Technology & Investments and Cytonn Weekly #43/2019

Real Estate

I. **Industry Report**

During the week, Jones Lang LaSalle (JLL), a real estate management services firm, released its Q4'2019 Spotlight on Africa Report, which tracks vital trends impacting hotel investment in Sub-Saharan Africa. According to the report, hotel investors in Sub-Saharan Africa are likely to attract investment for hotel projects that are set up as mixed-use developments. This is as transactions for mixed-use properties increased by 42.0% whereas other sectors such as Office, Retail, Industrial and Hotels, as single-use, declined by 4.0%, 20.0%, 6.0%, and 18.0%, respectively.

Mixed-Use Developments (MUD's) allow for risk diversification by including alternative types of property in one development. Residential developments are also increasing in prevalence as they provide up-front cash inflows and a more predictable source of revenue as compared to a hotel alone. The report echoes our sentiments as in the 2018 Mixed-Use Development Report, according to which, themes within MUD's recorded better performance compared to single-use developments. For instance, office and residential themes in MUD's registered higher rental yields by 0.3% and 0.6% points, respectively.

The table below shows MUD performance against other single-use developments in 2018:

MUD's Performance in Comparison to Single-use Developments Performance 2018

Themes	**MUD Themes Average Rental Yield %**	**Market Average Rental Yield %**	**Rental Yield Difference**
Retail	8.5%	9.5%	**(1.0%)**
Offices	8.2%	7.9%	**0.3%**
Residential	5.6%	5.0%	**0.6%**
Average	**7.4%**	**7.5%**	**(0.1%)**

· Office space and residential units in MUDs have higher rental yields at 8.2% and 5.6% compared to the market average at 7.9% and 5.0% mainly attributed to higher rents and prices charged due to amenities and facilities provided

Source: Cytonn Research 2018

Investors are therefore likely to be attracted to mixed-use developments due to their enhanced performance which is driven by:

i. **Operational Synergies** - The various themes in a mixed-use development complement each other. For instance, building residents will create a ready market for retail services while firms occupying office space are potential clients for hotel, restaurant and conferencing space in the hotel. As a result, improvement of the performance of one theme leads to better performance in other themes,

ii. **Risk Diversification** - Having multiple components in the development creates multiple revenue streams that help to diversify the risk of a project. In case uptake for one of the themes is low, the developer or property manager will continue to receive revenues from the other themes. The developer can also opt to alter uses, depending on each theme's performance; for example, underperforming residential units can be serviced or furnished apartments, and vice versa, and,
iii. **Potential for Higher Occupancies** – MUD's create an environment where occupants can live, work, play and invest all in one location, hence reducing time and cost incurred while commuting. By creating convenience, therefore, MUD's attract demand from both prospective homeowners and corporations

According to the report, the Sub-Saharan hotel industry Africa is characterized by a lack of consistency with volatile demand conditions and a low supply base expected to grow at 2.4% compound annual increase over the next three-years. The weak demand in the sector is attributed to elections in some nations such as Senegal, slow economic growth, regulatory changes that have negatively impacted business and tourism, and inaccessible funding which is also expensive. The Kenyan hotel sector, on the other hand, continues to perform well driven by a robust and diversified economy. However, the sector experienced weak occupancy rates which were worsened by the Dusit D2 terror attacks in January 2019.

We retain a positive outlook for the hospitality sector driven by differentiated concepts by investors, improved security and hotel standards with the entry of global hotel brands while existing hotels refurbish their developments.

The World Bank released its 'Doing Business Report 2020', a report that compares business regulation across economies from 190 countries. The major key take-outs were as follows:

- Kenya's ranking in terms of property registration dropped twelve positions to #134 in 2019 from #122 in 2018 attributed to additional payment slip generation, and increased online consent application and title search fees. The drop in ranking was despite a faster property registration and land-related processes aided the government's launch of the e-Citizen portal digitization system,
- Kenya's ranking in terms of dealing with construction permits, improved twenty-three ranks to position #105 in 2019 from position #128 in 2018 attributed to increased transparency by making building permit requirements publicly available online;

According to the report, Kenya's overall rank improved five positions to #56 in 2019 from #61 in 2018 with the largest contributing factors being:

i. Automation of systems such as property registration and land search,
ii. Ease of obtaining credit,
iii. Protecting minority investors, and
iv. Resolving insolvency.

The improvements in processes and economic reforms are a positive step towards improving the country's investment landscape and establishing it as a preferred investment destination. However, recent concerns the delay in the processing of construction permits as raised by the Architectural Association of Kenya (AAK) would have a negative impact on our ranking. The delays continue to affect developers by prolonging project implementation timelines and increasing development costs.

II. Residential Sector

During the week, Tilisi Developments Plc, a real estate developer, announced that they are set to begin construction of 186 high-end villas on a 41-acre parcel of land within the Tilisi masterplan development located in Rironi, Limuru area. The project will consist of 3-bed, 4-bed and 5-bed villas of 212 SQM, 232 SQM, and 585 SQM, and priced at Kshs 18.5 mn, Kshs 20.0 mn and Kshs 59.0 mn, respectively, translating to an average of Kshs 91,442 per SQM. In comparison to the Redhill/Sigona area market average of Kshs 105,218 according to the NMA Residential Report 2018/2019, the prices offered are 13.1% lower than the market average.

The area remains attractive to investors driven by;

i. The improving infrastructure such as the ongoing upgrading of Waiyaki Way to a six-lane highway, which is expected to ease of accessibility to areas such as Limuru on completion, and
ii. The relatively affordable prices of development land in Limuru area compared to Nairobi suburbs areas and satellite towns, which according to our research, recorded average prices of approximately Kshs 20.0 mn per acre in Limuru Town compared to the market average of Kshs 24.0 mn and Kshs 81.0 mn per acre for satellite towns and low-rise Nairobi suburbs, respectively. Masterplanned developments are mixed-use developments built in a rural or undeveloped area that offer varying themes such as residential, retail, industrial, education facilities, etc.

The table below shows the performance of detached Upper Mid-End suburbs in 2018/2019:

(All Values in Kshs Unless Stated Otherwise)

Detached Performance 2018/2019 (Upper Mid-End Suburbs)

Area	Price per SQM	Rent per SQM	Annual Uptake	Occupancy (%)	Rental Yield	Y/Y Price Appreciation	Total Returns
Loresho	**146,540**	575	17.5%	94.6%	4.5%	1.7%	**6.2%**
Runda Mumwe	**158,932**	662	26.1%	83.6%	4.3%	1.5%	**5.8%**
South C	**120,928**	494	23.8%	92.5%	4.6%	(0.7%)	**3.8%**
Redhill & Sigona	**105,218**	367	21.1%	77.5%	3.3%	0.3%	**3.6%**

Detached Performance 2018/2019 (Upper Mid-End Suburbs)

Area	Price per SQM	Rent per SQM	Annual Uptake	Occupancy (%)	Rental Yield	Y/Y Price Appreciation	Total Returns
Langata	142,183	556	13.0%	97.2%	4.7%	(1.7%)	3.0%
Lavington	180,021	555	27.3%	79.4%	3.3%	(0.3%)	3.0%
Average	**142,303**	**535**	**21.5%**	**87.5%**	**4.1%**	**0.1%**	**4.2%**

- ***Detached units in the upper mid-end suburbs registered average returns of 4.2%, 0.5% points lower than the residential market average of 4.7%***
- ***Loresho recorded the highest returns at 6.2%, while Langata and Lavington recorded the lowest returns at 3.0% each***
- ***Redhill& Sigona recorded annual uptake and total returns of 21.1% and 3.6% in 2018/2019, respectively***

Source: Cytonn Research 2019

Due to rapid population growth and urbanization, we expect to see developers continue shifting urban development from cities to rural or undeveloped areas with availability of large tracts of land at affordable prices.

III. **Hospitality Sector**

During the week, the Kenyan hospitality sector received global recognition as seven hotels received various awards at the World Luxury Hotel Awards 2019 in Finland. The winners from their respective categories are as shown below:

World Luxury Hotel Brand Award Winners 2019

	Hotel	Award Category
1.	Lantana Galu Beach	Luxury Family Beach Resort
2.	Maiyan	Luxury Private Pool Villa
3.	Sankara Nairobi, Autograph Collection	Luxury Boutique Hotel
4.	Sarova Stanley	Luxury City Hotel
5.	Sarova Whitesands Beach Resort & Spa	Luxury Beach Resort
6.	Sun Multinational	Luxury Hotel Group
7.	Elewana Kifaru House	Luxury Hotel Best Scenic Environment

Source: World Luxury Hotel Brands Awards 2019

The awards are an indication of the attractiveness of the sector driven by;

i. Concerted marketing efforts by the government and private sector,
ii. Improving air transport,
iii. Improved hotel standards with the entry of global hotel brands, and
iv. The increased number of inbound international visitors.

According to the Kenya National Bureau of Statistics (KNBS), Leading Economic Indicator August 2019, international visitor arrivals in the first nine months of the year were highest in 2019 since 2016, coming in at 1.02 mn, 5.4% higher compared to 0.96 mn last year and 75.6% higher compared to 0.58 mn in 2016.
