Kenya Listed Banks Q1'2019 Report, & Cytonn Weekly #24/2019

Real Estate

I. **Industry Reports**

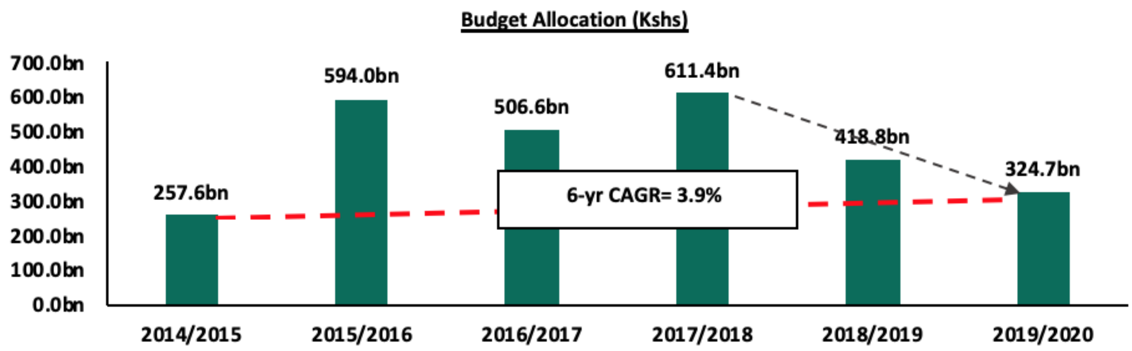
During the week, the National Treasury read the FY 2019/20 Budget statement themed *Creating Jobs, Transforming Lives - Harnessing the "Big Four" Plan*. According to the budget, the real estate sector is set to benefit through the funds allocation made to some of the sectors;

i. In housing, the affordable housing sector was allocated Kshs 10.5 bn, compared to the Kshs 6.5 bn allocated in 2018/2019. The amount was distributed as follows;
   - Kshs 3.2 bn for social housing and construction of affordable housing units, including staff housing units for the Police Service and Kenya Prisons,
   - Kshs 2.3 bn for the Public Servants Housing Mortgage Scheme, and
   - Kshs 5.0 bn set aside as the government's 1.5% contribution to the National Housing Development Fund (NHDF).

   The fund is expected to act as a saving for employees aimed towards house ownership, and we expect that this capital from the government's end is not only to facilitate operationalization of the fund, but also motivate employees and stakeholders to contribute towards the same. Despite being set to commence in May 2019, the implementation of the policy is currently on hold as the matter was challenged by various parties that include, Central Organization of Trade Unions (COTU), Trade Union Congress of Kenya, Consumers Federation of Kenya (CoFeK) and the Federation of Kenyan Employers (FKE) challenging the levy. For more details on the structure and operationalization of the fund, see our National Housing Development Fund Note 2019,

ii. The infrastructure sector was allocated Kshs 324.7 bn, 22.5% lower than the 418.8 bn allocated in the 2018/2019 budget. The funds will be mainly channeled towards the ongoing road construction projects as well as road rehabilitation and maintenance, completion of Phase 2A of the Standard Gauge Railway, the Lamu Port-South Sudan-Ethiopia-Transport (LAPSSET) Corridor project and the Mombasa Port Development Project. According to the Cabinet Secretary for the National Treasury, the funds allocated in the budget for infrastructure development are not adequate to meet the growing need for quality and sustainable services and to support the "Big Four" Plan, and therefore, the government will continue to leverage on the private sector to fund infrastructure development through public private partnership arrangements. Real estate development is intrinsically linked to infrastructure development, and we are therefore of the view that the improving infrastructure will continue opening up areas for development. However, we expect the reduced budget allocation, mainly due to the government decline on development expenditure aimed at containing the public debt that is currently estimated to be approximately 60.0% of GDP, 10.0% above the East African Community (EAC) Monetary Union Protocol, the World Bank Country Policy and Institutional Assessment Index, and the IMF threshold of 50.0%, to result in reduced real estate activities especially in areas that are yet to witness the much needed infrastructural development such as roads and electricity connection.

Below is the budget allocation to infrastructure over the last 6 years:



Source: National Treasury

iii. On capital gains, there is a proposed increase in the rate of Capital Gains Tax (CGT) from 5.0% to 12.5%, excluding the transfer of properties necessitated by restructuring. The increase in CGT is likely to negatively impact on the real estate sector by resulting in;

a. "Lock in effect" - the investors may result to holding properties that have appreciated to avoid paying the CGT on the same if the margins are low. This will, therefore, interfere with free flow of transactions, resulting to decline in number of property listings and sales, and,
b. Increased burden to the already struggling real estate sector- the real estate sector has continued to record decreased activities fuelled by the existing oversupply in some sectors such as the commercial office and retail sector, in addition to the unavailability and unaffordability of financing for both offtakers and developers. The increase in CGT will thus be an additional burden to the already struggling sector,
c. Increased property prices in the long run - increased CGT will lead to increased tax liability for investors realizing capital gains on disposal of property. This cost is most likely to be transferred to the buyer hence increased property prices.

Despite the above, the increase will have a positive impact on the nation, as it will;

a. Enhance tax equity given that it targets property owners who make up the wealthy individuals in the economy,
b. Increase revenue collection from the real estate sector to the government, and
c. Result in a decline in speculative demand – The speculators will shy away from purchasing property (land and buildings), expecting to gain from capital appreciation given the increase in CGT. This will lead to price stability in the market as speculation distort the property pricing.

II. **Residential Sector**

During the week, Fairdeal Group of Companies, a Nairobi based real estate company, announced that it had begun the construction of a Kshs 2.5 bn estate in Kikambala, Kilifi County. The project dubbed Sandy Shores Apartments, will see the development of approximately 196 residential apartments, a conference facility, swimming pools, a restaurant and sea sports facility, on a 6- acre parcel of land. The project will comprise of approximately 74 SQM- 1-bedroom units, 102 SQM- 2 bedroom, 149 SQM- 3 bedroom and 223 SQM- 4-bedroom units, selling at Kshs 6.75 mn, Kshs 11.0 mn, Kshs 17.5 mn and Kshs 28.0 mn, respectively translating to Kshs 110,517 per SQM. Other key projects in Kilifi include, i) Vipingo Estate, a 1.2 bn facility which is part of the mixed use Vipingo Development sitting on 10,254-acres of land, and comprises of an industrial park that covers 250-acres, Palm Ridge residential apartments on 20-acres and Awali Estate on 30-acres. See Cytonn Weekly #45/2018 for more details on the project, and ii) Sultan Palace, a 198- 4 bedroom villas beach project by Chinese firm, Sultan Development Limited. We attribute the investor interest in the coastal location to;

i. Proximity to sandy beaches creating demand for residential and serviced apartments from tourists,
ii. Affordability of development land with an average price per acre at Kshs 115.4 mn in Mombasa County according to Cytonn Research, compared to other major towns such as Nairobi with an asking price of up to Kshs 400 mn per acre, translating to lower development cost hence lower exit prices,
iii. Improvement in infrastructure such as construction of the Mombasa-Malindi Highway in 2018 and the expansion of the Mombasa port, opening up the area for development,
iv. Devolution has continued to open up the 47 county headquarters for development, attracting government institutions thus creating demand for office space, retail space and residential units.

Kilifi County, like Mombasa County, has witnessed an influx of real estate developments as investors aim to satisfy demand for housing by the growing coastal population and for accommodation by mid to long-term stay tourists. According to Cytonn's report, Mombasa Investment Opportunity 2018 Report, residential properties in Mombasa generated an average rental yield of 4.4% and an average price appreciation of 2.5%, in 2018. The upper mid- end market was the best performing segment in the residential sector during that year recording average returns of 8.1%, made up of an average rental yield of 5.5% and a capital appreciation of 2.6%, with investors in the region purchasing apartments with the aim of renting them to the growing middle class as well as long-stay visitors in the county.

The table below shows a summary of performance of the Mombasa market in 2018:

All values in Kshs unless stated otherwise

Mombasa Residential Sector- Segment Performance

Segment	Average Price Per SQM	Average Rent Per SQM	Average Occupancy	Average Annualized Uptake	Average Rental Yield	Average Price Appreciation	Average Total Returns
Upper Mid-End	115,199	600	81.1%	22.2%	5.5%	2.6%	**8.1%**
Lower Mid-End	60,240	288	89.2%	18.4%	4.6%	3.0%	**7.6%**
High-End	174,102	637	61.2%	15.3%	3.1%	1.8%	**4.9%**
Average	**116,514**	**508**	**77.2%**	**18.6%**	**4.4%**	**2.5%**	**6.9%**

• In 2018, the Mombasa residential market recorded an average rental yield of 4.4% and price appreciation of 2.5%

Source: Cytonn Research 2018

We expect the real estate sector to continue recording activities fuelled by the government's focus on the affordable housing initiative, the improving infrastructure and the existing demand for housing units in the middle- and low-income bracket.