Cytonn Monthly – February 2018

Real Estate

In our Annual Real Estate Outlook for 2018, we stated that we expect an increase in real estate development activities this year. This was evident this month with a number of developers announcing plans to launch developments and reports indicating an improvement in the sector's performance as outlined below;

Industry Reports

Deloitte released their African Construction Trends (ACT) Report 2017. The report tracked 303 projects that had broken ground by 1st June 2017, valued at USD 50.0 mn and above in Africa. The key takeouts from the report for the East African Region were:

i. The East African region recorded the highest growth both in the number and value of construction projects in Africa with the value and number of projects increasing by 19.0% and 65.1% y/y, respectively. The value of projects increased to USD 32.6 bn in 2017 from USD 27.4 bn in 2016 and number of projects increased to 71 from 43 over the same period. In the whole of Africa, the number of projects increased by 5.9% with the value of projects declining by 5.2%,
ii. Real estate projects accounted for only 14.1% of the projects sampled in East Africa compared to energy and power that accounted for 22.5% and transport that had the bulk at 52.1%, and
iii. Central Governments account for the largest number of projects in East Africa at 90.1% compared to 75.0%, 60.2%, 79.7% and 57.5% for Central, South, West and North Africa. This is as private sector financing for construction in East Africa is still in its nascent stages.

In our view, investment in infrastructure and capital projects is an important aspect for enabling GDP growth and more diversified economic and private sector activity. By providing access to basic services such as water, education, and healthcare, infrastructure ensures that economic growth is sustainable and inclusive. However, these investments would yield more impact to GDP growth if they were targeted towards the largest components of our GDP contributors, such as agriculture and agro processing.

Knight Frank also released their 2018 issue of the Inside View Kenya Report that tracks the trends and performance in the real estate sector and gives an outlook for the sector. The key takeouts from the report were;

i. Kenya came in 4th in Africa as the home of dollar millionaires. The number of High Net Worth individuals rose by approximately 100% over the last 10 years to approximately 9,400-dollar millionaires. The group are the main drivers of the luxury real estate as they prefer lifestyle products and capital appreciation opportunities, and
ii. The performance of prime residential property improved in 2017 compared to 2016 with prices increasing by 0.9% over the first nine months of 2017 compared to a 1.0% decrease over the same period in 2016 and rents declining at a slower rate of 2.8% in the first half of 2017 compared to 3.2% decline over the same period in 2016.

Despite the relatively better performance in 2017, the performance is still low and this is attributed to increased supply of prime properties for rents and budget cuts by multinational corporations reducing demand.

During the month, the performance and activities of the various real estate themes was as is outlined below:

1. **Residential**

The residential sector witnessed increased activities in February with various developers announcing plans to undertake developments in the country. These Include;

i. This month, according to the dailies Lordship Africa, a subsidiary of European international developer Lordship Group launched a 44-floor apartment complex, named the 88 Nairobi Condominium along Bishop Rd in Upperhill. The development will consist of 1,2,3 and 4-bed luxury apartments with price points of Kshs 11.5mn and Kshs 35.0mn for 1 and 2 beds. The development is set to be the tallest residential development in East and Central Africa. This is the latest launch of a luxury apartment in Nairobi with others recently launched being Cytonn Towers by Cytonn Investments in Kilimani and The Pinnacle by Hass Group in Upperhill. Luxury apartments are gaining traction in the country driven by; i) the 93.0% growth in the number of high net worth individuals between 2006 and 2016 who allocate at least 25.0% of their wealth to real estate according to the Knight Frank, Inside View Kenya Report, ii) the changing tastes and increasingly sophisticated lifestyles of consumers due to global exposure, (iii) Kenya's positioning as a regional hub, and (iv) presence of multinational firms who create demand for up-market housing, Cytonn Weekly #45
ii. The National Government announced plans to spend over Kshs 1.0 bn to construct 744 houses for security officers, in a bid to address the housing deficit that is mainly driven by lack of low-cost houses, and
iii. CIC Group announced plans to put up a Kshs 2.8bn housing project on a 200-acre parcel of land near Tatu City. From the plan, 77 acres would be secluded for medium density, 13 acres for high-end units, whilst 10 would be for high rise developments. According to the master plan, the development would feature office developments, retail, recreational parks, ecological restoration centers and high rise apartments.

The launch of the developments by the government and the other private sector stakeholders is a testament to the attractiveness of residential real estate theme mainly supported by; i) huge housing deficit that stands at 2.0mn units with an effective annual demand of 200,000 units, ii) positive demographic trends, for instance, population growth that stands at 2.6%, 1.4% higher than global averages and a high urbanization rate of approximately 4.4% against a global average of 2.1%, and iii) affordable housing initiatives, with affordable housing being named among the four key pillars of focus by the government, which should see increased government incentives for developers of affordable units and thus increased development activities. We thus expect to continue witnessing increased development activities.

2. **Commercial- Office**

During the month, Zamara Umbrella Solutions, a Retirements Benefits Fund Administrator, formerly Alexander Forbes, announced plans to construct a twin tower with 30 and 16 floors, respectively at the Junction of General Mathenge and Peponi Rd in Westlands, Nairobi. The Mixed Use Development will feature both commercial and retail centers with retail occupying 3 floors and the rest reserved for commercial office space. The commencement of construction is scheduled for the first half of 2018. Westlands continues to attract commercial office developments as it offers an attractive investment opportunity to investors with average rental yields of 9.5% and occupancy rates of 86.4%, in 2017 compared to a market average of 9.2% and 82.8%. Other upcoming developments in the area include the 43 Storey Avic Towers on Chiromo Lane and One Africa Place along Chiromo

Road. The high returns in the market are mainly driven by i) The proximity of the area to CBD ii) Ease of access due to availability of a good road network, iii) High plot ratios in the area allowing for densification and iv) sufficient accommodation as the area is surrounded by high-end residential zones.

With the expected relaxation of the zoning regulations in Springvalley and Loresho as well as the expansion of the Waiyaki Way, we expect to continue witnessing increased development activity in the area. Developers should, however, be cautious of investment in the area especially in the commercial office segment as the area has the third largest office supply in Nairobi with a market share of 23.7% after Upperhill and CBD with market shares of 24.4% and 24.3%, respectively, and the commercial office segment in Nairobi has an oversupply of 3.9mn SQFT. The product offering should thus be differentiated either by i). developing Grade A office which have high returns with average rental yields of 10.0% compared to 9.2% for conventional officesand low supply with a market share of just 10.0% from our sample, ii) Servicing the offices, as serviced offices also have high returns with rental yields of 13.4%, compared to a yield of 9.2% for conventional offices or iii) Developing Green buildings to boost uptake, occupancy and thus returns.

3. **Retail**

In the month of February, the retail sector recorded increased activity as both local and international retailers opened new branches as they seek to tap into the high returns in the sector as expounded below;

i. French-based retailer, Carrefour announced plans to open a new retail store in the Sarit Centre Shopping Mall in April. This will mark the store's fifth outlet in the country with the other outlets being in; The Hub opened in 2016, Two Rivers and Thika Road Mall opened in 2017, The Junction opened in 2018. In Sarit Centre, the retailer takes over space previously occupied by Uchumi,
ii. Naivas Supermarket, one of the largest retailers in Kenya, announced plans to open a new outlet at Freedom Height Mall in Lang'ata by May 2018. The store marks the retailer's 44th outlet and is set to occupy a GLA of 18,000 SQFT, and
iii. South African retailer, Shoprite announced that it had secured space in a cumulative 7 prime malls in Kenya, with lease agreements already concluded for the Westgate Mall and the Garden City Mall in Westlands and Thika Road, respectively with the stores set to be opened in 2018.

The expansion by the retailers above indicate the bullish outlook they have on the Kenyan retail market which in our opinion is driven by high demand boosted by demographics such as i) rapid population growth at 2.6% as compared to global averages of 1.2%, ii) high urbanisation rate of on average 4.4% against a global average of 2.1%, and iii) an expanding middle class with increased purchasing power due to higher disposable incomes that rose by 15.8% from Kshs 5.7tn in 2015 to Kshs 6.6tn in 2016 according to the KNBS Economic Survey 2017 that facilitates sustained demand.

4. **Hospitality**

In the hospitality sector, Sarova Group of Hotels announced plans to take over the management of Spirit of the Mara Lodge in a 15-year partnership agreement. The hotel located in Siana Conservancy overlooking the Mara, has 10-suites each having a lounge and sleeping area. This is the latest expansion activity by Sarova Group of Hotels who recently opened Sarova Woodlands in Nakuru and announced the refurbishment of the Sarova Panafric Hotel. The move brings the groups' cumulative room count to 1,250 in Kenya. We are of the opinion that the hotel's expansion and refurbishment moves are driven by i) the need for the hotel to match the quality standards currently being offered in the market, and improve their facilities which have depreciated over time, so as to remain competitive in the wake of stiff competition from global brands such as Radisson Blu and Mariott which are coming into the Kenyan Market, and ii) the need to increase room capacity to meet the growing demand for accommodation as a result of an increase in tourist arrivals, with international arrivals increasing to 1.5 mn in 2017 compared to 1.3 mn in 2016

Other highlights for the sector include:

i. The Kenyan Tourism Board released the 2017 Tourism Sector Report. The report noted that the hospitality sector remained resilient with earnings in the sector growing by 20.3% y/y from Kshs 99.7 bn in 2016 to Kshs 120.0 bn in 2017. The report noted that the number of international arrivals rose by 4.5% y/y to 1.4mn in 2017 from 1.3mn visitors in 2016 as a result of marketing efforts by the government especially in H1'2017, and improved security. This is in tandem with our Nairobi Hospitality Sector Report, where we had projected growth of arrivals by 6.2%, Cytonn Weekly #6,
ii. Kenya Airways announced plans to start operations between Kenya and Mauritius offering four weekly flights by June this year. The route is expected to complement Air Mauritius' existing operations,Cytonn Weekly #6
iii. DoubleTree, a brand by Global chain Hilton Group, opened its 4-star Hotel along Ngong' Road, following the rebranding of Amber Hotel. This marks the brand's third hotel chain in Nairobi, with the others being Hilton Hotel in the CBD and Hilton Garden Inn along Mombasa Road, opened in 1969 and January of 2018 respectively. Cytonn Weekly #7

We expect the hospitality sector to continue witnessing increased investment and better returns in 2018 especially with the improved security in the country and conclusion of the electioneering period. The performance will also be boosted by the continued marketing efforts by the Kenya Tourism Board.

Other highlights in the Real Estate sector include:

i. The government commenced the construction of four link roads that will connect the Garissa Highway to the upcoming Thika Bypass. The roads are; Broadway-Athena Link Road, Engen to Kijango Junction Road, BAT-Kiganjo Link Road, and the Kivulini-Kiganjo Road. On completion, the Bypass will ease traffic on Garissa Road, Thika Town and its environs by offering additional routes into Thika Town. This will also open up areas such as Kiganjo, Kiang'ombe, Kiandutu and Athena in Kiambu County, Cytonn Weekly #7
ii. Crystal Rivers, a Kshs 4.2 bn mixed-use development, comprising of a mall as well as a gated community, by Safaricom Pension Scheme in Athi River, is set to open shop in June 2018. The mixed-use-development brings to the market 138 townhouses, 260 apartments as well as 200,000 SQFT of commercial space, Cytonn Weekly #7
iii. The Construction of the superhighway linking Jomo Kenyatta International Airport and Rironi, Limuru is set to cost Kshs 59.0bn, 55.3% higher than the forecasted Kshs 38.0bn. This was prompted by changes in design. The new design, according to Kenya National Highways Authority (KeNHA), will incorporate underpasses and flyovers Cytonn Weekly #8
iv. Parliament extended the period for consideration of land regulations for a further 90 days from 14th February. The regulations, published in November 2017, are set to facilitate the implementation of the new land laws which among other items delineates the mandates of the various parties, including the ministry of lands, the National Land Commission and the county governments

Our outlook for the sector is positive given the increased traction in the sector evidenced by the entry of new retailers such as South African retailer Shoprite, increased development activities across all themes and government initiatives such as the focus on affordable housing.

advice or solicitation of any nature. Readers are advised in all circumstances to seek the advice of a registered investment advisor.

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