Investment Options in the Kenyan Market, & Cytonn Weekly #30/2019

Real Estate

I. Industry Reports

During the week, Hass Consult, a local real estate agency, released the Hass Land Price Index Q2'2019, and the key take- outs from the report were as follows;

- Land prices in the Nairobi suburbs recorded a marginal q/q increase of 0.6% and a 1.7% annual appreciation, while land in satellite towns recorded a significant 3.2% q/q and 4.2% annual appreciation. The growth in satellite towns is attributed to strong demand due to affordability of land especially in areas with land prices of Kshs 15 mn and below per acre,
- In Nairobi suburbs, Donholm recorded the highest drop in prices with a quarterly and annual decline of 2.0% and 2.4%, respectively, attributed to decreased investor interest in the area following the announcement by the National Lands Commission (NLC) that it was yet to determine the validity of disputed plots in the area,
- Spring Valley recorded the highest quarterly appreciation of 4.4%, while Loresho recorded the highest annual appreciation of 9.8%. We attribute this to increased demand for development land by investors supported by the relaxation of zoning regulations allowing for densification and thus maximization of land,
- Commercial areas such as Upperhill recorded a price correction of 0.6% quarterly and 1.8% annually, attributed to reduced demand for commercial land for development due to the existing commercial space oversupply, and,
- In satellite towns, Kitengela recorded the highest q/q appreciation of 8.0%, while Mlolongo and Juja recorded the highest annual appreciation of 12.0% and 10.0%, respectively, driven by relatively high demand due to affordability of land.

The above report is in line with Cytonn H1’2019 Market Review, which reported that the land sector in the Nairobi Metropolitan Area recorded subdued performance, attributed to an overall slowdown in real estate investment activity. According to the report, despite the rest of the zones recording a decline in asking prices, un-serviced land in satellite towns such as Ruiru, Juja and Limuru registered a 4.1% annual capital appreciation on average, attributed to the relatively high demand for land in these areas fueled by the affordability.

From the Hass Consult Property Sales and Rental Index Q2’2019 residential property performance recorded a slowdown attributed to slow economic growth during the quarter.

The key take-outs from the report include:

- Residential property sale prices recorded a 3.0% quarterly decline in sale prices, attributable to the slow economic growth during the period,
- Detached units and apartments recorded a quarterly price drop of 4.5% and 0.1%, and a y/y decline of 6.1% and 0.3%, respectively. The slowdown is attributed to distressed sellers move to

discounting property prices with the aim of increasing the uptake of the same,

- In the detached market, Ridgeways recorded the highest q/q price appreciation of 2.6%, which we attribute to strong investor demand, and also the superior location, while Nyari and Muthaiga recorded the highest y/y appreciation at 13.2% and 10.0%, respectively, attributed to sustained demand from local wealthy investors,
- Apartments across the sector recorded a decline in sale prices on a quarterly basis, with only Westlands recording a marginal price appreciation of 0.5% among the Nairobi suburbs. Upperhill recorded the highest annual price appreciation at 4.9%. We attribute this to demand for luxury apartments, especially from foreign nationals in addition to proximity to key nodes such as Kilimani and CBD,
- In satellite areas, detached units in Limuru recorded the highest quarterly and annual appreciation of 2.2% and 8.6%, respectively. Apartments in Athi River and Kitengela recorded the highest q/q appreciation at 2.8% and 2.7%, respectively, while on an annual basis, Kitengela recorded the highest price appreciation of 11.7%. We attribute the better performance in satellite towns compared to Nairobi suburbs to the increased demand for units in these areas boosted by infrastructural improvements, and affordability in comparison to the upper markets, and,
- On the rental index, rents recorded a 1.9% q/q drop with detached units recording the highest drop by 3.2% while semi-detached units dropped by 1.6%. We attribute the drop to a decline in demand for maisonettes and bungalows, in the wake of a growing need for affordability. Apartments recorded a q/q rental price appreciation of 0.4% boosted by the growing demand for the same, given their affordability compared to detached and semi-detached units.

The report is in tandem with Cytonn's Nairobi Metropolitan Area Residential Report 2018/19, which highlighted subdued performance in the high-end market with areas like Kitisuru and Rosslyn reaching their price ceilings, amidst a tough financial environment, which has led to a decline in effective demand. We expect the lower mid-end sectors will continue to exhibit fast growing demand from the majority of Kenyans seeking to buy affordable homes amidst a tough financial environment.

II. Residential Sector

During the week, Shelter Afrique a Pan-African finance institution signed a memorandum of understanding (MOU) with Terwilliger Centre for Innovation in Shelter (TCIS), the financing arm of Habitat for Humanity International, which will see TCIS back Shelter Afrique in mobilizing capital for affordable housing. TCIS has set aside approximately Kshs 10.0 bn (USD 100 mn) to be extended to institutions such as microfinances focusing on provision of housing loans to low-middle income population in Kenya and 43 other countries in Africa.

Affordability has continued to be a major constraint to the growth of the housing sector, and a key challenge to accessing decent housing in Kenya. The capping of interest rates has resulted to a decline in credit growth to the private sector as banks tighten their underwriting standards and government paper has become more attractive than lending to private sector on a risk-adjusted basis. Even with the capping of interest rates, the actual cost of credit is still high, averaging between 16.0% and 18.0% due to additional administration fees, which then raise the cost of financing. In addition, 83.4% of total employment is in the informal sector, which is characterized by small-scale activities, relatively unpredictable incomes and limited job security and thus they are unable to afford to buy a house.

We therefore expect the move by TCIS and Shelter Afrique to facilitate the provision of the much-needed housing finance through institutions that serve mainly the middle and low income earners, such as microfinances and Savings & Credit Co-operative Societies (SACCOs), thereby enhancing home ownership in Kenya. This will complement government initiatives aimed towards the same among them:

i. The exemption from stamp duty tax for first time home buyers under the affordable housing scheme,

ii. 0% corporate tax rate relief (half the statutory 30%) for developers who provide at least 100 low – cost housing units per annum,
iii. The affordable housing relief where buyers get a 15.0% tax relief up to a maximum of Kshs 108,000 p.a., or Kshs 9,000 p.m.,
iv. Formation of the Kenya Mortgage Refinancing Company (KMRC) whose main function is enhancing mortgage affordability by enabling long-term loans at attractive market rates, and
v. Establishment of the National Housing Development Fund (NHDF), which includes a 1.5% levy on employee's monthly basic salaries up to Kshs. 5,000 and the employer expected to match the same amount that will be channeled into the fund.

National Housing Corporation (NHC), announced plans to put up a Kshs 500 million project in Eldoret, using the Expanded Polystyrene Panel (EPS) technology, targeting low-income households. The 14-storey residential development will sit on 6.6 acres at the NHC Kapsuswa Rental Housing Scheme and will consist of 180 one-bedroom units and two studio-cum commercial spaces with sizes and price points of the units yet to be disclosed. According to NHC, the project will be built using EPS, and this will help spread technical skills on application of the alternative building technology outside Nairobi. The technology is yet to gain popularity with the poor perception from Kenyans who still prefer the conventional brick and mortar method of construction. However, developers are seeking for alternative building methods aimed at cutting on the construction costs, which has been identified as a key limitation to the delivery of affordable housing in Kenya. According to Cytonn Research, using the conventional brick and mortar, mid-level construction costs in Kenya range from Kshs 44,000 - Kshs 64,000 per square metre (SQM) depending on the level of finishes, height and other related factors, and account for 50% - 70% of development costs, thus limiting the affordability of housing units. EPS technology involves construction of houses by assembling ready-made EPS foam, sandwiched between a galvanised steel wire mesh that is plastered on both sides with concrete. Despite not being popular in Kenya, according to online research, cost benefits accrued from using EPS panels include;

i. Reduced costs as construction time is reduced by approximately 50.0%, as the panels are quick to fix thus resulting in a fast work rate,
ii. A lower cost of wastage of materials since leftover panels can be recycled,
iii. The panels have a higher resistance compared to conventional stones hence are safer during huge impacts such as earthquakes and tremors,
iv. A wider range of construction designs can be achieved, to come up with a unique and creative design when using the eps panels,
v. The longevity and durability of the eps panels are enhanced by the anti-mood and decay aspects, and,
vi. The high thermal insulation gives them the ability to withstand high and hot temperatures as well as maintaining the inside environments of the house cool and comfortable.

With a housing deficit of approximately 2.0 mn units according to the NHC, we expect continued adoption of the EPS technology will facilitate mass production and delivery of affordable homes in Kenya. Some EPS-built houses in Kenya include; Rongai La Casa Luxury apartments, Ndenderu Ruaka flats, Bungoma Sakata Gardens apartments and Kahawa Wendani hostels.

III. Retail Sector

During the week, Game Stores, a subsidiary of South Africa's retail company Massmart Holdings, opened its third outlet in Kenya and its first outside Nairobi, at the Kisumu Mega City Mall. Other branches of the Massmart Holdings subsidiary are located at the Garden City Mall along Thika Road, and at the Karen Waterfront. The store will be situated on the ground floor, previously occupied by Nakumatt, which has since moved to the first floor. We expect this to result in increased competition against the troubled retailer, which has continued to close down most its branches due to financial constraints brought about by poor cash flow and supply chain management. Kenya's retail sector has continued to attract entry and expansion of several international retailers, driven by a widening middle class, provision of high-quality mall spaces in line with international standards as well as improving infrastructure within counties. Game Stores marks the third international retailer in Kenya with presence outside Nairobi County, after Shoprite in Kisumu and Mombasa and Choppies, which has stores in counties such as Kiambu, Kisumu and Kisii, which continue to be underserved in formal retail supply in comparison to Nairobi County despite the relatively high GDP per capita.

In terms of performance, compared to other urban cities, the retail sector in Kisumu has continued to record relatively high returns thus attracting investors. According to Cytonn Research, the sector recorded 0.6% points annualized increase in rental yields between 2017- 2018, attributable to 11.6% points increase in occupancy rates over the same period. The increase in occupancy rates was mainly attributed to a high urbanization rate that stands at 5.5% p.a. compared to Kenya's average urbanization rate of 4.3% attributed to devolution which is the pull factor for growth in population in the area.

The table below shows the performance of the various urban cities:

All values in Kshs unless stated otherwise

Summary of Retail Market Performance in Key Urban Cities in Kenya 2018

Region	Average Rent 2018 per SQFT per Month	Average Occupancy Rate 2018	Rental yield 2018	Average Rent 2017 per SQFT per Month	Average Occupancy Rate 2017	Rental yield 2017	Change in Occupancy Y/Y	Change in Yield Y/Y
Mt Kenya	141.3	84.5%	9.9%	136.0	80.0%	9.1%	4.5%	0.8%
Kisumu	148.2	88.0%	9.7%	157.2	76.4%	9.1%	11.6%	0.6%
Nairobi	178.9	83.7%	9.4%	185.0	80.3%	9.6%	3.4%	(0.2%)
Mombasa	103.7	96.3%	8.3%	130.3	82.8%	7.3%	13.5%	1.0%
Eldoret	137.5	78.5%	7.6%	96.0	83.3%	6.6%	(4.8%)	1.0%
Nakuru	83.3	85.0%	6.9%					
Average	132.1	86.0%	8.6%	140.9	80.2%	8.3%	5.6%	0.6%

· *Mt. Kenya and Kisumu were the best performing regions, with average rental yields of 9.9% and 9.7%, respectively. This is attributable to an increase in occupancy rates of on average 4.5% and 11.6% points y/y for Mt. Kenya and Kisumu regions, respectively*

Source: Cytonn Research

Going forward, we expect to witness continued expansion of retailers into the Nairobi outskirts where there exists a growing demand for retail products supported by the growing middle class with a relatively high purchasing power. For developers, we recommend increased focus in areas such as Mt Kenya region and Kisumu, where there exists a high demand for quality retail space thus relatively high returns unlike Nairobi which has continued to record subdued performance given the existing oversupply of approximately 2.0 mn SQFT of retail space.

IV. Land Sector

During the week, the Nairobi City Council announced that it would cap the new land rates at 1.0% of the current value of the plots as opposed to using the 1980 valuation, where property owners pay land rates at 25.0% of the unimproved site value. The specific rates, which will be released at the end of July, will be based on the current value of undeveloped land and the new fees will be effective January 2020. Land rates are levies imposed on all parcels of land and payable to the county governments annually. Upon full payment of all rates, one is issued with the rates clearance certificate which is conclusive evidence that all rates due and interest accrued have been fully paid. In the case of rate defaulters, the county government may take measures against the property owners that may include; denial of building plan approvals and/or denial of loans by financial institutions to fund the new projects. Key to note, in Kenya, county governments charge different amounts for the land rates.

The above-mentioned review will result in higher rates in several parts of Nairobi County, where the land value has significantly appreciated, for example, in Dagoretti, where the price of an acre was Kshs 28.0 mn as at 2011 and has since grown by a 7-year CAGR of 20.2% to Kshs 100 mn in 2018/19, according to Cytonn Research. The review is thus likely to negatively impact on the real estate sector by resulting in;

i. Increased burden to the real estate sector as the sector has continued to record decreased activities fuelled by a tough economic environment, in addition to the unavailability and unaffordability of financing for both off-takers and developers. The increase in land rates will thus be an additional burden to the already struggling sector,
ii. Increased property prices- increased land rates will result in increased liability for investors who already own land in the county. This cost is most likely to be transferred to the buyer or tenant hence increased property prices.

Despite the above, the review will have a positive impact on the county, as it will result in higher revenues from the property owners to the county government, especially from property in areas that have appreciated significantly over the years.

Other highlights during the week;

i. Investment firm Centum, through its real estate arm Centum Real Estate, signed a refinancing deal with Nedbank Corporate and Investment Bank (CIB), the Nedbank property finance division. The Kshs 6.5 bn from Nedbank, will allow the firm to consolidate the debt facilities for the Two Rivers development which is currently in its second phase, which will utilize the 102 acres of land the company owns on Limuru Road in Nairobi, near the affluent neighborhoods of Runda, Nyari, Gigiri and Muthaiga. Centum Real Estate is currently the master developer in three projects namely; the Pearl Marina Development in Entebbe Uganda, Vipingo Development and Two Rivers Development, both in Kenya. The firm intends to put up 3,000 residential units across the three sites with the first phase of 1,200 units already under construction. The company highlighted that it had experienced challenges in the sector due to limited access to credit occasioned by the capping of the interest rates.

We expect the real estate sector to continue recording activities fuelled by entry and expansion of international retailers and the continued focus on the provision of affordable housing.
