Real Estate Investment Trusts, REITS, as an Investment Alternative, & Cytonn Weekly #52

Real Estate

I. **Retail Sector**

During the week, Naivas Supermarket opened its latest outlet in Westside Mall in Nakuru Town, which was previously occupied by Nakumatt Holdings. This marks Naivas' third location in Nakuru and 60th outlet nationwide following recent openings in Mombasa and Ngong Town. The move is in line with the retailer's expansion strategy aimed at widening its market share by tapping into Kenya's rapidly-growing urban cities and satellite towns, in the wake of increased competition from retailers such as Tuskys and Quickmart. The sector has continued to record increased activities, in major towns such as Nakuru attributed to:

i. Positive demographics in Nakuru with the population growing at an average of 3.0% p.a., compared to the Kenyan average of 2.2% p.a.,
ii. Improving infrastructure with the expansion of the Nakuru-Nairobi Highway, which has encouraged a growth in mall space as this encourages tenancy and footfall,
iii. The availability of relatively low- priced retail spaces. According to Cytonn Kenya Real Estate Retail Report 2019, Nakuru recorded average rent prices of Kshs 59.2 per SQFT, compared to the market average of Kshs 118.0 per SQFT

Despite the low rents, Nakuru town does not offer an attractive opportunity for investors due to its poor performance recording rental yields of 4.5% in 2019, 2.5% points less than the market average of 7.0%. This is mainly attributed to competition due to lower rental rates offered from more established mixed-use developments (MUDs) that are in the market such as CK Patel and Shoppers Paradise.

The table below shows the retail performance of key urban cities in 2019:

(all values in Kshs unless stated otherwise)

Kenya Retail Performance in Key Urban Cities 2019

Region	Rent per SQFT	Occupancy Rate (%)	Rental Yield (%)
Mt. Kenya	129.8	80.0%	**8.6%**
Nairobi	168.6	75.1%	**8.0%**

Kenya Retail Performance in Key Urban Cities 2019

Region	Rent per SQFT	Occupancy Rate (%)	Rental Yield (%)
Eldoret	131.0	82.3%	**7.9%**
Mombasa	122.8	73.3%	**7.3%**
Kisumu	96.9	75.8%	**5.6%**
Nakuru	59.2	77.5%	**4.5%**
Average	**118.0**	**77.3%**	**7.0%**

- **Nakuru recorded average rent prices of Kshs 59.2 per SQFT, compared to the market average of Kshs 118.0 per SQFT. This was mainly attributed to competition due to lower rental rates offered from more established mixed-use developments (MUDs) that are in the market such as CK Patel and Shoppers Paradise**

Source: Cytonn Research 2019

We expect the retail sector to remain vibrant with local retailers such as Naivas, Quickmart and international retailers such as Carrefour and Game continuing to expand to take advantage of the relatively low formal penetration rates, especially in regions outside Nairobi as well as to take up prime spaces that are vacated by struggling retailers.

II. **Statutory Reviews**

The Kenya Mortgage Refinancing Company (KMRC) was established under the Companies Act and licensed by the CBK to provide long-term funding to primary mortgage lenders. Section 57(2) of the Central Bank of Kenya Act 2013 empowered the CBK to come up with Mortgage Refinance Companies Regulations 2019. On 3rd December 2019, the National Assembly passed the Central Bank of Kenya (Mortgage Refinance Companies) Regulations 2019. The regulations are intended to guide the operation of the Kenya Mortgage Refinancing Company (KMRC), providing a framework for licensing, capital adequacy, liquidity management, corporate governance, risk management as well as reporting requirements of Mortgage Refinance Companies (MRCs). However, the Assembly annulled two sections that were mentioned to contravene with section 13 (m) of the Statutory Instruments Act that states legislative powers should not be inappropriately delegated:

i. **Section 26 (2)**, which gave the Central Bank of Kenya (CBK) the powers to approve the opening, relocation & closure of any branch of a mortgage refinance company, and,
ii. **Section 42**, which gave the Central Bank of Kenya (CBK) the powers to issue guidelines on group structures of mortgage refinance companies.

In our view, the adoption of the Mortgage Refinance Companies Regulations is a positive step towards the operationalization of the Kenya Mortgage Refinancing Company (KMRC), save for the grey areas occasioned by the two annulled sections. The annulled sections may delay operationalization of the Kenya Mortgage Refinancing Company (KMRC) as there is no authority prescribed to provide guidelines in which place a mortgage refinance company may be opened, relocated or closed.

Once operational, we expect the KMRC to (i) increase the amounts of money available for mortgage lending, and, (ii) lengthen typical mortgage tenors in Kenya from the current average of 12-years to 20-years, bringing down monthly payments by 14%, assuming current average interest rates of 13.6% and therefore assisting with affordability. For more information on the Kenya Mortgage Refinancing Company (KMRC), read our topical here.

III. **Infrastructure Sector**

During the week, the National Government announced plans to construct a 540-km road project that will connect Kiambu, Murang'a, Nyandarua, and Nyeri Counties and will consist of a network of over 80 feeder roads. The Kshs 30.0 bn project dubbed 'Mau Mau Road' is expected to start in January 2020 and will be completed in two years starting at Gataka, Limuru in Kiambu County and ending at Ihuru area in Nyeri County. The road is expected to reduce traffic congestion along the Nairobi-Nyeri highway, which experiences frequent snarl-ups because of several feeder roads to several counties such as Nanyuki, Meru, and Isiolo.

The continued provision of infrastructure and revamping of old roads in the recent years has opened up new areas for investment and helped reduce development costs for developers boosting prices for existing properties, evidenced by growth prices in areas like Juja and Ruaka towns, where land prices appreciated by 8.7% and 4.3% p.a., respectively, attributable to speculation stemming from expected infrastructural developments, such as Thika Road and the Northern by-pass, respectively.

We expect the project to enhance the accessibility of remote areas in the four counties opening up the areas for real estate development, enhancing demand for property in the respective areas, and resulting in an increase in property value.

We expect growth in the real estate sector to be fueled by (i) increased foreign direct investments, (ii) improvement in infrastructure that will open up areas for development in addition to the improving socio-economic environment, and, (iii) continued efforts towards the affordable housing initiative by increasing the availability and affordability of housing finance, thus boosting homeownership. The investment opportunity for retail mall developers is in markets such as Mombasa and Kiambu attributed to low retail space supply.