Student Housing Market in Kenya, & Cytonn Weekly #10/2020

Real Estate

I. **Residential Sector**

During the week, Mizizi Africa Homes, a local property development company, launched its 18-unit off-plan development located along Kenyatta Road in Juja. The development dubbed 'Heritage Estate' will comprise of 118 SQM 3-bedroom bungalow units selling at Kshs 3.8 mn, which translates to Kshs 32,200 per SQM, compared to the Juja market average of Kshs 73,182 per SQM in 2019 as per the NMA Residential Report 2018/2019, attributed to more affordable development land.

Driven by the heightened demand for affordable housing, satellite towns such as Juja continue to attract real estate investors driven by (i) availability of development class land at Kshs 18.5 mn per acre, compared to Nairobi Metropolitan Area average of Kshs 139.4 per acre, (ii) infrastructural developments with the Thika Superhighway, enhancing ease of access to the area, (iii) a growing demand for residential units from the working class from commercial nodes such as Nairobi CBD and Thika Road, evidenced by the annual uptake averaging at 16.6%, and (iv) attractive returns recording average yields of 5.1%, 0.4% points higher than the residential market average of 4.7%.

The table below shows the satellite towns' performance compared to other residential segments:

(All values in Kshs unless stated otherwise)

Residential Performance Summary 2018/2019

Segment	Average Price Per SQM	Average Rent Per SQM	Average Annual Uptake	Average Occupancy	Average Rental Yield	Average Y/Y Price Appreciation	Average Total Returns
High End	201,275	735	18.5%	83.5%	3.7%	0.1%	3.8%
Upper-Mid End	135,951	628	23.6%	85.1%	4.5%	0.3%	4.8%
Lower Mid-End	83,0634	404	19.3%	79.6%	4.4%	0.4%	4.8%
Satellite Towns	76,676	395	21.4%	79.6%	4.5%	0.6%	5.1%
Residential Market Average	**119,330**	**532**	**20.9%**	**82.1%**	**4.3%**	**0.3%**	**4.7%**

- ***Satellite towns recorded average returns of 5.1%, 0.4% points higher than the residential market average of 4.7% during the 2018/2019 period***

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We expect the residential sector in satellite areas to continue gaining popularity in Kenya, supported by (i) relatively high returns to investors, (ii) growing demand for affordable housing units, and (iii) infrastructure improvements, and thus attractive performance going forward.

II. Real Estate Investment Trust (REIT)

During the week, Acorn Holdings Limited, a local property developer, announced that it was in the process of structuring a Development Real Estate Investment Trust (D-REIT) through which it will sell part of its ownership of its branded Qwetu and Qejani student hostels. A D-REIT is a type of REIT in which resources are pooled together for purposes of running development and construction projects. The D-REIT will be used to finance the construction of sustainable and climate-resilient student hostel units in Nairobi, as the firm targets to put up 50,000 units in Nairobi. So far, the company has completed four developments in Ruaraka, Madaraka Parklands, and along Jogoo Road, totalling 1,572 units. Despite the D-REITs structure and regulations coming into effect in 2012, we don't have a single D-REIT in Kenya 8 years later. So far D-REITs in Kenya have failed with Fusion Capital D-REIT issuance in 2016 attaining a low subscription rate and the Cytonn D-REIT approval pending at the Capital Markets Authority (CMA). We ascribe the failure and lack of traction in the structure to three main reasons: (i) the high minimum amounts required for investments set at Kshs 5.0 mn, which is 100 times the Kenyan median income of Kshs 50,000, (ii) the high minimum capital requirement of Kshs 100 mn for a trustee, which is 10 times more compared to the requirement of Kshs 10 mn for a pension trustee, limiting the number of available trustees to just three banks, (iii) the lengthy approval processes that have no time limits. It has been 8 years since the regulations came into effect with nothing to show. Unless the structural market impediments are addressed, we are unlikely to see a D-REIT in the market anytime soon, making it hard to fund real estate initiatives such as the Affordable Housing initiative. We would suggest a candid and urgent review of the regulatory framework to understand why the structure has not worked so that we can make the necessary changes to make the framework relevant.

Also, during the week, the Capital Markets Authority (CMA) and the Competition Authority of Kenya (CAK) approved the transfer of the Fahari I- REIT by Stanlib Kenya to ICEA Lion Asset Management, a local Kenyan fund manager. The deal is part of an extensive review of Stanlib's operations, which according to online sources, has been informed by low historical returns, capital requirements, and competition. According to Stanlib Fahari I- REIT Earnings update- H1'2019, the firm's total assets comprised of investment property valued at Kshs 3.4 bn and cash reserves of Kshs 235 mn. The Fahari I- REIT performance has been on a decline since its listing in November 2015, trading at Kshs 7.8 per unit on 6th March 2020, 61.0% lower than its initial value of Kshs 20.0 per unit.

REITs in the Kenyan market, most notably the Stanlib Fahari I-REIT has traded in low volumes attributed to (i) opacity of the exact returns from the underlying assets, (ii) inadequate investor knowledge, and (iii) lack of institutional support for REITs. The REIT market in Kenya has the potential for growth if a supportive framework is provided. Some of the measures that may boost the REIT market include (i) teaming up with market players and regulators to offer constant training to the investing public, (ii) broadening the pool of trustees as currently, Kenya has only three institutions certified as REIT trustees. In countries with a successful REIT market such as the UK, a Chartered Accountant can register with the Financial Conduct Authority to be a trustee, and in South Africa, an insurance company can also be a trustee, and (iii) Continuous improvement on the regulation and government support for REITs. Currently, the average Kenyan investor is left to invest in informal, unregulated real estate schemes that have exposed them to risks. For more information, see our Real Estate Investment Trusts, REITs Note.

We expect the real estate sector to continue recording several activities fueled by; (i) the continued government focus on the affordable housing initiative, and, (ii) the existing housing demand within the low and middle segments of the residential market.