Capital Markets Based Home Ownership Savings Plans, & Cytonn Weekly #03/2020

Real Estate

I. **Residential Sector**

During the week, China State Construction handed over the 228 2-bedroom units of the first phase of Park Road affordable housing project in Ngara to the Kenyan National Government. The 1,370-unit project sits on a 7.9-acre parcel of land in Ngara, Nairobi, with Phase 2 expected to be completed by June 2020. Once complete, the project will comprise of 30 SQM 1-bed, 40 SQM 2-bed and 60 SQM 3-bed social housing units selling at Kshs 1.5 mn, Kshs 2.0 mn and Kshs 3.6mn, respectively, which translates to Kshs 53,056 per SQM, in addition to 60 SQM 2-bed and 80 SQM 3-bed affordable housing units selling at Kshs 3.0 mn and 4.0 mn, respectively, which translates to Kshs 50,000 per SQM.

According to the dailies, approximately 300 homeowners have so far paid the mandatory 12.5% deposit and are awaiting allocation which will be done through the running of a lottery (*timelines not disclosed).* In December 2019, the government published guidelines that would be used in allocating residential units at the Park Road affordable housing project in Ngara. The units will be allocated through the Boma Yangu Portal upon paying of 12.5% of the house value as a deposit with the main modes of purchase as follows;

i. Outright Sale – requires 12.5% of the house value as a deposit with the balance paid within 90-days,
ii. Mortgage Loan- financed under the Civil Servants mortgage scheme or partner banks, and,
iii. Tenant Purchase Scheme (TPS) - 12.5% of the house value as a deposit with monthly payments at an interest of 7.0% p.a for a period of 25-years. However in our view, the rate may not be sustainable as it may result in a high cost of debt for the KMRC facility as investors of the mortgage-backed bonds are likely to demand a relatively high rental yield of approximately 13.5%, assuming a 1.0%-point margin above the minimum of the risk-free rate for a 15-year bond, which currently stands at 12.5%, yet KMRC's target is providing mortgages at 9.0% interest. For more details, see our KMRC Topical.

To drive the affordable housing initiative, the government has already put in place various policies and strategies to support developers and first-time homebuyers, which include:

For Home Buyers:

i. 15.0% tax relief up to a maximum of Kshs 108,000 p.a.,
ii. Exemption from stamp duty tax for first time home buyers,
iii. Enabling homeowners to make savings for the purchase of a home through Collective Investment Schemes, through the expansion of approved institutions that can hold savings towards HOSP to

include Fund Managers and Investment Banks registered under the Capital Markets Act.

For Developers:

i. 50% corporate tax break from 30% to 15% for investors who put up 100 and above affordable housing units,
ii. Scrapping off, of the NEMA and NCA levies, which used to be 0.1% and 0.05% of the construction costs, respectively,
iii. Exemption of goods supplied through import or purchase for the direct and exclusive use in the construction of affordable houses by licensed Special Economic Zones(SEZ) from Value Added Tax (VAT),
iv. Exemption of companies implementing projects under the affordable housing scheme from the application of thin capitalization rules,
v. Exemption of the transfer of a house constructed under the affordable housing scheme from the developer to the National Housing Corporation from Stamp Duty, and,
vi. Reduction of Import Declaration Fee (IDF) on inputs for the construction of houses under the affordable housing scheme approved by the CS Finance from 2.0% to 1.5%.

We except continued activities in the affordable housing sphere fueled by the continued government focus to achieve the target of developing 500,000 housing units by 2022 and this is evidenced by the significant budget allocation of Kshs 10.5 bn in the 2019/2020 budget, in addition to the introduction of incentives for both developers and home buyers. In 2020, we expect the initiative to continue to gain traction with a significant number of potential home buyers registering for the affordable housing units in addition to the implementation of several projects in the pipeline, among them being; 1,142 units Park Road Phase 2, a 3,500 unit project in Starehe, 5,300 units in Shauri Moyo and 2,720 units River Estate in Ngara.

II. Retail Sector

During the week, Spur Corporation Ltd, a South African restaurant chain, announced plans to open two additional outlets in Kenya in 2020, as part of its expansion strategy. The restaurant chain currently has 7 outlets in Kenya which comprise of 5 steak houses, a restaurant and a pizzeria. This is an indication of the continued expansion efforts by international retailers aimed at increasing their local foothold in the country. The continued entry and expansion of international retail in Kenya has continued to boost the retail real estate sector through space uptake thus boosting the investors' returns. However, according to Cytonn Annual Markets Review – 2019, the sector has an existing oversupply of 2.8 mn SQFT of space, which has continued to cripple its performance. According to the report, the sector recorded a decline in rents and occupancies by 1.5% and 4.0%, respectively, to Kshs 175.5 and 75.9% in 2019 from Kshs 178.2 and 79.8%, respectively, in 2018, attributed to the oversupply which has created a bargaining chip for retailers forcing developers to reduce or maintain their rents in order to remain competitive and attract occupants to their retail spaces.

The table below shows the Nairobi Metropolitan Area (NMA) retail performance between 2018 and 2019:

(All values in Kshs unless stated otherwise)

Retail Sector Performance 2018-2019

Item	2018	2019	Δ Y/Y 2019
Average Asking Rents (Kshs/SQFT)	178.2	175.5	**(1.5%)**

Retail Sector Performance 2018-2019

Item	2018	2019	Δ Y/Y 2019
Average Occupancy (%)	79.8%	75.9%	**(4.0%) points**
Average Rental Yields	9.0%	7.8%	**(1.2%) points**

• The retail performance softened in 2019 with rents and occupancies declining by 1.5% and 4.0%, respectively, to Kshs 175.5 and 75.9% in 2019 from Kshs 178.2 and 79.8%, respectively, in 2018 attributed to an oversupply of 2.8 mn SQFT as at 2019

Source: Cytonn Research 2019

We expect international retailers to continue expanding their local footprint in the Kenya retail market supported by positive economic growth, rise in disposable incomes, change in consumer tastes & preferences, and improved infrastructural developments. This will fuel continued uptake of space and thus cushion the sector's performance, in the wake of the existing oversupply.

Other highlights during the week included:

i. Acorn Group, a real estate developer, listed its Kshs 4.3 billion green bond on the Nairobi Securities Exchange (NSE). The five-year bond will be listed in three tranches, with the newly listed first tranche floated at Kshs 786 million. The green bond is intended to finance the developer's sustainable and climate-resilient student accommodation in Kenya. Acorn Group has already put up approximately 1,000 hostel units located in Parklands, Jogoo Road and Ruaraka under the Qwetu brand. According to Cytonn Research, modern student hostels have potentially high yields of between 7.2% - 9.6% compared to the conventional real estate sectors i.e., commercial office, retail, and residential, whose average yields were 7.0% as at 2019. The green bond listing is a step in the right direction towards enabling the real estate sector to raise funds from the capital markets to finance their investment. For more information, see our Cytonn Q3'2019 Markets Review.

We expect increased activities in the real estate sector mainly in the residential and retail themes, supported by the increased focus on the provision of affordable housing by the National Government, and the continued entry and expansion of international retailers in the country.