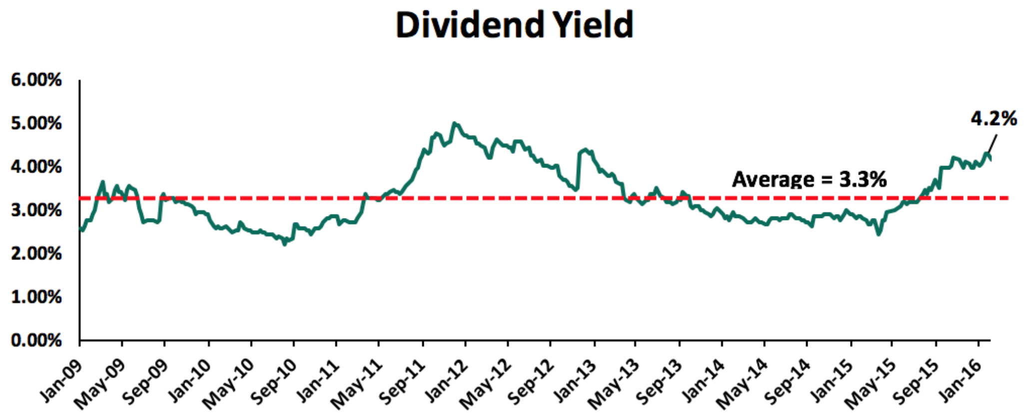
# Equities

During the week, the market was on an upward trend with NASI and NSE 20 gaining 0.4% and 1.0%, respectively, while NSE 25 declined slightly by 0.1%. This was on the back of gains in Bamburi, Co-operative Bank and Safaricom that gained 6.1%, 2.9% and 1.6%, respectively. On a YTD basis, NASI, NSE 20 and NSE 25 are down 3.1%, 4.2% and 2.9%, respectively, while from the February 2015 peak, NASI and NSE 20 are down 20.4% and 29.6%, respectively.

Equities turnover declined by 18.6% during the week to Kshs 1.5 bn from Kshs 1.9 bn the previous week. Foreign investors were net sellers for the third straight week, recording outflows of Kshs 36.1 mn as their participation declined to 62.8% from 69.6% last week.

The market is currently trading at a price to earnings (PE) ratio of 12.5x versus a historical average of 13.8x, and with a dividend yield of 4.2% versus a historical average of 3.3%. The charts below indicate the historical PE and dividend yields of the market.




To kick-off the banks earnings, Housing Finance Group Reported FY?2015 financial results

- PAT grew by 22.7% y/y to Kshs 1.2 bn from Kshs 0.98 bn in FY?2014. PAT growth was mainly attributed to growth of non-funded income at 39.1% to Kshs 1.2 bn from Kshs 0.8 bn in 2014, mainly as a result of sale of units from the group?s real estate projects, which is not the core non-funded income. The sale from real estate projects represent ?other income?, which grew 68.7% y/y to Kshs 768.4 mn, from Kshs 455.5 mn previously
- Net interest income also grew by 19.1% y/y to Kshs 3.6 bn from Kshs 3.0 bn in the previous period. Taking into account both non-funded and net interest income, operating revenue grew by 23.4% y/y. However, while PAT grew by 22.7%, the earnings per share declined 18.5% to Kshs 3.43 owing to the dilution from the rights issue shares which increased total number of shares by 117.3 mn to 348.9 mn shares
- Interesting to note is that interest expense outgrew interest income for FY?15. Total interest income grew by 27.0% from Kshs 6.3 bn to Kshs 8.1 bn, and interest expense by 34.3% from Kshs 3.3 bn to Kshs 4.5 bn. As stated previously, the core non-funded income did not grow, and was driven by ?other income? from real estate sales, boosting earnings. Core earnings for the bank remained subdued, with interest expense outpacing income, and core non-funded income, excluding real estate gains, growing by 4.0%, from Kshs 387.2 mn to Kshs 402.6 mn.

- Operating expenses grew by 26.6% y/y to Kshs 3.1 bn from Kshs 2.5 bn, which was higher than operating revenue growth of 23.4%, driven by a 62% growth in other expenses, associated with the restructuring of the business and staff costs growing by 12.5% y/y to Kshs 1.1 bn. This high expense growth led to an increase in the Cost to Income ratio to 65.1% from 63.4% same period last year
- The Loan book grew by 17.2% y/y to Kshs 53.0 bn from Kshs 45.2 bn outpacing deposits growth of 15.4% y/y, resulting in a higher loan to deposit ratio (LDR) of 127.3%, from 125.3% in FY?2014; the high LDR remains a concern and indicates funding pressures that can only be alleviated by more aggressive deposits gathering. While total loans and advances grew by 17.2%, it is curious that loans to directors, shareholders and associates rose by an outstanding 167% y/y to Kshs 735.9 mn, while total insider loans and advances increased 54.2% to Kshs 1.7 bn
- NPLs declined by 1.6% y/y to Kshs 4.1 bn from 4.2 bn, resulting in a reduction in the NPLs to total loans ratio to 7.7%, from 9.2% in FY?2014
- The yield from the bank?s interest earning assets stood at 14.1%, while the cost of funds came in at 7.5%, resulting in a net interest margin of 6.3%
- The bank?s ROaA was at 1.8% while the ROaE came in at 13.9%
- Dividend payment per share declined 13.3% y/y to Kshs 1.3 from Kshs 1.5 despite the increase in proposed dividends to Kshs 226.7 mn from Kshs 173.7 mn owing to the increase in the number of shares
- HF Group 2015 performance outperformed our estimates of an EPS of 3.16, owing to a strong growth in non-funded income. Following their rights issue, where the bank raised Kshs 3.5 bn, the bank improved its capital position, with total capital to total risk-weighted assets now at 18.1% from 15.1%, against a statutory minimum of 14.5%

Going forward, we expect the bank to grow its presence in the country with the planned opening of 7 new branches. This should help in deposit mobilization, which is needed to consistently drive core revenue growth, as the bank?s high LDR remains a concern, as well as address the concern over growth in interest expense outpacing interest income. However, deposit mobilization is extremely competitive and is currently dominated by KCB Bank, Cooperative and Equity bank as the leading deposit gatherers. Others such as Barclays and Stanchart have a niche in corporates and high end of the market. HF Group will need to find a niche to be able to assert itself in deposit gathering, but finding a niche will be difficult because every niche market is occupied and competitive. If HF does not solve the deposit gathering, then it will have to contend with being a mortgage financing shop with wholesale funding, or pair up its mortgage loan asset generating capabilities with deposit gathering capability. In addition, we expect the bank to increase its focus in housing development and commercial banking as it diversifies from mainstream mortgage business. We shall be meeting with Management this coming week to discuss the long-term growth strategy of the bank and we shall share our thoughts from the meeting.

Barclays Plc has decided to exit its African operations in order to refocus the bank on its core UK and US markets, a report by Financial Times indicated. The bank has appointed a subcommittee to study how and when to sell its 62.3% stake in Barclays Africa, which is valued at £3.5 bn (USD 4.8bn). Barclays CEO James Staley highlighted that despite the recognition that Africa is one of Barclay?s genuine growth areas, it is (i) becoming a costly distraction owing to the devaluation of the South African Rand, and (ii) extra risks of corruption and misconduct in Africa, which would tarnish the entire African operation if something was to go wrong.

Barclays' African business had USD 49.9 bn of assets on a risk-adjusted basis and made a profit of USD 1.1 bn in the first nine months of 2015, or 13% of the bank's core profits. In Kenya, the multinational holds 42.6% of Barclays Kenya and if the divesture comes to pass, the minority shareholders are likely to get a new partner and this might be a big blow to the Kenyan business given the huge brand equity the bank has. In our view, this:

1. Will increase the strength of other Tier I banks, namely Equity and KCB, which over time have displaced foreign banks such as Standard Chartered, Barclays and Citi from their perch as the key provider of banking solutions. 5 years ago, Barclays market cap was Kshs. 93.7 bn and today it is Kshs 70.3 bn, a decrease of 24.9%, compared to a local bank such as Equity bank whose market cap was Kshs 105.5 bn and is now Kshs 144.3 bn, an increase of 36.8%. It is becoming harder for foreign banks to grow and compete locally given the rapidly evolving landscape with the likes of MPesa, agency and informal sector banking, innovations that were adopted faster by local banks compared to foreign banks, and
2. Highlights the increased need for African countries to tackle corruption and misconduct in Africa. Global banks and brands such as Barclays have been at the forefront of instilling structures for governance and frameworks, and their impending exit over corruption is a blow to the African Continent.

However, important to consider is the irony in Barclays, which has brought to the forefront the uniqueness in the African banking business environment, which include regulation and transparency, that has made it difficult for established global brands to gain a firm foothold. Former Barclays CEO, Bob Diamond, through his company Atlas Mara, has already made banking investments in seven African countries, including Rwanda, Zimbabwe, Nigeria and Botswana. This comes at the same time that Barclays, the global banking giant he used to run, is planning to exit Africa. The irony points out to a key qualitative indicator; while banking in Africa is attractive, and the opportunity vast, the stricter regulatory regimes in developed markets make the African banking business too risky for global banks.

Kenya Power released its H1?16 financial results recording a 16.6% decline in profit to Kshs 5.7 bn, down from Kshs 6.9 bn recorded in 2014. This decline in profits is attributed to increase in non-fuel purchase costs by 24.5% to Kshs 25.0 bn from Kshs 20.0 bn in the previous period, as a result of additional capacity charges by Kengen, Gulf power and Triumph Power Company for new power plants, as well as an increase in energy charges. Sales revenue grew by 5.6% to Kshs 41.7 bn from Kshs 37.6 bn as a result of increased consumption due to an expanding customer base. Fuel costs reduced drastically by 52.9% to Kshs 8.1 bn, down from Kshs 17.2 bn. This is attributed to more usage of geothermal sources after two additional Olkaria plants became operational during the year and the decline in oil prices globally. Transmissions and distributions costs increased by 25% from Kshs 10.5 bn to Kshs 13.1 bn largely due to expansion of transmission network, increase in staff costs as well as an increase in depreciation and amortization of assets. However, distribution efficiency increased by 0.5% as a result of a decrease in distribution losses from 80.1% in 2014 to 79.1% in 2015. We are of the view that KPLC will be able to sustain growth in the future due to (i) increase in connectivity of households to the electricity grid, (ii) reduced cost of fuel due to increase in geothermal production, and (iii) an increase in distribution efficiency.

Mumias Sugar Company released its H1?16 financial results recording a 9% y/y increase in loss after tax to Kshs 1.6 bn up from Kshs 1.5 bn recorded in the same period in 2014. The company?s revenue grew by 11% y/y to Kshs 3.0 bn up from Kshs 2.7 bn in 2014 driven by increased tonnage of sugarcane crashed by 31% to 581,541 tons up from 443,425 tons. The company?s expenses however increased at a faster rate, with administration costs rising by 22% to Kshs 1 bn up from Kshs 0.8 bn while finance costs rose by 93% to Kshs 0.7 bn from Kshs 0.4 bn in 2014. High finance costs are as a result of high interest payments on its dollar obligations of USD 25 mn owed to PROPACO and Ecobank, and a further Kshs 3.5 bn owed to local financial institutions. Going forward we have a negative outlook on Mumias due to depressed sugar prices as a result of influx of cheap illegal imports and the company dispute with Kenya Power that has halted the selling of electricity to the National Grid since 2014. The challenges facing Mumias are further complicated by the emergence of sugar millers in western Kenya that have more efficient operating models, and are able to pay sugar farmers in good time compared to Mumias Sugar Company Ltd.

East Africa Portland Cement released its H1?16 financial results, recording a 498.7% increase in loss after tax to Kshs 745 mn, a greater loss from the Kshs 124 mn loss in 2014. The company consequently issued a profit warning for the full year ending June 2016. During the period, the company?s mining activities were disrupted due to invasion of its lands in Athi River reducing the availability of raw materials and increasing the cost of production. The company suffered forex losses of Kshs 187.6 mn compared to a gain of Kshs 233.7 mn in a similar period in 2014, as a result of the Kenyan Shilling weakening against the dollar and the yen. Finance costs increased by 50% to Kshs 279.7 mn from Kshs 186.8 mn in 2014. These costs result from a currency hedge, which moved against them. These funds were used to set up a cement packing line that has seen a growth in revenue by 16% to Kshs 4.6 bn up from Kshs 4.1 bn recorded in the same period in 2014. We have a negative outlook on EAPC due to cement over supply despite a growing local demand putting a downward pressure on prices in the medium-term.

**We remain neutral on equities given the low earnings growth prospects for this year. The market is now purely a stock picker?s market, with few pockets of value.**

Below is our equities recommendations table;

| *all prices in Kshs unless stated* | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **EQUITY RECOMMENDATIONS - for the week ending 26/02/2016** | | | | | | | | |
| **No.** | **Company** | **Price as at 19/02/16** | **Price as at 26/02/16** | **w/w Change** | **Target Price*** | **Dividend Yield** | **Upside/ (Downside)**** | **Recommendation** |
| 1. | KCB Group | 39.5 | 40.0 | 1.3% | 59.1 | 5.5% | 53.1% | Buy |
| 2. | Standard Chartered | 191.0 | 194.0 | 1.6% | 247.9 | 5.5% | 33.3% | Buy |
| 3. | Equity | 39.8 | 39.0 | (1.9%) | 48.6 | 5.2% | 29.7% | Buy |
| 4. | Centum | 43.8 | 44.3 | 1.1% | 57.2 | 0.0% | 29.3% | Buy |
| 5. | Barclays | 12.7 | 13.0 | 2.4% | 15.5 | 8.2% | 27.5% | Buy |
| 6. | DTBK | 199.0 | 201.0 | 1.0% | 250.1 | 1.3% | 25.7% | Buy |
| 7. | Kenya Reinsurance | 20.0 | 20.0 | 0.0% | 23.5 | 3.3% | 21.1% | Buy |
| 8. | NIC | 39.5 | 40.0 | 1.3% | 45.4 | 2.7% | 16.2% | Accumulate |
| 9. | Uchumi | 7.0 | 6.5 | (7.1%) | 7.5 | 0.0% | 15.4% | Accumulate |
| 10. | I&M | 100.0 | 98.5 | (1.5%) | 110.5 | 2.6% | 14.8% | Accumulate |
| 11. | National Bank | 14.8 | 14.9 | 0.3% | 16.8 | 0.0% | 13.4% | Accumulate |
| 12. | Britam | 12.2 | 12.0 | (1.2%) | 13.4 | 1.3% | 13.0% | Accumulate |
| 13. | Safaricom | 15.9 | 16.1 | 1.6% | 16.6 | 5.1% | 8.3% | Hold |
| 14. | Co-operative bank | 17.3 | 17.8 | 2.9% | 18.0 | 3.7% | 5.3% | Hold |
| 15. | Liberty | 15.9 | 16.0 | 0.9% | 16.7 | 0.0% | 4.6% | Lighten |
| 16. | HF Group | 20.0 | 20.8 | 4.0% | 20.1 | 5.7% | 2.6% | Lighten |
| 17. | Pan Africa | 52.0 | 52.0 | 0.0% | 52.8 | 0.0% | 1.5% | Lighten |
| 18. | CfC Stanbic | 78.0 | 76.5 | (1.9%) | 77.2 | 0.0% | 0.9% | Lighten |
| 19. | CIC Insurance | 6.0 | 6.0 | 0.8% | 5.8 | 1.3% | (2.2%) | Sell |
| 20. | Jubilee Insurance | 470.0 | 473.0 | 0.6% | 440.7 | 1.5% | (5.3%) | Sell |
| ***Target Price as per Cytonn Analyst estimates** | | | | | | | | |
| ****Upside / (Downside) is adjusted for Dividend Yield** | | | | | | | | |
| ***Accumulate ? Buying should be restrained and timed to happen when there are momentary dips in stock prices.*** | | | | | | | | |
| ***Lighten ? Investor to consider selling, timed to happen when there are price rallies*** | | | | | | | | |
| ***Data: Cytonn Investments*** | | | | | | | | |

# Private Equity

German pharmaceutical firm Pharmaken has announced plans to enter the Kenyan market targeting health facilities and medical staff in its range of disinfectant products. The deal, whose details are undisclosed, will retail hygiene products used on hospital surfaces, surgical tools and medical staff for controlling germ infection. Pharmaken joins the local market to compete with brands such as French Anios and local players Orbit, Canon, Kronex, Biodeal and Osho Chemicals as well as homemade brands. The company is banking on its new range of products to offer the company a competitive advantage in Kenya and improve their USD 5 bn in revenues that it made in 2015. The growing demand for quality healthcare, devolution of government and increase in new overall infections globally will boost growth of supporting services in the industry.

Goodwell Investments based in Netherlands has acquired a minority stake in a Dutch cloud-based software provider Musoni Services that provides affordable core banking software to microfinance institutions in East Africa, wider Sub-Saharan Africa and Myanmar that was founded 2009. This is a good move to respond to the need by microfinance institutions to manage their customer databases cost effectively and efficiently. Microfinance in Africa has been on the rise with countries like Ghana enforcing a major bank to act as the Central Bank for the promising financial services provider. Musoni is one of the first companies to offer cloud computing and software as a service, a move that is expected to change the financial services landscape in Africa. The company has presence in 8 countries in Africa supporting 39 Microfinance institutions as of 2015. Incorporating SACCOs in Nigeria into the pool of target customers will grow the company that plans to use the funds for expansion into new markets and provide a strategic deal for acquirers Goodwell.

South African solar company Mettle Solar has acquired a 50% stake in engineering, procurement and construction firm, Sustainable Power Solutions for an undisclosed amount. The deal comes after a strong working relationship that has co-existed between the two firms with SPS designing and installing several grid contracts for Mettle Solar. Power production in Africa has been increasing to cater for increased demand. Alternative sources of power are gaining popularity and this deal will allow Mettle Solar to roll out solar projects more cost effectively. This deal is expected to grow others and attract investors to South Africa within the next 10 years.

***Private equity investment in Africa continues to improve, as evidenced by the increase in the number of deals and deal volumes into the region, and the closing of various fund raising activities by funds focused on investing in Africa. Infrastructure, real estate, and natural resources continue to be preferred by PE firms, but financial services, healthcare, education, and IT are gaining ground*. *We remain bullish on PE as an asset class in Sub Saharan Africa given (i) the abundance of global capital looking for investment opportunities in Africa, (ii) attractive valuations in private markets, and (iii) better economic growth projections compared to global markets.***

# Real Estate

Shelter Afrique, a real estate finance company with operations in Kenya and across Africa is set to receive a Kshs 836.4 mn private equity investment from the Africa Development Bank (AFDB) Corporation. It will also receive Kshs 2.5 bn loan from the Islamic Corporation for Development (ICD). Shelter Afrique plans to use these funds to finance on-going projects by King?s Pride in Kiambu, Glenwood gardens in Ruaka and Karibu Homes and Everest Park in Athi River. Shelter Afrique operates by providing financing to real estate developers for provision of affordable housing to the residents of a given African country. The funds received will hence go a long way to improve operations in the Kenyan real estate industry through completion of the on-going projects it is financing. The capital-intensive nature of real estate has led to many financiers and developers seeking financing from abroad. Cytonn Investments recently received Kshs 400 mn additional funding from Taaleri to finance the on-going Situ Village residential project in Karen. Home Afrika is also targeting a Kshs 15 bn financing in form of debt and equity mix in the next 18 months. The funds will be used to finance the on-going and new projects such as Lakeview Heights in Kisumu, Tamarind tree residence in Kiambu and other projects within the Migaa Estate in Kiambu.

The Kenyan real estate market remains attractive to foreign investors mainly due to:

1. High returns of up to 25% (Capital appreciation and yield)

2. Increased importance of the sector to the economy with its contribution to GDP increasing from 4.9% in 2013 to 8% in 2015
3. Lower risk since it is secured and it?s easier to reclaim a project if repayments are defaulted
4. Rapid urbanization rate of 4.4% per annum
5. Improved operating environment such as legal, technological advancements and an increase in the number real estate professionals and practitioners
6. High opportunity due to the large estimated housing deficit of about 150,000 annually; the demand for over 200,000 houses that outweighs the current supply of 50,000 houses annually

Increased financing has led to an increase in developer activity and with the above factors remaining unchanged, we expect the development momentum to be sustained.

This week, Coldwell Banker Kenya, a subsidiary of US based Coldwell Banker, launched a real estate Customer Relationship Management (CRM) system aimed at providing a global customer base for realtors in Kenya as well as help them increase their sales. The cloud-based system is set to enable real estate companies connect, market and service clients globally. This comes at a time when the fast growing real estate market has attracted online marketing services from companies such as Lamudi, Buyrent Kenya and Property24 among others. Given the current technological advancements, many real estate companies are going online with most of their marketing activities being done on company websites, product specific websites as well as online marketers such as the above mentioned.

A Report released by Lamudi indicates that many home shoppers use the internet as their first stop for information before engaging the available real estate vendors. Over 62% of online property shoppers are within the 25yrs ? 44yrs age bracket. These are the middle income class whose key determinant in purchasing property is affordability. Kenya is currently experiencing increased growth in this income class and we expect this to result in increased demand for low to middle income housing costing between Kshs 5 mn to 30 mn. This is expected to create a ripple effect causing increased competition amongst online real estate marketers and thus lead to increasingly innovative marketing apps and software.

# Focus of the week: Ruaka Investment Opportunity

Cytonn Report #6 focused on Nairobi household settlement characteristics in the satellite towns around Nairobi. We saw people in the satellite towns take on average 3 years or less to buy land, build and settle down. Given Cytonn?s key focus towards providing middle income housing, this week we focus on Ruaka, which is an attractive real estate investment satellite town. The town is close to Nairobi and has two prime commercial retail developments within its vicinity ? Two Rivers and the Rosslyn Riviera mall. Research by our Real Estate team shows that Ruaka developments deliver an average rental yield of 5.1% p.a. and potential total returns of more than 21% p.a.

Following our market research on Ruaka in August 2015, highlighted in Cytonn Report #34, a supplementary study was conducted to reaffirm on the performance of the market in the last 6 months. We widened our scope of research to include one-bedroom apartments, as well as increase the number of comparable developments. The market study focused on properties built within the last 5 years along Limuru Road where Cytonn is developing The Alma.

Ruaka was historically a rural shopping centre with the hinterland being utilized for agricultural purposes. However, the on-going relaxation of zoning restrictions that is in line with strategic planning will allow for more comprehensive and high-density development of both residential and commercial properties. According to the data from KNBS on the 2009 Census, the population of the larger Karuri area stood at 129,000 from the 2009 which is a 41.7% increase compared to the 1999 census. It is projected that by 2025 the population will be 176,191 translating to an annual population growth of 1.97%. Ruaka?s population is a mix of both local middle income earners as well as foreign residents.

As per our research on uptake of housing units in Nairobi?s satellite towns, Ruaka has the highest uptake at 93% compared to an average of 73% for the other satellite towns.

**Ruaka?s Residential Market Research**

Demand for housing has led to an increase in land and property prices in areas around Nairobi Metropolitan Region. Land in Ruaka is priced at approximately Ksh 100 Million per acre and this is relatively expensive in comparison to other satellite towns such as Ngong, Athi River and Ruiru. Prime land with frontage to tarmac road is scarce in the town resulting to an increase in linear developments along Limuru road towards Ndenderu.

The market research focuses on the following areas:

- *Sizes of apartments:* this is to be used in unbiased comparison of the rental and selling prices as well as the developments trends in the area
- *Selling prices of apartments*: this will give an overview of the average exit prices of apartments in the area
- *Rental rates for various units* will inform on the average rental prices, and yields for investment analysis
- *Uptake of the apartments* indicates the rate at which apartments have been bought hence indicating the attractiveness of residential property in the area

**Research Findings:**

| *1 bedroom apartments* | | | | | | | |
|---|---|---|---|---|---|---|---|
| Name of Development | Year of Completion | Size of Unit (SQM) | **Current Selling Price per SQM (Ksh)** | Rent per SQM (Ksh) | Uptake (%) | Yield (%) | CAP Rate (%) |
| Junica Apartments | 2013 | 43.0 | 86,047 | 419 | 94 | 5.5 | 14.7 |
| Ruaka Ridge | 2015 | 63.0 | 99,206 | 397 | 100 | 4.8 | 13.9 |
| Makao Roselyn | 2015 | 58.5 | 94,017 | 342 | 85 | 3.7 | 15.6 |
| Ruaka Spearnet | 2015 | 45.0 | | 400 | 94 | 3.9 | |
| Elite Heights | 2013 | 58.0 | | 379 | 100 | 5.1 | |
| **Average** | | **53.5** | **93,090** | **387** | **94.6** | **4.6** | **14.7** |
| **Total Return** | | | | | | | **19.3** |
| *One bedroom apartments have the highest price per square metre at Ksh 93,090 as compared to two and three bedroom apartments at Ksh 91,307 and Ksh 84,214 respectively* | | | | | | | |

| *2 bedroom apartments* | | | | | | | |
|---|---|---|---|---|---|---|---|
| Name of Development | Year of Completion | Size of Units (SQM) | Current Selling Price per SQM (Ksh) | Rent per SQM (Ksh) | Uptake (%) | Yield (%) | CAP Rate (%) |
| Mulberry | 2013 | 90.0 | 100,000 | 444 | 100 | 6.1 | 9.5 |
| Temus | 2012 | 107.0 | 79,439 | 374 | 95 | 5.4 | 19.6 |
| Runda View | 2015 | 86.0 | 113,372 | 465 | 100 | 4.9 | 17.9 |
| Ruaka Ridge | 2015 | 92.0 | 76,087 | 408 | 94 | 5.8 | 14.8 |
| Makao Roselyn | 2014 | 88.9 | 95,613 | 450 | 85 | 5.1 | 16.6 |
| The Pearl | 2016 | 108.0 | 83,333 | | 85 | | |
| Glenwoods Gardens | 2017 | 88.0 | 71,023 | | 96 | | |
| **Average** | | **95.3** | **91,307** | **428** | **93.2** | **5.45** | **15.7** |
| **Total Return** | | | | | | | **21.1** |
| *2 bedroom apartments have the highest yields at 5.45% as compared to 1 and 2 bedroomed apartments at 4.6% and 5.2% respectively. They are thus the best option for investors seeking to let their property in the area* | | | | | | | |

| *3 Bedroom apartments* | | | | | | | |
|---|---|---|---|---|---|---|---|
| Name of Development | Year of Completion | Size of unit (SQM) | Current Selling Price per SQM (Ksh) | Rent per SQM (Ksh) | Uptake (%) | Yield (%) | CAP rate (%) |
| Mulberry | 2013 | 110 | 109,091 | 455 | 100.0 | 4.7 | 18.8 |
| Runda View | 2015 | 104 | 103,365 | 481 | 84.0 | 4.7 | 15.7 |
| The Pearl | 2016 | 123 | 79,675 | 390 | 58.3 | 5.6 | 19.1 |
| The Pearl | 2016 | 131 | 79,389 | 344 | 93.8 | 4.9 | 17.9 |
| Makao Roselyn | 2014 | 109 | 87,156 | 459 | 82.0 | 5.6 | 17.8 |
| Makao Roselyn | 2014 | 122 | 90,164 | 410 | 82.0 | 4.9 | 18.4 |
| Makao Roselyn | 2014 | 162 | 79,938 | 463 | 82.0 | 6.2 | 17.3 |
| Temus | 2012 | 107 | 88,785 | 430 | 95.0 | 5.5 | 19.1 |
| Haven Park | 2012 | 115 | 86,957 | 435 | 85.0 | 5.1 | 16.6 |
| Glenwoods Gardens | 2017 | 120 | 62,500 | | 94.0 | | |
| **Average** | | **120.3** | **84,214** | **426** | **85.6** | **5.2** | **17.9** |
| **Total Return** | | | | | | | **23.1** |
| *3 bedroom apartments have the highest price appreciation at 17.9% as compared to 14.7% and 15.7% for one and two bedroom apartments respectively.* | | | | | | | |

Summary of the research findings can be summarised as below:

| | 1 BR | 2 BR | 3 BR | Average |
|---|---|---|---|---|
| Average size (SQM) | 54.5 | 95.3 | 120.3 | |
| Average Monthly Rent per SQM (Ksh) | 387 | 428 | 426 | |
| Price per SQM (Ksh) | 93,090 | 91,307 | 84,214 | **89,537** |
| Uptake (%) | 94.6 | 94.0 | 90.5 | **93.0** |
| Yield (%) | 4.6 | 5.4 | 5.2 | **5.1** |
| Price Appreciation (%) | 14.7 | 15.7 | 17.9 | **16.1** |
| Total Return (%) | 19.3 | 21.1 | 23.1 | **21.2** |

**Performance Comparison ? Last 6 Months:**

A follow up on a research conducted in August 2015 shows that there has been appreciation of rent and price of units on the subject properties that had been used. On average, the prices and rental rates have increased at an annual rate of 6.8% and 15.5% respectively over the last 6 months. Investors who own apartments in Ruaka are likely to have an annual total return of 22.1%

| Type of Apartment | Rent Appreciation | Price Appreciation | Increase in Uptake | Total Return |
|---|---|---|---|---|
| 2BR | 19.0% | 7.0% | 6.5% | 21.1% |
| 3BR | 12.0% | 6.6% | 1.8% | 23.1% |
| **Average** | **15.5%** | **6.8%** | **4.2%** | **22.1%** |

Ruaka is in the rising phase of the real estate market evidenced by high returns and appreciation of both the rental rates and prices. The zoning regulations are favourable to property developers who densify their developments hence reaping high returns. Ruaka is thus ideal for investment in residential apartments with a mix of one, two and three bedroom units. Developers should however differentiate their developments through provision of other social amenities.

Cytonn Real Estate has ventured into the Residential market in Ruaka through the proposed Alma. The 408-unit mixed-use development project is located in Ruaka town near Joyland supermarket. The ground breaking for the development is scheduled to take place in March 2016. The breath-taking development will offer a retail centre as well as 1,2 and 3 bedroom apartments. In addition, there will be amenities such as a nursery school, a gymnasium and elevated gardens. The development has provision for adequate parking space for both residents and visitors. For details, see the development at Alma Video  and brochure at Alma Brochure .

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