End of Interest Rate Caps?, & Cytonn Weekly #42/2019

Real Estate

1. **Residential Sector**

Ndemi Gardens Estate, a 14-floor residential estate located along Ngong Road, is set to open in December this year. The project, which is near completion has 4 blocks of 3-bed units of 133 SQM and 152 SQM, and priced at Kshs 12.0 mn and Kshs 14.0 mn, respectively. This translates to Kshs 92,105 per SQM, which is 7.7% lower than the Ngong road market average of Kshs 99,800 per SQM, according to the Cytonn (NMA) Residential Report 2018/2019.

The table below summarizes apartment's performance in 2018/2019 in the lower mid-end suburbs:

(All Values in Kshs Unless Stated Otherwise)

Apartments Performance 2018/2019 (Lower Mid-End Suburbs)

Area	Average Price per SQM	Average Rent per SQM	Average Annual Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Total returns
Lang'ata	97,012	544	15.0%	85.4%	5.5%	1.3%	6.8%
South B/C	99,059	497	20.6%	88.8%	4.8%	0.8%	5.6%
Imara Daima	63,203	354	22.3%	98.9%	5.6%	(0.2%)	5.4%
Dagoretti	89,807	627	16.5%	88.7%	5.1%	0.0%	5.1%
Ngong Road	99,800	508	20.7%	84.7%	4.5%	0.9%	5.4%
Upper Kabete	97,719	380	25.8%	82.3%	4.3%	1.0%	5.3%
Kahawa West	74,521	396	19.0%	72.8%	3.9%	(0.7%)	3.1%
Lower Mid-End Suburbs Average	**88,731**	**472**	**20.0%**	**85.9%**	**4.8%**	**0.4%**	**5.3%**

Source: Cytonn Research

Despite the tough financial environment in Kenya, we continue to see increased activities in the lower mid-end residential sector with developers adopting prudent ways of increasing uptake by charging relatively lower prices than the market rates and offering additional amenities such as gyms and spacious gardens. We expect this to enhance uptake in the lower mid-end segment given the existing demand for affordable housing units, in the wake of unmatched demand in the high and upper mid-end segments.

2. **Retail Sector**

During the week, local retailer Naivas Supermarket announced plans to open four additional branches in the next few months, bringing the total number of outlets to fifty-nine. The additional branches will be situated in Mombasa, Embu, near Yaya Centre and along the Eastern Bypass. The move is in line with the retailer's expansion strategy aimed at tapping into the Nairobi outskirts and urban cities in the wake of increased competition from international retailers such as Carrefour and Shoprite, and local players such as Quickmart.

Expansion strategies by local retailers such as Naivas and Tuskys aimed at increasing market share in the Kenyan retail market are supported by:

i. Positive demographics as Kenya's urban population continues to expand at an annual rate of 4.3%, compared to a global average of 2.0%,
ii. Continued change in tastes and preferences by a growing middle class towards international products, thus creating a niche for international retailers,
iii. Improving infrastructure, which has encouraged a growth in mall space as this encourages tenancy and footfall,
iv. Growth of Small and Medium-Sized Enterprises (SMEs), and,
v. The availability of relatively low-priced retail spaces especially in the satellite towns. According to Cytonn's Kenya Real Estate Retail Report 2019, the average rent prices for urban cities such as Mombasa, Kisumu and Nakuru in Kenya came in at Kshs 118.0 per SQFT, with Nairobi recording the highest at Kshs 168.6 per SQFT.

Despite the increased activity, the performance of key urban cities in Kenya softened during the year with rental yields declining by 1.6% points to 7.0% in 2019, from 8.6% in 2018, driven by a drop in occupancy rates by 8.7% points to 77.3% in 2019, from 86.0% in 2018. The decline in performance is mainly attributed to the adoption of informal retail spaces and mixed-use developments by retailers and the increase in supply of retail space by 0.8 mn SQFT in 2019 with malls such as Lake Basin Mall in Kisumu and the Signature Mall in Kitengela. Mt. Kenya was the best performing region, with average yields of 8.6% and rental rates of Kshs 129.8 per SQFT. The Mt. Kenya region has a relatively low mall space supply accounting for 7.7% market share in Kenya, which means high occupancy rates.

The performance of the key urban centres in Kenya is as summarized below:

(All Values in Kshs Unless Stated Otherwise)

Summary of 2019 Retail Performance in Key Urban Cities in Kenya

Region	Rent Per SQFT 2019	Occupancy Rate 2019	Rental Yield 2019	Rent Per SQFT 2018	Occupancy Rate 2018	Rental Yield 2018	Change in Occupancy Y/Y	Change in Yield Y/Y
Mt. Kenya	129.8	80.0%	**8.6%**	130.1	84.5%	**9.9%**	(4.5%)	**(1.3%)**
Nairobi	168.6	75.1%	**8.0%**	178.9	83.7%	**9.4%**	(8.6%)	**(1.4%)**
Eldoret	131.0	82.3%	**7.9%**	134.1	78.5%	**7.6%**	3.8%	**0.3%**
Mombasa	122.8	73.3%	**7.3%**	135.8	96.3%	**8.3%**	(22.9%)	**(0.9%)**

Summary of 2019 Retail Performance in Key Urban Cities in Kenya

Region	Rent Per SQFT 2019	Occupancy Rate 2019	Rental Yield 2019	Rent Per SQFT 2018	Occupancy Rate 2018	Rental Yield 2018	Change in Occupancy Y/Y	Change in Yield Y/Y
Kisumu	96.9	75.8%	**5.6%**	106.3	88.0%	**9.7%**	(12.2%)	**(4.1%)**
Nakuru	59.2	77.5%	**4.5%**	63.0	85.0%	**6.9%**	(7.5%)	**(2.4%)**
Average	**118.0**	**77.3%**	**7.0%**	**124.7**	**86.0%**	**8.6%**	**(8.7%)**	**(1.6%)**

• Mt. Kenya was the best performing region, with average yields of 8.6% and rental rates of Kshs 129.8 per SQFT
• Kisumu and Nakuru had the lowest rental yields recording 5.6% and 4.5%, respectively. Kisumu's lower performance is attributed to an oversupply of retail space in the area after the opening of Lake Basin Mall with over 300,000 SQFT of retail space

Source: Cytonn Research

We expect to witness the continued expansion of retailers into the outskirts of Nairobi, as they seek to not only grow their market share but also leverage from the growing demand for retail products by the growing middle class, with a corresponding high purchasing power in urban cities around the country.

3. **Infrastructure Sector**

During the week, the President of the Republic of Kenya, His Excellency Uhuru Kenyatta, launched Phase 2 of the Standard Gauge Railway (SGR) project, bringing to operationalization the rail between Nairobi and Suswa. This is after a five-month delay, due to a delay in compensation of the affected persons. The 120.5 km (Phase 2A) project, which commenced in 2017, cuts across Nairobi, Kajiado, Nakuru and Narok with four passenger stations - Ongata Rongai, Ngong, Mai Mahiu and Suswa, and has seen the Madaraka Express passenger and freight services commence operation.

In addition, The President also launched the construction of the Jomo Kenyatta International Airport (JKIA) -Westlands Expressway, an 18.6-kilometer road project, which will start at JKIA and terminate at James Gichuru, along Waiyaki Way Road, in Westlands. The two-year project will be implemented through a Public-Private Partnership with China Roads and Bridges Corporation (CRBC), and motorists will have the option of using the expressway at a fee or toll charges to help the private firm building the road recover its investments.

Infrastructural development plays a key role in the development of the economy as a whole by enhancing connectivity and the creation of a better operating environment for individuals and businesses alike. Given the ease of movement as a result of operationalization of the railway line, we expect areas such as Ngong and Suswa to significantly gain popularity as Nairobi's dormitories for the working population, thus resulting in increased demand for real estate properties and a subsequent increase in land and property value. For instance, according to Cytonn Research, Ongata Rongai recorded a 7-year CAGR of 36.1% with an acre of land currently valued at Kshs 18.3 mn per acre on average, and we expect this to grow significantly with the improved accessibility enhanced by the operationalization of the railway line. Likewise, we expect the Nairobi Expressway to enhance increased accessibility and reduce traffic congestion, resulting in increased demand for property in satellite towns such as Ruaka.

The table below shows the change in land prices in satellite towns:

(All Values in Kshs Unless Stated Otherwise)

Land Prices- Satellite Towns in Nairobi Metropolitan Area 2018/19

Location	*Price in 2011	*Price in 2015	*Price in 2016/17	*Price in 2017/18	*Price 2018/19	7-year CAGR
Ruiru	7m	15m	19.3m	19.7m	21m	18.2%
Utawala	6m	9m	10.9m	11.0m	12m	10.5%
Limuru	5m	13m	16.6m	19.5m	20m	20.8%
Ruaka	40m	58m	74m	77m	80m	10.5%
Athi River	2m	3m	3.8m	4.1m	4.2m	11.1%
Ongata Rongai	2m	10m	18.4m	17.9m	18m	36.1%
Juja	3m	7m	8.8m	9.6m	9.7m	17.1%
Average	**9m**	**17m**	**22m**	**23m**	**24m**	**17.8%**

***Asking land price per acre**
- ***Ruiru recorded the highest capital appreciation of 8.1%, attributed to the relatively high demand for development land in the area supported by the ease of accessibility through the Northern and Eastern bypasses and the improving infrastructure with the area set to benefit from the expansion of the sewer line***

Source: Cytonn Research

In addition, improving infrastructure also boosts the real estate sector by reducing development costs. According to a Centre for Affordable Housing Finance in Africa report, infrastructural costs in Kenya account for approximately 25.6% of construction costs. By providing infrastructure, the government thus provides an impetus for real estate developers to develop, as the cost of construction reduces considerably. For more information on the effects of infrastructure on real estate, please see Nairobi Metropolitan Area Infrastructure Report 2018.

We expect the real estate sector to continue recording increased activities supported by the continued expansion of retailers, and the improving infrastructure which continues to open up areas for development.