Personal Financial Planning, & Cytonn Weekly #08/2020

Real Estate

I. **Industry Report**

During the week, Knight Frank released Kenya's Market Update for H2'2019. The report tracks developments in the capital markets, real estate and economic growth in Kenya. The key take-outs from the report with a focus on real estate were as follows:

i. High-end residential prices decline slowed down during the period coming in at 4.0% in 2019, compared to a decline of 4.5% in 2018, attributable to increased transaction volumes in the second half of 2019 as investors were eager to close on deals before the end of 2019,
ii. Residential rents decreased at a higher rate of 2.8% in 2019 compared to 1.3% in 2018. This was attributed to the oversupply of residential units as well as a decline in expatriates relocating to Kenya,
iii. In the office sector, asking rents in Nairobi remained unchanged in the second half of 2019 at Kshs 130 per SQFT, a result of the existing oversupply and a tough economic climate,
iv. Absorption of Grade A and B office space increased by 41.0% during the second half compared to the first half of 2019 indicating that the oversupply situation has begun correcting. This was attributed to the increased uptake of serviced offices, as well as various Grade A offices delivered to the market by large multinational setting up regional headquarters,
v. In the retail sector, monthly rents for prime stores decreased by 4.2% to Kshs 466.4 per SQFT in the second half of 2019 attributable to the retail market adjusting to continued oversupply in certain locations, making it a tenant's market. Overall, the retail sector registered average occupancy rates of 77.0% with established malls remaining relatively high at over 90.0%.

The report is in line with our findings. According to Cytonn Annual Markets Review 2019, high-end residential markets recorded a decline in price appreciation which came in at 1.1% in 2019 in comparison to 4.2% in 2018, which the report attributed to developers offering lower prices in a bid owing to increased supply and thus, competition, while the office and retail sectors also recorded a decline in rental yields by 0.6% and 1.2%, respectively, attributable to constrained spending amid a tough financial environment as well as an oversupply in the respective sectors by 5.6 mn SQFT and 2.8 mn SQFT, respectively. However, differentiated concepts such as mixed-used developments and serviced offices are expected to perform well due to their low market share of 0.4% as well as continued demand from affluent individuals and expatriates on short business stints.

II. **Residential Sector**

During the week, Liason Homes, a local real estate developer, announced that they are set to begin construction of 32 bungalows in a gated community on Kenyatta Road in Nyeri Town, with phase one expected to be completed in 2021. The project dubbed 'Orchard Park' will consist of 3-bedroom units of 135 SQM priced at Kshs 4.9 mn and projected rent of Kshs 45,000, translating to a price and rent of Kshs 39,963 per SQM and Kshs 333 per SQM, respectively, which is 37.3% and 13.5% lower than the market average of Kshs 63,768 and Kshs 378 per SQM, respectively, as per the Nyeri Real Estate Investment Opportunity 2019.

Assuming the 3-bed market average occupancy rate of 100.0%, as per our research note, the development is projected to offer rental yields of 10.0%, 2.4% points higher than the Nyeri market average of 7.6% as of 2019. The residential market is mainly rental, in and around Nyeri town as the market, with the majority of the residential houses being owner-built, however, the area remains attractive to investors driven by:

i. The improving infrastructure such as the ongoing rehabilitation of roads such as the Baden Powell – Muhoya road in Nyeri town and the proposed construction of the Kenol-Nyeri-Isiolo Highway, which is expected open up the areas for real estate development,
ii. Devolution has continued to open up Nyeri Town, attracting government institutions such as the Independent Policing Oversight Authority (IPOA) and private firms, thus creating demand for office space, retail space and residential units to host investors and government officials,
iii. Its central location in the Mt. Kenya Region, thus attracting Mt. Kenya Regional offices for both local and international companies such as the Safaricom, National Construction Authority (NCA), and Coca Cola, thus creating demand for office space, retail and in the housing sector, and,
iv. Relatively High Income among the population with Nyeri ranking as the 12th richest county in terms of GDP per capita in the country at USD 958, according to the Gross County Product report 2019 by the Kenya National Bureau of Statistics (KNBS).

The table below shows the performance of detached units in Nyeri:

All values in Kshs unless stated otherwise

Nyeri Residential Detached Units Performance (2017-2019)

Typology	Price per SQM 2017	Price per SQM (2019)	Rent (2017)	Rent (2019)	Rent per SQM 2017	Rent per SQM 2019	Occupancy 2017	Occupancy 2019	Annual Sales 2019	Rental Yield (2017)	Rental Yield (2019)	Δ Rental Yields 2017-2019
1-bed	76,190	76,190	10,000	15,000	238	357	80%	80%	20%	3.8%	4.5%	0.7%
2-bed	74,074	74,074	20,000	20,000	370	370	71%	80%	25%	4.3%	4.8%	0.5%
3-bed	63,768	63,768	28,000	28,000	406	406	67%	100%	25%	5.1%	7.6%	2.5%
Average	**71,344**	**71,344**	**19,333**	**21,000**	**338**	**378**	**73%**	**87%**	**23%**	**4.4%**	**5.6%**	**1.2%**

· 3-bed detached units recorded average rent per SQM of 378 in 2019, 1.2% points higher than the market average of 4.4% recorded in 2017, attributed to the increase in the monthly rent charges from Kshs 338 per SQM in 2017 to Kshs 378 per SQM and occupancy rates from 73% to 87%

Source: Cytonn Research 2019

We expect to continue seeing increased real estate developments in other counties driven by the improving infrastructure and availability of land for development and at affordable prices. According to Cytonn Research, Nyeri registered an average price per acre of Kshs 60.9 mn, 54.5% lower compared to the Nairobi Metropolitan region with Kshs 134.0 mn per acre.

III. **Retail Sector**

During the week, Giordano, a Hong Kong fashion chain, opened its first Kenyan outlet at Garden City Mall as it aims at targeting Kenya's market with its casual wear and accessories. The chain has over 2,400 stores worldwide in 40 countries including Zambia and South Africa that were opened in 2015 and 2018, respectively.

The increased interest by international retailers into the Nairobi Metropolitan Area (NMA) is supported by (i) growing demand for international brands from the expanding middle class, (ii) the supply of high-quality retail spaces that meet international standards, and (iii) the expanding middle-income class population, with increasing disposable incomes creating demand for differentiated retail products. Other international retailers that have entered into the Kenyan retail market in the past year include Tendam group, Hugo Boss and Mango.

The increased entry of multinational retailers is a welcome move for developers who have been experiencing increasing vacancy rates due to the tough economic climate with occupancies declining by 4.0% to 75.9% in 2019 from 79.8% in 2018, according to the Cytonn Annual Markets Review – 2019.

The table below shows the Nairobi Metropolitan Area (NMA) retail performance over time:

(All values in Kshs unless stated otherwise)

Summary of NMA Retail Sector Performance 2016-2019

Item	2016	2017	2018	2019	Δ Y/Y 2019
Average Asking Rents (Kshs/SQFT)	186.9	185.3	178.2	175.5	**(1.5%)**
Average Occupancy (%)	89.3%	80.3%	79.8%	75.9%	**(4.0%) points**
Average Rental Yields	10.0%	9.6%	9.0%	7.8%	**(1.2%) points**

· ***The retail performance softened with yields declining by 1.2% points to 7.8% in 2019 from 9.0% in FY'2018 attributed to an introduction of 0.4 mn SQFT of retail space into the Nairobi Metropolitan Area (NMA) market driving down rents and occupancy rates by 1.5% and 3.3% points, respectively,***

Source: Cytonn Research 2019

IV. **Hospitality Sector**

During the week, Kenya was ranked among the top five African destinations for tourism by Safari Bookings, an online site that compares Africa's safaris, coming in after Botswana, Tanzania, Zambia, and Zimbabwe. The ranking is attributed to the country's (i) excellent wildlife viewing, including the annual wildebeest migration, (ii) wide variety of habitats and scenery, and (iii) beautiful beaches with a variety of resorts.

The tourism sector's performance over the past couple of years, which has been characterized by continued increase of tourist arrivals and tourism earnings, has continued to boost the hospitality sector's performance owing to the increased demand for quality accommodation and other hospitality services by both local and international guests, the stable political environment and improved security, thus making Kenya an ideal destination for both business and holiday travelers. According to the Kenya National Bureau of Statistics (KNBS) Leading Economic Indicators (LEI) December 2019, total number of visitors arriving through Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) increased by 6.2% to 1.6 mn persons in 2019, from 1.5 mn persons in 2018, attributed to the calm political environment and improved security, which has continued to boost tourists' confidence in the country. We expect the hospitality sector's performance to remain vibrant supported by the continued marketing efforts by the Kenya Tourism Board, improved security and improved flight operations and systems, which will make it easier and more convenient for travelers.

Other Highlights

Also during the week, the Nairobi County Government announced that it had started speeding up clearance of construction permits after having stopped their issuance in June of 2019 following the disbandment of the technical committee of the Lands, Housing and Urban Planning Department charged with the approval of permits. We expect this to have a positive impact on the real estate sector as it puts various developers back on track with their respective projects thus boosting construction activity in the sector.

We expect increased activities in the real estate sector mainly in the residential and retail themes, supported by (i) the continued entry of international retailers in the country, (ii) the improving infrastructure, (iii) positive demographics and (iv) a stable economic environment.

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