Nairobi Metropolitan Area (NMA) Residential Report 2018/2019, & Cytonn Weekly #28/2019

Real Estate

I. Residential Sector

During the week, Stima Investment Cooperative, a local investments company, was appointed as the lead sales agent of Pangani Heights, one of the seven Nairobi Urban Regeneration Projects under the affordable housing initiative. The development set on 5.2 acres along Ring Road Ngara, was launched in December 2018 and was awarded to Technofin Kenya as the lead developer. The project construction is expected to begin in August 2019 and will consist of 1,434 units, comprising of social and low-cost units. The social units will comprise of 25 SQM- 1-bed and 50 SQM- 2-bed units at Kshs 1 mn and Kshs 2.5 mn, respectively, translating to Kshs 45,000 per SQM. The low-cost units will comprise of 30 SQM- 1-bed, 40 SQM- 2-bed, 60 SQM- 3-bed and 90 SQM- 3-bed duplex units, selling at Kshs 1.5 mn, Kshs 2.25 mn, Kshs 3.0 mn and Kshs 7.5 mn, respectively, translating to Kshs 59,896 per SQM. According to Stima Investment Cooperative, in order for prospective buyers to be eligible they must; (i) be members of Stima Investment Co-operative Society, and (ii) earn a basic salary of not more than Kshs 100,000 p.m.

As per the Kenyan Government affordable housing development framework, the affordable housing units target the following income group categories as follows:

i. Social Housing: (individuals earning up to Kshs 19,999),
ii. Low-Cost Housing: (Kshs 20,000 – Kshs 49,999),
iii. Mortgage Gap: (Kshs 50,000 – Kshs 149,999).

Individuals who fall under social and low-cost housing categories will acquire homes through Tenant Purchase Schemes while those earning above Kshs 50,000 will purchase through low-interest rate mortgage loans. According to State Housing and Urban Development, individuals will be acquiring the units through a rent-to-own model with monthly payments at an interest rate of 3.0%-7.0% p.a., however it is not yet clear how the funding for the low interest rates will be sourced.

For the investor and developers, the expected returns are 5.3% on average for lower mid-end apartments according to Cytonn research 2018/2019.

Residential Apartment Performance Summary 2018/2019: Y/Y Change

Segment	Average Rental Yield 2018/19	Average Y/Y Price Appreciation 2018/19	Average Total Returns 2018/19	Average Rental Yield 2017/18	Average Y/Y Price Appreciation 2017/18	Average Total Returns 2017/18	Change in Rental Yield	Change in Y/Y Price Appreciation	Change in Total Returns
Apartments: Upper Mid-End	5.0%	0.4%	5.3%	6.0%	2.9%	8.8%	-1.0%	-2.6%	-3.5%

With the continued government incentives in support of the affordable housing initiative, we expect to see increased developments in the lower and middle-income segment of the market as developers tap into government incentives to maximize returns amid the falling performance in the upper and high-end markets.

II. Retail Sector

Kenya's retail sector has been vibrant over the past few years, attracting interest from renowned international retailers as well as the robust expansion of local retailers. In line with this, during the week, Naivas Supermarkets, a local supermarket chain, opened their latest outlet in Ongata Rongai, Kajiado County. The 8,000 SQFT store is the retailer's 53rd store in Kenya. The continued expansion of local retailers is supported by; (i) the improving macroeconomic environment, with the country's GDP growing by 6.3% in 2018, 1.4% points higher than 4.9% recorded in 2017, (ii) Increased disposable income as a result of an expanding middle class thus creating demand for goods and services, with GDP per Capita growing at a CAGR of 10.3% p.a. over the last 4-years, from Kshs 125,756 in 2014 to Kshs 186,296 in 2018, and (iii) the exit of struggling local retailers, such as Nakumatt and Uchumi, leaving prime locations for occupation, creating an easy gap for the international retailer's expansion.

In our view, satellite towns such as Ongata Rongai, Kitengela and Ruaka, are increasingly presenting a viable opportunity to retailers due to: (i) low rental charges of Kshs 129 per SQFT in H1'2019 compared to market average at 170 per SQM hence maximizing on profits, and (ii) positive demographics with these areas acting as the Nairobi dormitory areas thus creating a demand for consumer goods & retail services.

For investors in retail real estate, with an average rent of Kshs 129 per SQFT, retail space in Satellite Towns, records rental yield of 5.7%, 2.5% points lower than the market average of 8.2%, with an average occupancy rate of 69.2% compared to the market average of 75.6%. The poor performance in satellite towns is mainly attributable to the competition from the informal retail stalls such as kiosks. We, however, expect the performance in these areas to improve as they attract middle-income earners looking for affordability in the housing sector, hence boosting adoption of the formal retail in the location.

The table below shows a summary of Nairobi's Retail Market Performance in H1'2019:

(All Values in Kshs Unless Stated Otherwise)

Summary of Nairobi's Retail Market Performance H1' 2019

Location	Rent Kshs/SQFT H1' 2019	Occupancy H1' 2019	Rental Yield H1' 2019	Rent Kshs/SQFT FY' 2018	Occupancy FY' 2018	Rental Yield FY' 2018	H1' 2019 Δ in Rental Rates	H1' 2019 Δ in Occupancy (% points)	H1' 2019 Δ in Rental Yield (% points)
Westlands	209	89.0%	12.0%	219	82.2%	12.2%	(4.7%)	6.8%	(0.2%)
Kilimani	173	91.4%	10.5%	167	97.0%	10.7%	3.6%	(5.6%)	(0.2%)
Ngong Road	171	87.5%	9.3%	175	88.8%	9.7%	(2.3%)	(1.3%)	(0.4%)
Karen	219	71.8%	8.8%	225	88.8%	11.0%	(2.5%)	(17.0%)	(2.2%)
Eastlands	145	74.2%	7.5%	153	64.8%	6.8%	(5.6%)	9.4%	0.7%
Kiambu Road	169	65.3%	7.3%	183	69.5%	8.1%	(7.6%)	(4.2%)	(0.8%)
Thika road	168	66.5%	6.8%	177	75.0%	8.3%	(5.4%)	(8.5%)	(1.5%)
Mombasa road	144	65.5%	6.3%	162	72.4%	7.9%	(10.7%)	(6.9%)	(1.6%)

We maintain a neutral outlook for the real estate sector supported by; (i) the continued entry and expansion of local and international retailers, (ii) the improving infrastructure, (iii) positive demographics and (iv) a stable economic environment. The investment opportunity lies in the lower mid-end residential sectors, which continue to exhibit fast growing demand from the majority of Kenyans seeking to buy affordable homes amidst a tough financial environment.
