Impact of Proposed Budget Changes to Pensions Industry, & Cytonn Weekly #29/2019

Real Estate

?. **Residential Sector**

During the week, the County Government of Nairobi commenced works on the Pangani Regeneration Project, one of the 7 flagship projects earmarked for Nairobi County as part of the Kenyan Government's Affordable Housing Initiative. The project, which is set on 12.5-acres in Pangani Estate, is to be undertaken by Technofin as the main contractor and Stima Sacco as the sales agent, and will see the development of approximately 1,434 units in a span of one year at an estimated cost of Kshs 4.0 bn. This will mark the second public-private affordable housing project to commence construction since the Park Road Project, which is currently under construction and scheduled to hand over 228 units of Phase One in September this year to Kenyans registered on the Boma Yangu portal. Since the launch of the Big Four Agenda, the initiative has recorded notable progress, with (i) growing aggregate demand as Kenyans continue to register for the units, (ii) financial backing from various international and private institutions towards support of homebuyer financing, and (iii) government incentives such as scrapping of stamp duty for first-time homebuyers and 15.0% affordable housing income tax relief, meant to boost offtake. Despite the said positive factors the affordable housing initiative has, however, continued to face delays with regards to operationalization of (i) the KMRC due to lack of licensing from the CBK despite having drafted the facility's regulations in February 2019, which is key to end-buyers, and (ii) the National Development Housing Fund due to legal oppositions, which is key for supply side financing. With the government targeting to construct 200,000 units annually, at least 500 units have to be delivered daily, thus, necessitating the need to engage more local private developers, which in our view will be facilitated by incentives such as financial backing, fast and efficient building approval processes, as well as actual provision of land and sufficient infrastructure.

During the week, Cytonn Real Estate, the development affiliate of Cytonn Investments, handed over the first phase of its Ruaka project, The Alma, after full uptake of the 16 one-bedrooms, 70 two-bedroom and 27 three-bedroom units selling at Kshs 6.3 mn, Kshs 9.9 mn and Kshs 12.9 mn, respectively. With initial investors realizing capital gains of up to 55.0%, Ruaka Satellite Town has been an attractive real estate investment opportunity owing to (i) relatively good transport network – with the Northern Bypass set for expansion whereas the Western Bypass connecting the Southern Bypass and the Northern Bypass is ongoing, (ii) close proximity to shopping facilities, namely Two Rivers, and others along Limuru Road such as the Village Market and Rosslyn Riviera, (iii) proximity to a UN blue zoned area and foreign organizations, thus, promoting its security, and (iv) relatively high returns and uptake.

II. **Commercial Office Sector**

Kenya Ports Authority (KPA) announced plans to put up an office building, to be located in Mombasa. According to the state agency, the building will have a total built up area of 75,000 SQM making it the largest office building in Kenya after Britam and UAP Towers with 32,716 SQM and 29,000 SQM, respectively. The KPA Office Tower Complex, which is currently at tendering process, is set to have 1,000 parking bays covering 18,000 SQM, 12,000 SQM of conference facilities, 15,000 SQM of commercial spaces, 12,000 SQM lettable office space while KPA will occupy 9,000 SQM. Also, according to the state agency, the provided area allocation is subject to change as the project gains traction.

As a real estate investment opportunity, Mombasa County is boosted by stable economic growth evidenced by the fast infrastructural development such as the Standard Gauge Railway, Dongo Kundu Bypass, Moi International Airport upgrade, as well as growth of maritime trade, growth of the tourism sector, and as per the KNBS Gross County Product data 2018, the county ranked 4^{th} in contribution to national GDP per capita, accounting for 4.7% after Nairobi, Nakuru and Kiambu Counties with 21.7%, 6.1%, and 5.5%, respectively, hence attracting more of developers to the coastal region. According to the Cytonn 2018 Mombasa Research Report, the office sector recorded average rental yields of 5.1%, with office mixed-use buildings registering an average of 7.4%, as shown below:

(*all values in Kenya Shillings unless stated otherwise*)

Mombasa Office Market Performance Summary August 2018

Class	Current Price/SQFT (Kshs)	Asking Rent Per SQFT per Month (Kshs)	Service Charge (Kshs)	Occupancy Rate	Rental Yield 2018
Grade B	15,000.0	79.6	20.0	71.7%	5.9%
Grade C		61.3	19.0	59.1%	3.2%
Office MUD	11,750.0	108.5	14.7	64.4%	7.4%
Average	**12,833.3**	**75.7**	**18.6**	**65.8%**	**5.1%**

- ***Mixed-use developments recorded better returns with average rental yields of 7.4% compared to the market average of 5.1%, attributable to their relatively high rental rates with an average of Kshs 108 per SQFT compared to the market average of Kshs 75.7 per SQFT, as they are mostly located in exclusive high end or upper mid-end residential areas thus target high-end clientele***

Source: Cytonn Research

We expect the commercial real estate sector in Mombasa to continue picking up, boosted by ongoing infrastructural developments in the region, the government's emphasis on investment in sectors such as manufacturing and the maritime business, and the national economic expansion, which has a spill-over effect as companies expand to the nation's largest cities including Mombasa, increasing demand for commercial real estate.

We expect to see increased real estate developments in counties other than Nairobi, facilitated by the ongoing infrastructural improvements, growth of GDP per capita. In Nairobi Metropolitan Area, pockets of value remain in themes such as housing for lower-middle to low-income earners in the residential sector and in differentiated concepts such as serviced offices and offices in mixed-use developments (MUDs) that attract average rental yields of upto 13.4% and 8.2%, respectively