NMA Mixed Use Developments Report 2019 & Cytonn Weekly#45/2019

Real Estate

I. **Industry Reports**

During the week, the Kenya National Bureau of Statistics (KNBS) released the Leading Economic Indicators (LEI) September 2019, highlighting the continued growth of the hospitality sector. The key take-outs were;

i. The total number of visitors arriving through Jomo Kenyatta (JKIA) and Moi International Airports (MIA) increased by 5.4% from 1.1 mn persons for the period between January to September 2018 to 1.2 mn persons during the same period in 2019. We attribute the continued growth of the sector to the calm political environment and the improved security, which have continued to boost tourists' confidence in the country and thus, making it a preferred travel destination for both business and holiday travelers.

Source: KNBS

ii. The quantity of cement consumed dropped by 0.5% from 3.93 mn metric tonnes for the period between January and August 2018 to 3.91 mn metric tonnes during the same period in 2019. The reduction in consumption of cement illustrates reduced activities in the construction sector, which has been crippled by the tough economic environment. However, with the launch of infrastructural projects such as the Western bypass and the Standard Gauge Railway Phase 2, we expect the consumption to increase in the coming months.

Despite the continued growth of the hospitality sector, the real estate sector continues to record a slowdown in development activities as evidenced by the above statistics. We attribute this mainly to the tough economic environment and surplus supply in the retail, commercial office, and high-end residential sectors and thus have a neutral outlook for the sector. However, we have a positive outlook for the hospitality sector and mid-end and low-end residential sector, as we expect improved performance boosted by the demand for hospitality services and the continued focus on the provision of affordable housing, respectively.

The Kenya National Bureau of Statistics also released the 2019 Kenya Population and Housing Census Volume I, highlighting a 2.2% yearly growth in the last decade. The key take-outs were;

i. The current total population stands at 47.6 mn, a 2.2% growth rate from the previous 37.7 mn as at 2009, indicating a decline in the inter-censual growth rate by 0.7% points from 2.9% in 2009,

ii. The total number of households came in at 12.1 mn, with the average household size declining to 3.9 in 2019 from 4.2 in 2009. This indicates that households have become slightly smaller, in terms of the number of people, in the last 10 years,

iii. At the county level, Nairobi, Kiambu and Nakuru counties recorded the highest population at 4.3 mn, 2.4 mn and 2.1 m, respectively, while the number of households stood at 1.5 mn, 0.8 mn and 0.6 mn, respectively

Source: Kenya National Bureau of Statistics, 2019

The above demographics is an indication of the continued growth of Kenya's population, relatively faster at 2.2%, compared to the global average at 1.2%, and translates to continued demand for public utilities, infrastructural facilities, shopping outlets and entertainment facilities. For the real estate sector, this will fuel the continued demand for property both for residential purposes and for investment. According to the National Housing Corporation, Kenya had a housing deficit of approximately 2.0 mn units as at 2018, and this continues to grow by approximately 200,000 units annually, yet the incoming supply is at approximately 50,000 units annually. We thus expect the recently released statistics to prompt the need for both the public and private sectors to focus on provision of housing to accommodate the growing population, in addition to providing other complimentary facilities such as shopping outlets, hospitality facilities and utilities such as water and electricity.

For counties, we expect growth in demand for property mainly in Nairobi, Kiambu, and Nakuru counties that recorded the highest population. Investors are likely to focus on such areas in a bid to leverage from the high population, which means relatively high demand for property. We also expect these counties to be target areas for infrastructural improvement by the government aimed at serving the population and relieving pressure on the available facilities. This will eventually open up the areas more for development thus attract real estate activities.

II. **Residential Sector**

During the week, the Finance Act, 2019 (the Act) was assented to by the President. In addition to the Act introducing policy and taxation measures for revenue generation in the financial year 2019/2020 for government's expenditure, it as well focused on supporting the Big Four Agenda, mainly the provision of affordable housing. The main amendments made with regard to this pillar include;

For home buyers:

i. Inclusion of Fund Managers or Investment Banks registered under the Capital Markets Act as approved institutions which can hold deposits of a Home Ownership and Savings Plan (HOSP), in addition to adoption of investment guidelines issued by the Capital Markets Authority (CMA) to guide investment of deposits held in a registered HOSP. This is in addition to the previously approved prudential guidelines issued by the Central Bank of Kenya. This thus means that inspiring home owners can now make savings for purchase of a home through Money Market Funds, through which their money gains interest over time, with the current money market fund yield averaging at 10.0%. This lightens the burden for the homeowners who will also pay rent for the house they will be living in during the construction period, in addition to benefiting from the tax rebates associated with the HOSP program. Please see our topical on Home Ownership Savings Plan, "HOSP" Schemes in Kenya for more information on how the HOSP program operates,

ii. Stamp duty exemption on the transfer of a house constructed under the affordable housing scheme from the developer to the National Housing Corporation. This exemption will relieve the finance burden on home buyers who would have otherwise incurred the cost while buying the houses, and would likely result in the units being unaffordable,

iii. Income tax exemption for withdrawals from the National Housing Development Fund (NHDF) to purchase a house by a first time home owner. With this change, we expect individuals making savings through the Fund to enjoy the tax break thus reduced financial burden,

For developers:

iv. Exemption of goods supplied for the direct and exclusive use in the construction of houses under the affordable housing scheme (AHS) from Value Added Tax (VAT). This exemption shall be subject to the AHS approval by the Cabinet Secretary (CS) for Finance. Currently, the tax on imports stands at approximately 25% of the value of the goods,
v. Exemption of companies implementing projects under the affordable housing scheme from the application of thin capitalization rules,
vi. Reduction of Import Declaration Fee (IDF) from the previous 2.0% to 1.5% on inputs for the construction of houses under the affordable housing scheme approved by the Cabinet Secretary for Finance.

Others include:

vii. Exemption of the income of the National Housing Development Fund (NHDF) from income tax, and this we expect to enhance easier operation and efficiency of the Fund. Please see our topical on the National Housing Development Fund for more details on the structure and operationalization of the Fund.

The above tax and policy changes, which will be effective as from 1st January 2020, are an indication of the continued government focus on promoting the affordable housing agenda by empowering both inspiring homeowners and private sector developers, through offering an extensive list of incentives. We thus expect more potential homeowners to join the program given the significantly reduced financial burden in the strive towards homeownership, and developers and other private sector players taking up affordable housing projects as they are bound to maximize on the reduced costs. We, therefore, recommend that potential home buyers and developers look into ways of leveraging on the discussed incentives as they stand to benefit. Specifically, we recommend that potential home buyers look into making savings through the HOSP program, especially with the option of doing so through money market funds, which offers a competitive interest rate of up to 10.0%, in addition to being a flexible platform whose initial investments can be as low as Kshs 1,000.

During the week, the government announced that the first lottery on the Park Road affordable housing project in Ngara was set to be conducted at the end of November 2019, following the completion of the first phase of the project comprising of 228 housing units. Previously registered homeowners were thus instructed to review their income profiles and update their details on the *boma yangu* portal ahead of the planned lottery-based allocation. 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 listed previously, meant to boost offtake. However, despite the above factors the initiative has, continued to face delays with regards to operationalization of; (i) the Kenya Mortgage Refinancing Company due to lack of licensing from the Central Bank of Kenya 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. Nevertheless, we expect the allocation of the Park Road project to homeowners to boost confidence in the government's affordable housing initiative, given that the Phase I of the project is the first to be completed and handed over to the owners, and thus lure more inspiring homeowners to join the program. Some other affordable housing projects in the pipeline include; 2,720 units River Estate in Ngara, 1,434 units Pangani Regeneration Project that are ongoing, among others.

Vaal Real Estate, an Egyptian and Turkish owned developer, launched a 15 floor residential development along Elgeyo Marakwet road in Kilimani Area, Nairobi. The development dubbed

"Wilma Towers" will comprise of 227- 1, 2 and 3 bedrooms units, built on half an acre, and is set for completion in October 2020. The units, sized at 45 sqm, 80 sqm and 100 sqm, are priced at Kshs 4.9 mn, Kshs 11.6 mn and Kshs 14.6 mn, respectively, which translates to an average of Kshs 133,296 per SQM. The price is 8.6% higher than the Kilimani market average of Kshs 121,845 per SQM as per the Nairobi Metropolitan Area Residential Report 2018/2019.

All values in Kshs unless stated otherwise

Nairobi Metropolitan Area Apartments Performance 2018/2019

Area	Average Price per SQM	Average Rent per SQM	Average Annual Uptake	Average Occupancy	Average Rental Yield	Average Price Appreciation	Total returns
Riverside	135,813	737	22.9%	76.2%	5.1%	0.9%	5.9%
Loresho	113,122	479	20.9%	95.4%	4.3%	1.4%	5.7%
Kilimani	121,845	852	30.4%	76.8%	5.6%	0.0%	5.6%
Westlands	145,042	665	27.8%	80.4%	5.2%	0.2%	5.4%
Parklands	123,146	744	23.3%	85.7%	5.1%	(0.3%)	4.8%
Kileleshwa	138,619	846	28.1%	81.7%	4.2%	0.0%	4.2%
Upper Mid-End Average	**129,598**	**720**	**25.6%**	**82.7%**	**4.9%**	**0.4%**	**5.3%**

- ***The average price per SQM for apartments in the upper mid- end market in the NMA stands at Kshs 129,598 with Kilimani's average at Kshs 121,845 per SQM***

Source: Cytonn Research 2019

Kilimani area continues to record increased activities, attributed to strong investor demand fuelled by the relatively high returns at approximately 5.6%, compared to the upper mid-end market average at 5.3%, and annual unit uptake at 30.4%, compared to market average at 25.6%. This has mainly been boosted by; (i) its proximity to commercial nodes such as Upperhill, CBD and Westlands, (ii) good infrastructure and ease of access in addition to the ongoing dualling of Ngong Road, (iii) availability of social amenities such as shopping facilities such as The Junction Mall, Adlife Plaza and Prestige Plaza, and (iv) High levels of security as the area is situated within the UN blue zone, which attracts expatriates. However, key to note, from our analysis, Kilimani market unit prices stagnated in 2018/2019, attributed to the current oversupply of apartments in the upper mid-end market and resultant low occupancy rates. Therefore, despite the above factors, we expect the market to record minimal development activities.

III. Listed Real Estate

During the week, ICEA Lion Asset Management, a Kenya based fund manager, signed an agreement to acquire Stanlib Kenya, a Kenya based fund manager as well, from South Africa based Liberty Holdings Ltd. The implementation of the Agreement is subject to the fulfillment of conditions, which include, but are not limited to, the approval of the Competition Authority of Kenya, the Capital Markets Authority of Kenya and the Trustee, by no later than 29 February 2020. According to Stanlib Fahari I- REIT Earnings update- H1'2019, the firm's total assets comprised of investment property valued at Kshs 3.4 billion and cash reserves of Kshs 235 million. The divestment is part of an extensive review of its operations, which according to online sources, has been informed by low historical returns, capital requirements, and competition. The Fahari I- REIT performance has been on a decline since its listing in November 2015, trading at Kshs 8.8 on 8th November 2019, 56% lower than its initial value of Kshs 20.0 per unit. The poor performance of the REIT is attributable to;

i. Inadequate investor knowledge,
ii. The opacity of the exact returns from the underlying assets,
iii. The negative sentiments currently engulfing the sector given the poor performance of Fahari I-REIT, and
iv. Lack of institutional support for REITs.

In our view, the subject announcement is likely to cause unsteadiness in the market thus causing investors to adopt a wait and see attitude awaiting closure on the sale, and hence result in poor performance of the REIT on the bourse. If successful, we still do not foresee improvement of the performance of the I- REIT, unless the above factors resulting in its poor performance are addressed.

Despite REITs not being a popular product in the Kenya market evidenced by the poor performance of the Fahari I-REIT mentioned above, the government of Kenya continues to make strides towards promoting the development of the product. During the week, the Finance Act, 2019 (the Act) was assented to by the President, highlighting a plus for the REIT market. As per the approved amendments, the income of REITs investee companies has been exempted from income tax, and this thus translates to higher profits for investees. Previously, only the income of REITs was exempt from corporation tax. This amendment aims at increasing the flexibility of REITs in making investments and thus attract more investors into buying into the product.

Other highlights during the week;

i. GCG India and East Africa, an Italian Company, announced that it had set up a Kshs 500 mn plant in Kenya targeting to produce bottle caps for alcohol and beverage manufacturers across East Africa. Guala Closures East Africa (GCEA) is a wholly-owned member of the Guala Closures Group of companies (GCG), and also supplies the caps to more than five alcohol and beverage companies in Kenya, Uganda, and Tanzania. The above is an indication that Kenya continues to attract investors and multinationals, and this we attribute to; (i) recognition of Kenya as a regional hub, (ii) infrastructural improvement, (iii) political stability and (iv) the ease of doing business with the World Bank ranking Kenya as #56 in 2019, from #61 in 2018 out of 190 countries.

We expect the real estate sector to continue recording development activities fueled by the growth of the hospitality sector with the increasing entry of international arrivals, the continued focus on the affordable housing initiative, entry of multinationals, in addition to investor focus on selected markets in the residential sector.