Master-Planned Communities, & Cytonn Weekly #06/2020

Real Estate

I. **Industry Reports**

During the week, Kenya Bankers Association released its Housing Price Index Q4'2019 Report, which highlighted that residential house prices recorded a 0.6% decline in Q4'2019, and apartments continue to dominate the real estate market fuelled by their affordability, compared to detached units. The other key take-outs from the report included;

i. Residential house prices contracted by 0.6% in Q4'2019, compared to 2.3% in Q3'2019, attributed to slow demand given the sluggish economy and thus a resultant low disposable income. In addition, the limited access to credit has prevented willing home buyers from purchasing homes in the wake of increasing supply and thus vendors have been forced to drop their asking prices with the aim of attracting buyers,
ii. Apartments continue to dominate the market with a total market share of 74.0%, while bungalows and maisonettes registered a market share of 9.0% and 17.0%, respectively. The relatively high market share of apartments is mainly supported by the affordability of the units as opposed to bungalows and maisonettes, and,
iii. Nevertheless, the market share of apartments declined by 11.0% points from 85.0% in Q3'2019, to 74.0% in Q4'2019, attributed to a change of preference as some home buyers prefer low-density developments, as opposed to the high-density developments, which do not offer privacy.

As per the Cytonn Annual Markets Review 2019, there was y/y slowdown in the residential house price, with appreciation coming in at 1.1% in 2019, compared to 4.2% in 2018. The slowdown in performance was attributed to slow private sector credit growth before the interest rate cap law was repealed and slow property demands as home homebuyers' spending power remained low amid a tough economic environment. In terms of residential segments, apartments recorded a price appreciation of 1.2%, 0.1% points higher than detached units, which recorded a price appreciation of 1.1%. The better performance of the apartment segment was mainly supported by the fact that apartments are relatively more affordable recording an average price of Kshs 97,675 per SQM, as compared to detached at Kshs 141,968 per SQM, thus more preferred by home buyers.

We expect the uptake of residential units to remain subdued as the negative effects of a sluggish economy continue to persist into 2020. However, we expect better performance particularly in the lower mid-end and low-end segments as investor appetite for the same continues, enabled by the continued government support in the form of incentives to developers and buyers, in addition to the growing demand for affordable housing units.

II. **Residential Sector**

During the week, the Principal Secretary for Housing and Urban Development, Mr. Charles Hinga announced that the Shauri Moyo and Starehe affordable housing projects in Nairobi's Eastlands were set for commissioning subject to the transfer of title deeds of the land from the National Treasury. This follows communication from the Housing and Urban Development Department, that civil servants who vacated Old Park Road Estate in Nairobi's Ngara area would be given first priority in purchasing residential units from the Phase 1 of the Park Road housing project, which has 228 units. The said units were handed over to the National Government in January 2020, with the second and third phases of 260-units and 882-units, respectively, scheduled for completion in June and December 2020, respectively.

The above is an indication of the National Government's continued focus on the provision of affordable housing mainly for the low and middle-income earners, with the program seeking to construct 500,000 units by 2022, in counties such as Nairobi, Nakuru, and Kiambu. In addition to setting out the land for development, the government has also continued to bring forth tax and policy reforms aimed at boosting both the supply and demand of the affordable housing units. Some of the incentives that the government has recently introduced to support the initiative include:

For Developers:

- A reduction in the Import Declaration Fee (IDF) from 2.0% to 1.5% on any input that will be made to construct houses under the affordable housing initiative,
- Exemption of companies implementing the affordable housing projects from the application of thin capitalization rules, and,
- Value Added Tax exemption for goods supplied for direct and exclusive use in the construction of affordable houses by licensed Special Economic Zones (SEZ).

For Home Buyers:

- 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 the adoption of investment guidelines issued by the Capital Markets Authority (CMA) to guide the investment of deposits held in a registered HOSP,
- Stamp duty exemption on the transfer of a house constructed under the affordable housing scheme from the developer to the National Housing Corporation, and,
- Exemption from income tax of withdrawals from the National Housing Development Fund to purchase a house from a first-time owner.

We expect a continued focus on the affordable housing initiative to result in increased development activities especially in the lower mid-end and low-end submarkets. We also anticipate more potential homeowners will 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 development costs.

III. **Retail Sector**

During the week, Tendam Group, a Spanish fashion retailer, opened its first Kenyan outlet at the Westgate shopping mall in Westlands. The retail store will consist of 'Women's Secret' and 'Springfield' brands that will specialize in men's and women's fashion. The entry of the retailer into the market is an indication that Westlands' retail sector continues to attract international investors, with others such as Hugo Boss and Mango having gained a foothold in the market in 2019. The entry is supported by; (i) Westlands' positioning as an affluent neighborhood hosting middle to high-income earners with relatively high purchasing power, (ii) growing demand for international brands from the expanding middle class, and (iii) the supply of high-quality retail spaces that meet international standards. The same is reflected in the performance of the submarket, as it was ranked as the best performing retail submarket in the Nairobi Metropolitan Area recording average rental yields of 10.3%, 2.5% points higher than the 2019 market average of 7.8%, according to Cytonn's Real Estate Annual Markets Review 2019 Note.

Quicksmart, a local retailer, opened its latest outlet along Kamiti Road in Roysambu, off the Nairobi-Thika Superhighway, marking its 27th location nationwide following recent openings in Ongata Rongai and along Waiyaki Way. In September 2019, Quick Mart Limited and Tumaini Self Service merged their operations, under the brand name Quick Mart, in order to; (i) gain a stronger footing in Kenya's competitive formal retail space, (ii) strengthen operational efficiencies in order to gain a competitive edge, and (iii) expand their market share by tapping into the growing population and middle class.

The above developments are an indication of the local and international retailers' confidence in Kenya's retail consumer market thus guiding the continuous alignment of their expansion strategies aimed at tapping into the Nairobi outskirts, especially the rapidly urbanizing areas such as Roysambu with the aim of leverage on the growing middle class, ease of accessibility and the availability of relatively low priced retail spaces. According to our Real Estate Annual Markets Review 2019 Note, the sector recorded an average yield of 7.8%, with Westlands and Thika recording rental yields of 10.3% and 7.1%, respectively, as summarized in the table below:

Nairobi Metropolitan Area (NMA) Retail Submarket Performance 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%**

- ***The retail sector recorded an average yield of 7.8%, with Westlands and Thika recording rental yields of 10.3% and 7.1%, respectively***

Source: Cytonn Research 2019

Despite the existing retail office oversupply of approximately 2.0 mn SQFT of space, we expect the continued entry and expansion of both local and international retailers to cushion the sector in 2020, with a projected rental yield of 7.4%, according to the Cytonn 2020 Market Outlook.

We expect the real estate sector to continue recording several activities fuelled by; (i) the continued government focus on the affordable housing initiative, (ii) increased entry and expansion of both local and international retailers into the Kenya retail market, and, (iii) the existing housing demand within the low and middle segments of the residential market.