Cytonn Monthly - July 2019

Real Estate

During the month, real estate saw overall increased activity in the residential sector and retail sectors, while the commercial office sector and other themes remained sluggish.

I. **Industry Reports**

Coverage	**Report**	**Key Take-outs**
Real Estate & Infrastructure	Quarterly Gross Domestic Product Report Q1'2019	• The construction sector's contribution to GDP remained constant at 5.2% in Q1'2019, similar to Q1'2018, while recording a 1.0% point decline in growth rate from 6.6% in Q1'2018, to 5.6% in Q1'2019, attributable to a decline in real estate activities, in addition to government slowdown on infrastructural developments, • The real estate sector contribution to GDP decreased marginally by 0.1% points, from 8.4% in Q1'2018 to 8.3% in Q1'2019, while the growth rate of the sector declined by 1.1% points to 4.2% in Q1'2019, from 5.3% in Q1'2018, attributed to a decline in activities in the sector during the quarter. • For more information, see our Cytonn Weekly #27/2019
General Real Estate	Status of The Built Environment Jan-Jun 2018 *(AAK noted that the report will be published on a later date)*	• Construction jobs and building material sales dipped sharply following a 34.6% drop in projects approved by the Nairobi County govt from January to June 2019, • The number of building plans application approvals have been falling for the past three years according to Architectural Association of Kenya (AAK) due to the length of approvals that took as 41.35 days on average, compared to 37 days last year, • 955 projects were approved, a 16.2% and 18.2% decline from 1,140 projects and 1,167 projects approved in 2017 and 2018, respectively, • Residential buildings took up 74.3 % of approvals followed by public use at 11.2 %, industrial 8.6%, commercial 5.9%, while education developments took a paltry 0.2%. The residential sector reported increased activities mainly driven by the government's affordable housing agenda, • Consumption of cement dropped by 5.0% to 5.49 mn ton in 2018 from 5.79 mn ton in 2017 attributable to reduced pace of putting up new buildings.

Coverage	Report	Key Take-outs
Residential Sector	Hass Consult Property Sales and Rental Index Q2’2019	• Residential property sale prices recorded a 3.0% q/q decline in Q2’ 2019, attributable to the slow economic growth during the period, • In Q2’2019, detached units and apartments recorded a q/q 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 discount property prices with the aim of increasing the uptake of the same, • On the rental index, rents recorded a 1.9% q/q drop with detached units and semi-detached units recording 3.2% and 1.6% q/q decline, respectively, while apartments recorded a q/q rental price appreciation of 0.4% attributable to the decline in demand for maisonettes and bungalows, in the wake of a growing need for affordability. • For more information, see our Cytonn Weekly #30/2019
Land Sector	Hass Land Price Index Q2'2019	• In Q2’2019, 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 the 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, • For more information, see our Cytonn Weekly #30/2019.

Based on the above real estate research reports, we retain our neutral outlook for the real estate sector mainly constrained by commercial real estate space surplus in the market, inaccessibility and unaffordability of off-take financing and slow credit growth at 3.4% as at February 2019, compared to a 5-year average of 12.0%. The sector, however, exhibits pockets of value in select sectors driven by; (i) the improving macroeconomic environment, (ii) continued National Government support for the affordable housing initiative, and (iii) the continued infrastructural improvement.

II. **Residential Sector**

During the month, activity in the residential sector was mostly focused on the Affordable Housing Initiative (AHI) as shown below:

i. An Indian firm, Shapoorji Pallonji Real Estate (SPRE) and UK private equity investor-developer Actis, announced that they are set to begin development of a 624-units, middle-class, residential development on a 4.5-acre parcel of land at the Garden City Mall, along Thika Road. The construction of the first phase of the project, dubbed Mida Vida Homes, is set to commence in Q3’2019. The phase will consist of 208 units, of 1, 2 and 3-bedroom units, priced at Kshs 6 mn, Kshs 9 mn and Kshs 14 mn, respectively (*the unit sizes are yet to be disclosed*). For more information, see our Cytonn Weekly #27/2019

ii. 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 housing units. For more information, see our Cytonn Weekly #28/2019

iii. 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. For more information, see our Cytonn Weekly #30/2019.

In the mid-end segment, Cytonn Real Estate, the development affiliate of Cytonn Investments, handed over the first phase of its Ruaka project, The Alma, upon completion and 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. For more information, see our Cytonn Weekly #29/2019.

We expect the residential sector to continue recording activities owing to; (i) improved business environment, which is bound to attract foreign investors, (ii) improved infrastructure, and, (iii) the National Government's commitment towards the Affordable Housing Initiative

III. **Commercial Sector**

In the commercial 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. The KPA Office Tower Complex, which is currently at the 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. For more information, see our Cytonn Weekly #29/2019.

Kenya's retail sector was vibrant during the month, attracting interest from the renowned international retailers as well as the robust expansion of local retailers as shown below:

i. Fast-food chain Big Square, opened their 13th branch at Shell Service Station in Mountain View, with some of the other branches being in the Nairobi CBD, Lavington and along Lang'ata Road. The South African owned eatery joins other food chains such as KFC and Java Coffee that have continued to expand their footprint in the Kenyan market. For more information, see our Cytonn Weekly #27/2019
ii. 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. The store will be situated on the ground floor, previously occupied by Nakumatt, which has since moved to the first floor. For more information, see our Cytonn Weekly #30/2019,
iii. 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. For more information, see our Cytonn Weekly #28/2019,

With the increased commercial space supply in the Nairobi Metropolitan Area (NMA), we expect declined activities in the sector, with developers expected to shift focus to counties such as Mombasa, boosted by ongoing infrastructural developments and the national economic expansion, which has a spill-over effect as companies expand to the nation's largest cities including Mombasa, hence increasing demand for commercial real estate.

IV. **Land Sector**

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 will be based on the current value of undeveloped land and the new fees will be effective in January 2020. For more information, see our Cytonn Weekly #30/2019.

Private equity firm Fusion Capital has partnered with real estate firm, Optiven Group to sell 70 prime residential plots located on Gatanga Road, Thika (*the details are yet to be disclosed*). This follows a similar partnership last year when two parties partnered to sell a 100 -acre land development called Amani Ridge in Ruiru, Kiambu County. Thika market has attracted many investors supported by (i) increased housing demand in satellite towns driven by increased urbanization rate at 4.4% against a global average of 2.1%, (ii) high capital appreciation with land prices in the area growing by a 7-year CAGR of 10.7% p.a, and (iii) infrastructural development in the area such as connectivity via the Thika- Nairobi highway and a railway station providing access to the 131km of railway line available in the county.

Other highlights during the month;

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. For more information, see our Cytonn Weekly #30/2019,
ii. The National Government designated 9,000 acres of land in Naivasha, Mombasa and Machakos as special economic zones. This move would allow the areas to benefit from special tax (*yet to be disclosed*) and infrastructure that facilitate storage and export.

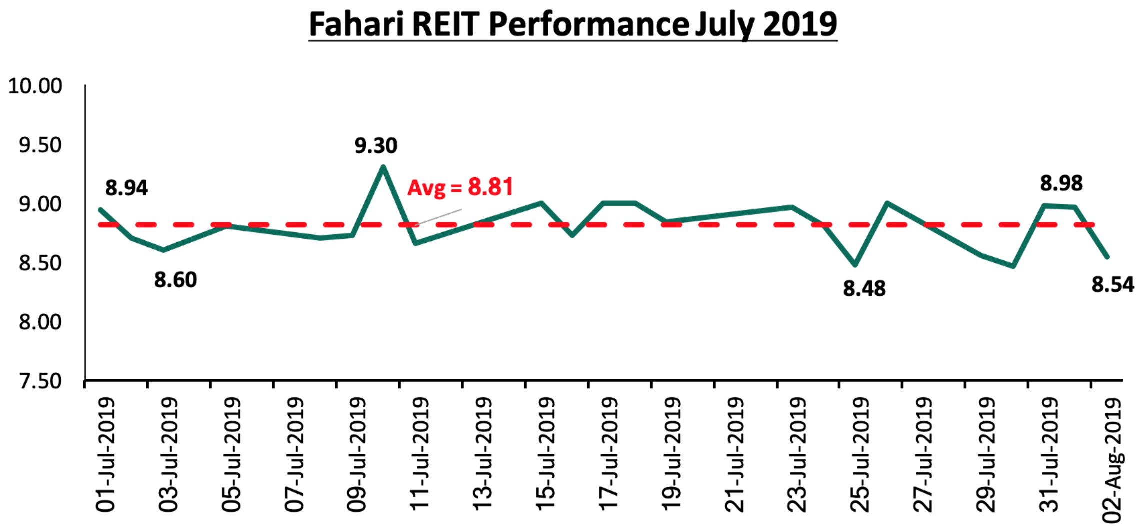
V. **Listed Real Estate**

Stanlib Fahari I-REIT released their H1’2019 earnings, registering a 16.2% growth in earnings to Kshs 0.42 per unit, from Kshs 0.36 per unit in H1’2018. Total income rose by 10.8% to Kshs 193.5 mn, from Kshs 174.6 mn in H1’2018, while net profit grew by 16.2% to Kshs 76.4 mn, from Kshs 65.8 mn in H1’2018. The performance was driven by a 26.3% growth in rental income to Kshs 170.7 mn, from Kshs 135.1 mn in H1’2018, as the REIT positively benefitted from rental income contribution as a result of increased occupancies by its properties, including the Grade A office, 67 Gitanga Place, which was acquired in May 2018. The REIT did not recommend an interim distribution of dividends for the period ended 30th June 2019. It was noted that a full distribution will be declared in line with the requirements of the REITs Regulations to distribute a minimum of 80% of distributable earnings within four months after the end of the financial year, which ends on 31st December 2019.

We project a FY’2019 dividend yield of 7.9%, assuming the market maintains an average price of Kshs 9.2 per unit and the dividend payout ratio remains at the 3-year average (2016 -2018) of 96.5%, with the dividend yield in line with the commercial real estate market average of 8.0%, with 8.2% rental yield for retail space and 7.9% yield for office space in H1’2019. However, the expected high yield is attributable to its declining stock price closing at Kshs 9.2 per unit as at 28th June 2019 in comparison to Kshs 11.3 as at 29th June 2018, representing an 18.6% loss of value.

For a more comprehensive analysis on the REIT H1’2019 performance, see our Stanlib Fahari I-REIT Earnings Note - 2019.

On the bourse, the REIT’s performance has been on a decline since its listing at Kshs 20.0 in November 2015. Stanlib Fahari I-REIT share price declined by 2.4% to close at Kshs 8.98 per share at the end of July, from Kshs 9.2 per share at the end of June. On average, the REIT traded at Kshs 8.81 per share in July, a 6.3% decline from an average of Kshs 9.4 per share in H1’ 2019. The REIT closed the week at Kshs 8.54 per share. The instrument has continued to trade in low prices and volumes, due to; (i) opacity of the exact returns from the underlying assets, (ii) inadequate investor knowledge, and (iii) lack of institutional support for REITs.



Our outlook for Stanlib's listed real estate is neutral supported by favorable projected dividend yield, in line with the real estate performance.

We expect the real estate sector to continue recording increased activities in the residential, retail and listed real estate sectors supported by the National Government's commitment to the Affordable Housing initiative, the continued demand for commercial space in prime locations and increasing demand for alternative sources of capital in the real estate industry.