Is There a Real Estate Bubble in Kenya? & Cytonn Weekly #04/2020

Real Estate

I. **Residential Sector**

During the week, United Kingdom Climate Investment (UKCI), a joint venture between the Green Investment Group, a UK-based specialist developer and investor of green infrastructure, and the United Kingdom Government's Department for Business, pledged to invest GBP 30 mn (Kshs 3.9 bn) towards affordable green housing in Kenya, a major boost for the Kenyan Government's affordable housing agenda. The pledge will be delivered through a locally managed vehicle that also seeks to raise between Kshs 8.0 bn and Kshs 25.0 bn, from Kenyan and international institutional investors, to be geared towards alleviating the affordable housing shortage, currently estimated at 2.0 mn units, while embedding green design standards and stimulating institutional investment in sustainable buildings locally. With the affordable housing initiative's estimated total cost of Kshs 1.3 tn, the investment will provide a significant impetus to the programme, which aims to deliver 500,000 units by 2022. The government has thus far allocated a total of Kshs 16.5 bn from the 2018/19 and 2019/2020 budgets and a further Kshs 28.0 bn from the Supplementary Appropriation Bills of 2018 and 2019. Previously, the government also received similar support in 2018, from the United Nations Project Services (UNoPs), in which the UN subsidiary committed to deliver 100,000 low cost green homes across Kenya at an estimated cost of Kshs 64.7 bn. As such, we expect continued interest in Kenya's investment scene particularly affordable housing owing to; (i) government's investor-friendly incentives and regulations, (ii) a stable macroeconomic environment, and (iii) positive demographics characterised by an expanding middle class and rapid population growth, which have continued to sustain the demand for housing.

II. **Retail Sector**

During the week, leading local retailer Naivas Limited signed a deal to sell 30.0% of its business to Paris-based private equity fund, Amethis Finance, for an undisclosed amount. The PE firm, which has presence across Africa in cities such as Accra, Abidjan, and Casablanca aims to grant entrepreneurs access to external growth opportunities, while improving their efficiency and governance, and therefore, we expect that the move will boost the local retailer's expansion strategy that has seen it open 57 branches across the country, while also help it avoid corporate governance and management issues that have plagued retail giants such as Nakumatt, Choppies, and Uchumi. In our view, the move affirms the continued investor confidence by international players in Kenya's retail sector signalling its positive outlook, which is largely driven by; (i) Kenya's attractive economic projections as compared to global markets, with Kenya among the countries expected to spearhead growth in the Sub Saharan Africa (SSA) region with an expected GDP growth of 5.7%, as per the Cytonn Markets Outlook 2020, in comparison to SSA's projections of 2.9%, (ii) strong domestic demand driven by the growing middle class population and rapid population growth, which has led to international retailers such as Mango and Skechers setting up shop in the region to satiate demand for quality international products, and (iii) a general improvement in ease of doing business in the region evidenced by Kenya's move from position #61 in 2018 to #56 in 2019 on the Ease of Doing Business Index by World Bank .

For investors in retail real estate, the entry of foreign players boosts retail space performance and stabilizes uptake and thus, enhancing investor returns. As of 2019, the retail sector recorded average yield of 7.8% in comparison to the office and residential sectors with 7.5% and 5.0%, respectively, with markets such as Westlands and Karen offering relatively high returns of up to 10.3%.

Nairobi Retail Sector Performance by Nodes 2019

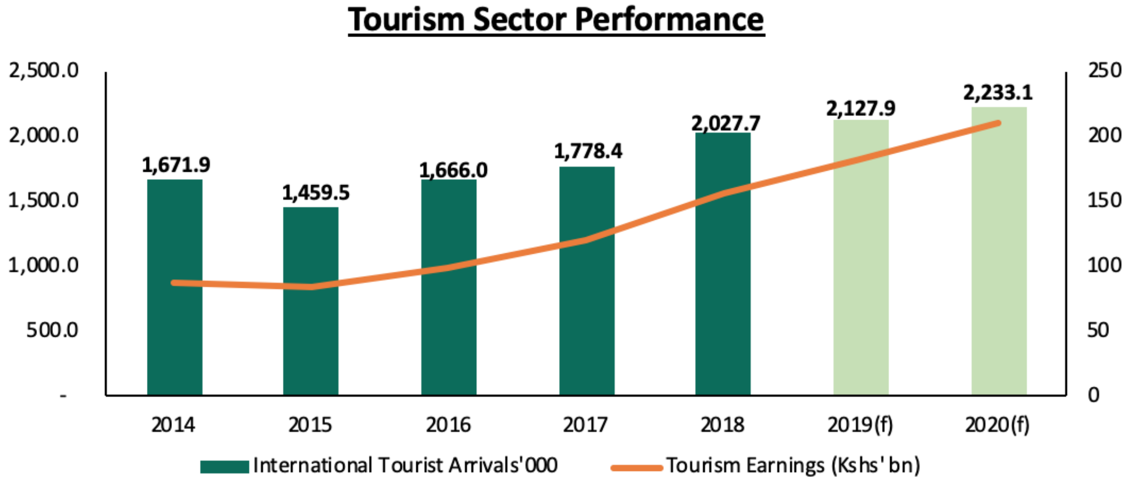
Location	Rent Kshs/SQFT FY' 2019	Occupancy FY' 2019	Rental Yield FY' 2019
Westlands	215	82.8%	10.3%
Karen	222	80.0%	9.5%
Kilimani	167	87.4%	8.8%
Ngong Road	181	80.5%	8.3%
Kiambu Road	180	67.6%	7.2%
Thika road	173	72.8%	7.1%
Eastlands	150	71.7%	6.8%
Mombasa road	156	66.8%	6.3%
Satellite Towns	136	73.3%	5.9%
Average	176	75.9%	7.8%

- ***As of 2019, the retail sector posted average yield of 7.8%, with nodes such as Westlands, Karen, Kilimani and Ngong Road registering average yields of 10.3%, 9.5%, 8.8% and 8.3%, respectively***

Source: Cytonn Research

III. **Hospitality Sector**

PrideInn, a local hospitality group, revealed plans of undertaking its first management facility, Azure Hotel, a Kshs 1.2 bn five-star hotel with 164-rooms located in Westlands. Currently, PrideInn operates various own-facilities in Westlands, Nairobi and others in Mombasa. Overall, this plays testament to Westland's attractiveness as a hospitality node, attributable to; (i) proximity to business nodes such as Kilimani, Central Business District (CBD), and Upperhill, enabled by relatively good road connectivity, (ii) availability of amenities such as the Westgate Mall, Sarit Centre, and other recreational amenities that help to attract visitors, and (iii) convenient accessibility to the main airports, that is, Jomo Kenyatta International Airport (JKIA) and Wilson Airport – and this is bound to improve further with the planned JKIA-James Gichuru Express Highway. The move also affirms Nairobi's vibrant hospitality sector that is driven by; (i) Nairobi's status as a key financial hub in Africa, which attracts business and Meeting, Incentives, Conferences and Exhibitions (MICE) travellers, (ii) relatively good infrastructure, and (iii) the government's open sky policy that has enhanced the ease of movement for Africans, thereby attracting tourists and investors. According to Kenya National Bureau of Statistics (KNBS), international visitors reported in 2018 increased by 14.0% to 2.0 mn from 1.8 mn in 2017, and this is expected to increase in 2020. The graph below shows the growth of the number of in tourism earnings and tourist arrivals;



Source: Kenya National Bureau of Statistic

We expect the sector to remain vibrant in 2020 and based on the KNBS historical data, we expect that international arrivals will grow by 4.9% on average to 2.1 mn and 2.2 mn for 2019 and 2020, respectively, boosted by:

i. The recent pledge by the UK government to abolish travel advisories on Kenya, which tend to have a grave impact on the economy and more so on the hospitality sector's performance, and,
ii. The calm political environment and improved security, which have continued to boost tourists' and investors' confidence in the country.

Overall, we expect the real estate sector to continue improving with pockets of value in themes such as affordable housing, hospitality sector and select retail markets, boosted by; (i) rapid urbanization, growing middle class and thus, increased consumerism, (ii) Kenya's attractive economic projections compared to global markets, with Kenya among the countries expected to spearhead growth in the Sub Saharan Africa (SSA) region with GDP growth expected to come in at 5.7% in comparison to SSA's projections of 2.9%, and (iii) government's investor-friendly incentives and regulations for real estate investors.