Effect of the Election on the Real Estate Environment in Kenya, & Cytonn Weekly #7-2017

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Executive Summary

Fixed Income: During the week, T-bills were oversubscribed for the third week running, with overall subscription coming in at 182.5%, compared to 174.5% recorded the previous week. We are projecting inflation for the month of February to rise to the range of 7.9% - 8.2%, from 7.0% in January 2017, driven by increase in food prices triggered by the ongoing drought and the increase in fuel prices;

Equities: During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 losing 0.4%, 0.1% and 0.4%, respectively. I&M Bank Rwanda, the Rwandan subsidiary of I&M Holdings, has launched its public offer to sell a 19.6% stake in the bank, which is currently held by the Government of Rwanda;

Private Equity: Energy, health and technology sectors continue to witness increased private equity activity in Sub-Saharan Africa, with listed South African transport and logistics company, Imperial Holdings, set to acquire a 70.0% stake in Kenya's Surgipharm, a leading distributor of pharmaceutical and medical supplies. Bamba Group, a start-up company that offers cloud based data collection services, has raised USD 1.1 mn in its first round of seed funding from investors in less than a year for its expansion strategy;

Real Estate: The construction of the second phase of Upper Hill Road has commenced with Tosha Holdings Limited and Interways Works Ltd as the contractors. This is expected to be completed within 2 years;

Focus of the Week: In our 2017 outlook, we covered the various factors likely to influence the performance of the real estate sector in Kenya and the expected performance for each real estate sub-sector. See Cytonn Real Estate Annual Market Outlook 2017. This week we turn our focus on one of those factors that is expected to affect the performance of real estate sector in Kenya - the upcoming election and the election season, and the effect it could have on the real estate market;

Other Relevant Updates: In December 2016, Cabinet approved the Nairobi International Financial Centre Bill, which seeks to provide a framework to facilitate and support the development of an efficient and globally competitive financial services sector in Kenya. In this note, our legal team assess the benefits and feasibility of this initiative; See International Financial Centres;

Company Updates

- We continue to see very strong interest in our Private Wealth Management training, which is at no cost, and is held bi-weekly, but is open only to pre-screened participants. To register for the training kindly use this link: See training
- In a bid to continue showcasing the real estate developments by our real estate development affiliate, Cytonn Real Estate, we organize site visits every week. If interested in attending the site visits, kindly register here
- For recent news about the company, see our news section here
- We have 12 investment-ready projects, offering attractive development returns and buyer's targeted returns of around 25.0% p.a. See further details here: Summary of investment-ready projects
- To invest in any of our current or upcoming real estate projects, please visit Cytonn Real Estate. We continue to see very strong interest in our products:
    - The Alma, which is over 55.0% sold and has delivered an annualized return of 55.0% p.a. for investors who bought off-plan. See The Alma.
    - Amara Ridge is currently 100.0% sold. See Amara Ridge
    - The Ridge Phase One is currently 20.0% sold. See The Ridge

- Taraji Heights is currently 10.0% sold. See Taraji Heights
- Following the completion of sales for Amara Ridge, we are currently looking for land in Karen for our next development. Contact us at res@cytonn.com if you have any land for sale or joint ventures in Karen

- We continue to beef up the team with the ongoing hires: Careers at Cytonn

Fixed Income

During the week, T-bill auctions were oversubscribed for the third week running, with overall subscription coming in at 182.5%, compared to 174.5% recorded the previous week. Subscription rates for the 91, 182 and 364-day papers came in at 37.8%, 300.4% and 161.1% compared to 44.0%, 298.6% and 137.4% the previous week, respectively. The 91-day paper continues to witness undersubscription as investor preference is more skewed towards the 182 and 364-day papers, which continue to offer investors higher returns on a risk-adjusted basis. Yields on the 91, 182 and 364-day T-bills remained relatively unchanged during the week, closing at 8.6%, 10.5% and 10.9%, from 8.7%, 10.5% and 10.9%, respectively, the previous week. The Central Bank (CBK) has remained disciplined in stabilizing interest rates in the auction market by rejecting bids that CBK considers as above the market, and we have seen the market respond to this, with the current overall bids received acceptance rate of 90.7%, compared to 71.6% at the beginning of the year. Given the possible upward pressures on interest rates, we maintain our recommendation for investors to be biased towards short-term fixed income instruments.

The liquidity in the money market was relatively stable with a slight reduction in the overall liquidity position by Kshs 3.8 bn and this led to the average interbank rate remaining stable at 6.8%, whereas the volumes transacted decreased to Kshs 10.4 bn from Kshs 16.5 bn transacted the previous week. There was a decline in government payments and T-bill redemptions, which came in at Kshs 21.8 bn and Kshs 20.6 bn, from Kshs 59.7 bn and Kshs 23.7 bn, respectively, the previous week. There was also a decrease in Term Auction Deposit placements by commercial banks, which came in at Kshs 19.3 bn, from Kshs 40.2 bn the previous week.

Below is a summary of the money market activity during the week:

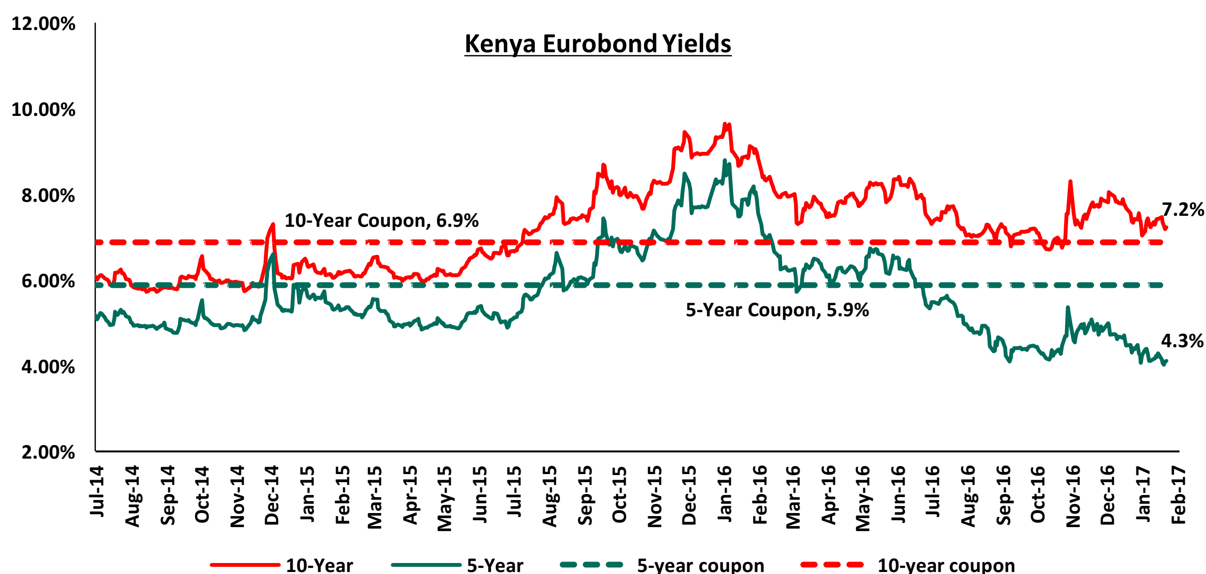
all values in Kshs bn, unless stated otherwise

Weekly Liquidity Position – Kenya			
Liquidity Injection		**Liquidity Reduction**	
Term Auction Deposit Maturities	19.7	T-bond sales	0.0
Government Payments	21.8	Transfer from Banks - Taxes	27.8
T-bond Redemptions	4.8	T-bill (Primary issues)	22.9
T-bill Redemption	20.6	Term Auction Deposit	19.3
T-bonds Interest	1.2	Reverse Repo Maturities	7.1
Reverse Repo Purchases	4.2	Repos	12.8
Repos Maturities	13.8	T-Bills/T-Bonds Tap Sale	0.0
Total Liquidity Injection	**86.1**	**Total Liquidity Withdrawal**	**89.9**
		Net Liquidity Injection	**(3.8)**

The Kenyan government is seeking to issue a 12-year amortized Infrastructure Bond (IFB 1/2017/12) with an effective tenor of 8.8 years, and a coupon of 12.5%, in a bid to raise Kshs 30.0 bn for partial support of infrastructural projects in the roads, energy and water sectors. Given that (i) the government has only borrowed Kshs 45.8 bn from the foreign market against its foreign borrowing target of Kshs 462.3 bn, and (ii) the Kenya Revenue Authority (KRA) has already missed its first half of 2016/17 fiscal year revenue collection target by 10.6%, and therefore expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year, we expect these to result into an upward pressure on interest rates and investors are likely to demand premium in this auction. The bond has a weighted tenor of 8.8 years after

adjusting for partial redemptions, and a similar taxable bond with the same tenor is currently trading at a yield of 13.7% in the secondary market. We therefore recommend investors to bid at a yield of between 13.50% and 14.25%.

According to Bloomberg, the yield on the 5-year and 10-year Eurobonds increased by 20 bps and 10 bps w/w to 4.3% and 7.2%, from 4.1% and 7.1%, respectively, the previous week. Since the mid-January 2016 peak, yields on the Kenya Eurobonds have declined by 4.5% points and 2.4% points, respectively, for the 5-year and 10-year bond due to improving macroeconomic conditions. This is an indication that Kenya remains an attractive investment destination.



The Kenya Shilling remained relatively firm this week, closing the week at Kshs 103.6 on account of reduced dollar demand from oil importers. On a year to date basis, the shilling has depreciated against the dollar by 1.1%. In recent months, we have seen the forex reserves reduce to USD 6.9 bn (equivalent to 4.6 months of import cover), from USD 7.8 bn in October 2016 (equivalent to 5.2 months of import cover). The level of forex reserves has now stabilised, an indication of the confidence of the Central Bank with the current levels of the shilling.

The rate of inflation is expected to be on the rise this year, driven by (i) high food prices due to the ongoing drought, which according to the Meteorological Department (KMD) department will persist, as it projects below average rainfall in the March-May season, and (ii) high fuel prices following the revisions by the Energy Regulatory Commission (ERC) this week, which saw the prices of diesel, petrol and kerosene increase by 6.0%, 4.4% and 5.9% to Kshs 89.3, Kshs 100.3 and Kshs 67.2 per litre, from Kshs 84.2,Kshs 96.0 and Kshs 64.3 in January 2017, respectively. The upward movement of fuel prices was attributed to (i) the depreciation of the Kenya Shilling, following the global strengthening of the dollar, and (ii) the recovery of global oil prices, which saw the prices of crude oil in the global market increase by 20.0% in the period between November 2016 and January 2017. We are projecting inflation for the month of February to rise to the range of 7.9% - 8.2%, from 7.0% in January 2017.

The National Treasury has released estimates for the 2017/18 budget which continues to grow. The growth is however slower compared to the previous increases over the last five years as they project a 2.4% growth, compared to 52.9% over the last 5 years, translating to a compounded annual growth of 11.2%.

- Total expenditure is expected to rise by 2.4% to Kshs 2.3 tn, up from Kshs 2.2 tn in the 2016/2017 budget,
- Development expenditure is projected to drop by 12.2% to Kshs 640.8 bn, down from Kshs 729.8 bn in the 2016/2017 budget, with most of the outlay expected to support critical infrastructure,

- The total revenue collection is expected to rise by 12.5% to Kshs 1.7 tn, from Kshs 1.5 tn projected in the 2016/2017 budget, with the government citing ongoing reforms in tax policy and revenue administration as the factors that are expected to support the revenue collection growth
- Income tax revenue (PAYE) is projected to rise by 16.5% to Kshs 400.5 bn, up from Kshs 343.7 bn in the 2016/2017 budget as the government is looking to complete the review of the income tax law, with the reforms intended to enhance compliance with the tax system and ensure stability in tax revenue flows,

all values in Kshs mn, unless stated otherwise

2016/17 Budget Projections against 2017/18 Budget Estimates				
Expenditure	**2015/16 Estimates**	**2016/17 Estimates**	**2017/18 Budget**	**Change (2016/17 vs 2017/18)**
Recurrent	1,015.0	1,212.7	1,345.9	11.0%
Development	717.6	729.8	640.8	(12.2%)
Other	265.9	289.8	300.3	3.6%
Total Expenditure	**1,998.5**	**2,232.3**	**2,287.0**	**2.4%**
Ordinary Revenue	1,254.9	1,371.5	1,549.4	13.0%
Ministerial AIA	103.2	143.9	155.1	7.8%
Total Revenue	**1,358.0**	**1,515.5**	**1,704.5**	**12.5%**
Grants	73.5	51.5	58.8	14.3%
Deficit	**566.9**	**665.4**	**523.7**	**(21.3%)**
Foreign Borrowing	349.5	382.7	206.0	(46.2%)
Domestic Borrowing	219.2	280.1	328.9	17.4%
Domestic Financing	(1.8)	2.6	(11.2)	(525.7%)
Total Financing	**566.9**	**665.4**	**523.7**	

From the 2017/2018 budget projections, the expected 16.5% rise in income tax revenue seems ambitious, considering the number of lay-offs experienced in the banking, manufacturing, media industry & telecom sectors over the past year, coupled with slowing private sector credit growth, which slowed to 4.3% in December 2016. While the expansionary fiscal policy is primed to see increased developments in the country with the realization of key infrastructural projects, the heightened domestic borrowing target, coupled with expected subdued revenue collection, is likely to put interest rates under pressure, impacting economic growth adversely.

According to data from the National Treasury, Kenya's foreign debt repayment came in at Kshs 15.5 bn for the quarter ending September 2016, with China accounting for approximately 42.0% of the repayments, coming in at Kshs 6.4 bn, comprising a principal amount of Kshs 1.1 bn and interest payments worth Kshs 5.3 bn. The country also repaid Kshs 4.8 bn to the International Development Association (IDA), an arm of the World Bank that offers concessional funds to low-income and post-conflict countries, with the repayment of Kshs 1.1 bn and Kshs 1.0 bn being made to France and Japan, respectively. Last year the World Bank warned Kenya over the rising appetite for Chinese debt, which grew by 54.0% annually between 2010 and 2014, arguing that the huge repayment burden is unsustainable and risks crippling the economy. This is especially due to the fact that these loans are characterised by a lack of transparency, given China does not tie conditions based on key governance reforms to loans. Further, some of the loans issued are non-concessional and expensively priced. Despite this, the debt sustainability update in March 2016 indicated that Kenya faces low risk to external debt distress as we also highlighted in our Cytonn Weekly #49. However, going forward, there are risks associated with the changing funding patterns that could see the debt levels continue to rise, and are already above the 50.0% threshold set by International Monetary Fund (IMF) for frontier markets, currently at 54.9% of GDP as per the Annual Public Debt Management Report for the year ended June 2016.

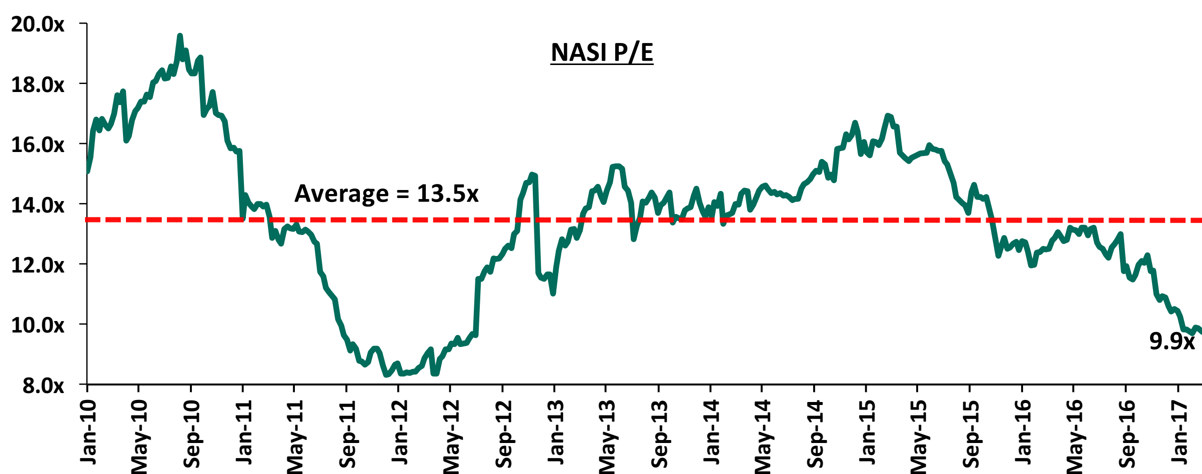
The Government is ahead of its domestic borrowing for this fiscal year having borrowed Kshs 168.2 bn for the current fiscal year against a target of Kshs 150.1 bn (assuming a pro-rated borrowing throughout the financial year of Kshs 229.6 bn budgeted for the full financial year). It is important to note, however, that the government is in the process of revising its domestic borrowing target upwards to Kshs 294.6 bn, which will take the pro-rated borrowing target to Kshs 192.6 bn, implying that the government will fall behind its borrowing target. The government has only borrowed Kshs 45.8 bn from the foreign market, representing 9.9% of its foreign borrowing target of Kshs 462.3 bn, and given Kenya Revenue Authority (KRA) has already missed its first half of 2016/17 fiscal year revenue collection target by 10.6%, and it is expected to miss its overall revenue collection target of Kshs 1.5 tn for the current fiscal year. This creates uncertainty in the interest rate environment as the government might have to plug in the deficit by borrowing from the domestic market, a move that may exert upward pressure on interest rates, and result in longer term papers no longer offering investors the best returns on a risk-adjusted basis. It is due to this that we think it is prudent for investors to be biased towards short-term fixed income instruments.

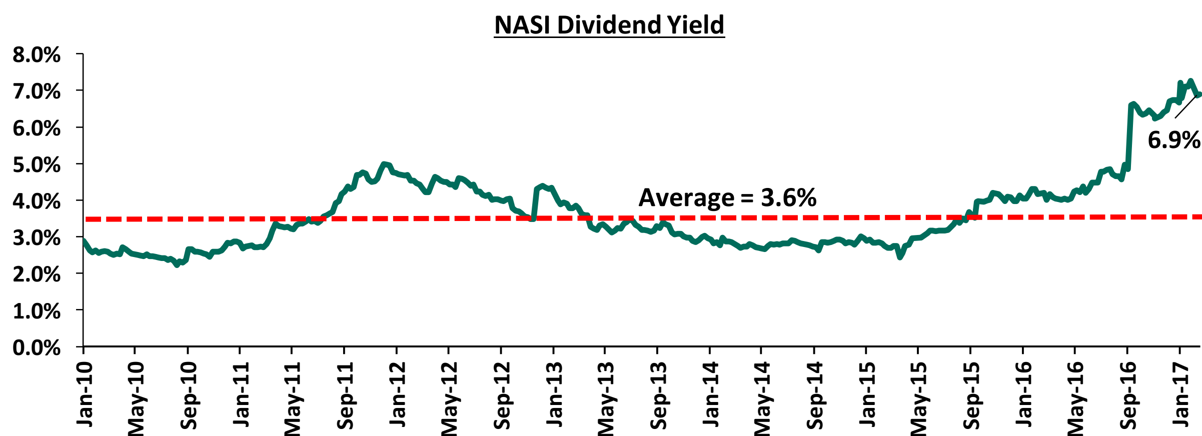
Equities

During the week, the equities market was on a downward trend, ending 2 straight weeks of gains, with NASI, NSE 20 and NSE 25 losing 0.4%, 0.1% and 0.4%, respectively, taking their YTD performances to (6.3%), (7.5%) and (8.0%), respectively. The decline was as a result of losses by select large cap stock in the banking sector such as KCB Group, Co-operative and Barclays Bank, which lost 3.9%, 3.6% and 5.1%, respectively. Since the February 2015 peak, the market has lost 46.4% and 29.6% for NSE 20 and NASI, respectively.

Equities turnover declined by 33.7% to close the week at USD 26.7 mn, from USD 40.4 mn the previous week due to reduced activity across banking sector stocks and Safaricom. Foreign investors remained net buyers with net inflows of USD 1.0 mn, a decline of 63.7% compared to a net inflow of USD 2.7 mn recorded the previous week, with foreign investor participation increasing to 81.0%, from 61.8% recorded the previous week. Safaricom remained the top mover for the week, accounting for 51.0% of market activity. We expect the Kenyan equities market to be flat in 2017, driven by slower growth in corporate earnings, neutral investor sentiment on the coming general elections and the aggressive rate hike cycle in the US.

The market is currently trading at a price to earnings ratio of 9.9x, versus a historical average of 13.5x, with a dividend yield of 6.9% versus a historical average of 3.6%. The current 9.9x valuation is only 19.3% above the most recent trough valuation of 8.3x experienced in December of 2011. The charts below indicate the historical P/E and dividend yields of the market.





I&M Bank Rwanda, the Rwandan subsidiary of I&M Holdings, has launched its public offer to sell, a 19.6% stake in the bank, which is currently held by the Government of Rwanda. The details of the offer are as follows;

- The government targets to raise Kshs 1.1 bn from its 99.0 mn shares on offer, at a price of Kshs 11.2 per share. The offer is set to run from February 14 to March 3, with proceeds to be used in funding construction of the new Bugesera International Airport
- The offer is priced at 1.6x book value, a premium of 0.6% against Bank of Kigali, Rwanda's only listed bank,
- Participants in the offer will however be locked out of the bank's dividend pay-out for the FY'2016, which is only limited to the shareholders prior the public offer

The Rwandan banking sector has in the recent past attracted both regional and foreign players supported by (i) robust economic growth, (ii) favourable regulatory environment, and (iii) the sector is also unsaturated compared to other regional countries. Being the first public offer in the East African region this year, we expect vibrant investor participation, also supported by heightened regulatory risk in the Kenyan banking sector, which has experienced exits by mainly foreign investors following the implementation of the law capping interest rates. The issue is expected to (i) induce activity in the Rwanda bourse, which is under-developed compared to other regional bourses with only 7 listed companies, 4 of which are cross-listed regionally, and the main Rwanda All Share Index that has remained relatively flat since the beginning of the year due to this low activity on the bourse, (ii) deepen the Rwandan capital markets as it offers both local and foreign investors a platform to contribute to the long term growth of the private sector, and (iii) boost investor confidence especially in the financial services sector, following the increase in publicly owned financial services institutions. We however do not recommend participation in the offer given:

a. The offer is priced at 1.6x book value, a premium of 0.6% against Bank of Kigali, Rwanda's only listed bank, which is trading at 1.5x book value, and 84.9% premium to Kenyan banks, which are trading at 0.8x book value; we don't see value unless buying for other reasons other than return upside, and
b. The supporting fundamentals do not give the bank any edge over Kenyan banks since, (i) private sector credit growth in Rwanda slowed down to 5.0% in 2016, just 70 bps above Kenya's 4.3% registered in December 2016, (ii) the bank's cost to income ratio of 58.0% is above Bank of Kigali's and Kenyan banks' average of 44.0% and 48.6%, respectively, and is expected to remain at current levels in the medium term as the bank plans to undertake upgrading of its core banking system and construction of bank headquarters, (iii) the bank's Non-Funded Income as a proportion to total income has been declining to 35.0% as at Q3'2016 from 53.0% in December 2011, showing over-reliance on interest income

and undiversified revenue streams, and (iv) I&M Rwanda's Net Interest Margin of 9.0% is also below Bank of Kigali's and Kenyan Bank's average of 11.0% and 9.4%, respectively.

As indicated in our Cytonn Weekly #6/2017, banks are increasingly adopting cost rationalization measures such as laying off staff and closing branches to remain profitable during this interest rate cap era, with 10 banks having announced downsizing plans thus far.

Kenya Banking Sector Restructuring			
No.	Bank	Staff Retrenchment	Branches Closed
1.	Sidian Bank	108	-
2.	Equity Group	400	-
3.	Ecobank	-	9
4.	Family Bank	Unspecified	-
5.	First Community	106	-
6.	Bank of Africa	-	12
7.	National Bank	Unspecified	-
8.	NIC	32	-
9.	Standard Chartered	300	-
10.	KCB Group (Rwanda)	28	-

The (i) ongoing layoffs and branch closings, (ii) reduced access to credit as illustrated by credit growth falling to 4.3% in December 2016 from 18.0% a year ago – a decline that will reduce economic activity and hence declining GDP growth, and (iii) the reduced tax revenue from the sector point to a compelling case to review the rate cap legislation. Other than scoring political points, it has demonstrably been damaging to the economy, in line with our Cytonn Weekly Report #34 in which we argued against the enactment.

The Central Bank of Kenya (CBK) has approved for 12 banks to operate PesaLink, a mobile banking platform to facilitate real-time transfer of money between banks without going through mobile money transfer platforms such as M-Pesa. Amongst the 12 banks are 5 listed namely, Standard Chartered, Co-operative, Barclays, DTB and I&M bank. Customers will be able to make real-time transfers of a minimum of Kshs 10.0 and a maximum of Kshs 999,999.0, with varying fees charged per transaction amount. Even as banks increasingly adopt digital channels, the CBK has cautioned the lenders to be wary of cyber risks in mobile money, with the consulting firm Deloitte is projecting that the cost of cybercrime could rise by as much as 30.0% this year from Kshs 18.0 bn recorded last year, as criminals take advantage of increased internet connectivity.

Below is our equities recommendation table. Key changes from our previous recommendation are:

- I&M Holdings moved to an "Accumulate" recommendation, with an upside of 18.0% from a "Buy" recommendation with an upside of 25.6%, following a 6.7% w/w price increase
- NIC Bank moved to an "Accumulate" recommendation, with an upside of 17.6% from a "Buy" recommendation with an upside of 48.4%, following a 27.1% w/w price increase
- Barclays Bank moved to a "Lighten" recommendation with an upside of 1.3% from a "Sell" recommendation with a downside of 3.4%, following a 5.1% price decline

all prices in Kshs unless stated

EQUITY RECOMMENDATION									
No.	Company	Price as at 10/02/17	Price as at 17/02/17	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**	Recommendation
1.	KCB Group***	25.5	24.5	(3.9%)	(14.8%)	39.6	7.5%	69.1%	Buy
2.	Bamburi Cement	148.0	148.0	0.0%	(7.5%)	231.7	7.8%	64.4%	Buy
3.	ARM	19.4	20.0	3.1%	(21.6%)	31.2	0.0%	56.0%	Buy
4.	Kenya Re	20.0	19.5	(2.8%)	(13.6%)	26.9	3.6%	41.9%	Buy

5.	HF Group	10.7	10.8	0.9%	(23.2%)	13.8	9.2%	37.6%	Buy
6.	Stanbic Holdings	65.0	65.5	0.8%	(7.1%)	84.7	7.9%	37.2%	Buy
7.	Britam	10.0	10.3	2.5%	2.5%	13.5	2.9%	34.6%	Buy
8.	Equity Group	27.0	27.3	0.9%	(9.2%)	31.3	7.7%	22.6%	Buy
9.	Liberty	12.2	11.5	(5.3%)	(12.9%)	13.9	0.0%	20.9%	Buy
10.	Co-op Bank	12.5	12.1	(3.6%)	(8.7%)	13.6	6.8%	19.7%	Accumulate
11.	I&M Holdings	74.5	79.5	6.7%	(11.7%)	90.7	3.9%	18.0%	Accumulate
12.	NIC	21.3	27.0	27.1%	3.8%	30.8	3.5%	17.6%	Accumulate
13.	BAT (K)	906.0	905.0	(0.1%)	(0.4%)	970.8	6.2%	13.5%	Accumulate
14.	DTBK***	107.0	107.0	0.0%	(9.3%)	116.8	1.8%	11.0%	Accumulate
15.	Barclays	8.8	8.3	(5.1%)	(8.8%)	7.6	9.7%	1.3%	Lighten
16.	Jubilee	480.0	490.0	2.1%	0.0%	482.2	1.8%	0.2%	Lighten
17.	Safaricom	18.5	18.1	(2.4%)	(5.7%)	16.6	3.6%	(4.4%)	Sell
18.	SCBK***	175.0	189.0	8.0%	0.0%	157.7	6.6%	(10.0%)	Sell
19.	NBK	6.3	6.1	(4.0%)	(16.0%)	3.8	0.0%	(37.2%)	Sell

**Target Price as per Cytonn Analyst estimates*

***Upside / (Downside) is adjusted for Dividend Yield*

****Indicates companies in which Cytonn holds shares in*

Accumulate – Buying should be restrained and timed to happen when there are momentary dips in stock prices.

Lighten – Investor to consider selling, timed to happen when there are price rallies

We remain "neutral with a bias to positive" for investors with short to medium-term investments horizon and are "positive" for investors with long-term investments horizon.

Private Equity

Listed South African transport and logistics company, Imperial Holdings, is set to acquire a 70.0% stake in Kenya's Surgipharm, in a deal valued at USD 35.0 mn, effectively valuing the company at USD 50.0 mn. Surgipharm, a leading distributor of pharmaceutical and medical supplies in Kenya, has an annual turnover of approximately USD 70.0 mn implying the transaction will be carried out at a 0.7x Price-to-Sales multiple. The acquisition of Surgipharm is strategic for Imperial Holdings as it aligns with its future plan of being a significant route-to-market partner of multi-national companies in the consumer goods and pharmaceutical sectors in South, East and West Africa. Imperial's prior acquisitions include Imperial Health Sciences, Eco Health, a Nigerian pharmaceutical distributor and Imres, a Netherlands-based pharmaceutical wholesaler. There has been a notable increase in the number of investment activities in the health sector with LeapFrog acquiring an undisclosed stake in Goodlife pharmacy in a deal worth USD 20.0 mn in November 2016. The health sector will witness more deals in future due to i) growing middle class hence increased demand in quality health care, ii) failure of our public healthcare system, and iii) improved infrastructure development especially roads which have increased access to healthcare facilities.

ARM-Harith infrastructure fund (ARMHIF) through its fund manager, ARM-Harith Infrastructure investment limited, has invested an undisclosed amount in Amandi IPP in Ghana. This is the only large scale independent power generating project in Sub-Saharan Africa that came to its financial close in 2016. The Company has commenced the construction of the USD 552.0 mn Amandi power plant in Aoadze Ghana with a capacity of 200 Megawatt. The Project, which has a debt to equity ratio of 311.9% is financed with USD 134.0 mn equity from sponsor group, which includes Endeavor Energy, AFG, Aldwych, Pan African Infrastructure Development Fund 2 managed by Harith General Partners (PAIDF2), and ARM-Harith Infrastructure Fund (ARMHIF). The USD 418.0 mn in debt financing is provided by a group of lenders, including the US Government's development finance institution, Overseas Private Investment Corporation (OPIC), which will provide a USD 250.0 mn loan, as well as CDC Group, which will provide a USD 83.0 mn loan, Nedbank and Rand Merchant Bank. The financial close of the Amandi Project represents a critical moment in addressing Africa's growing demand for reliable power infrastructure and the persistent lack of properly packaged, bankable projects in the energy space in Sub-Saharan Africa.

On the fund-raising front, Bamba Group has raised USD 1.1 mn in its first round of seed funding from investors in less than a year for its expansion strategy. In November 2016 Bamba group received USD 0.24 mn worth of investment from Darshan Chandaria, CEO and Director of Chandaria industries Group after pitching their business model at Lion's Den, a TV investment Forum sponsored by NTV Kenya and KCB Group. It also received support from a US based firm, Techstars. This offered Bamba group co-founders (Al Ismaili, Faiz Hirani and Shehzad Tejani) a 13-week training and access to Techstar's network of founders, alumni and mentors. Bamba Group founded in 2015, has been providing SMS based solutions and data collection software to companies and organizations in different sectors in any country's economy. Their clientele includes organizations involved in market research consulting, private equity, agriculture, education, health finance government agencies, NGOs and private companies. The demand for technology-based research is a key indicator on how technology is playing a critical role in the research and development that enhances efficiency in organizational operations.

Private equity investments in Africa remains robust as evidenced by the increased deals and deal volumes in the region key note sectors; financial services, energy and technology. Given (i) the high number of global investors looking to cash in on the growing middle class of Africa, (ii) the attractive valuations in private markets compared to global markets, (iii) better economic projections in Sub Sahara Africa compared to global markets, and (iv) the high number of exits that is evidence of the attractiveness of the region, we remain bullish on PE as an asset class in Sub-Sahara Africa.

Real Estate

The construction of the second phase of Upper Hill Road has commenced with Tosha Holdings Limited and Interways Works Ltd set to conclude construction within 2 years ending December 2018. The project will cost approximately Kshs 3.5 bn for the upgrade of several roads in Upper Hill such as roads linking Upperhill to Mbagathi way from Matumbato road, Masaba road, Chyulu road among others, with an aim to improve and create links in and out Upper Hill hence ease congestion in the area. Upper Hill, being one of the key commercial nodes, is characterised with various multi-nationals and businesses such as hotels and commercial banks, and the area is rapidly growing and attracting businesses as they relocate from the Nairobi Central Business District (CBD). This project will thus have a positive impact through easing congestion in Upper Hill hence leading to:

- Increased office uptake, that is currently at 90%, compared 93% and 92% for Kilimani and Westlands office nodes respectively, attributed to the traffic congestion that is changing Upper Hill into a public service vehicles transit route
- Boost economic growth and attract investors into the area due to improved infrastructure and to tap into attractive rental yields averaging 9.3% for Grade A offices as compared to other office nodes characterized by high traffic such as Nairobi CBD and Mombasa road at 9.0% and 8.9% respectively

The performance of Upper Hill node is further evidenced by its performance in comparison to other areas in terms of rent, price and yields as shown below.

Summary of Commercial Office Performance in Nairobi by Nodes (2016)				
Area	Rent Per Sqft "Kshs"	Price Per Sqft "Kshs"	Occupancy (%)	Rental Yields (%)
Gigiri	150	14,000	90%	12.90%
Thika Road	104	13,771	80%	11.30%
Parklands	109	12,500	80%	10.40%
Karen	125	15,063	88%	10.30%
Kilimani	107	13,676	93%	9.50%
Westlands	104	13,216	92%	9.50%

Upperhill	113	14,747	90%	9.30%
Nairobi CBD	92	11,750	93%	9.00%
Mombasa Rd	83	11,098	86%	8.90%
Average	**110**	**13,313**	**88%**	**10.10%**
• *Gigiri is the best performing submarket due to prime location and high quality office space and are hence able to charge a premium above market*				

Source: Cytonn Research

We are of the view that this initiative along with the on-going expansion of Ngong Road will improve and sustain real estate development in the commercial hub since traffic has negatively affected real estate performance in Upper Hill.

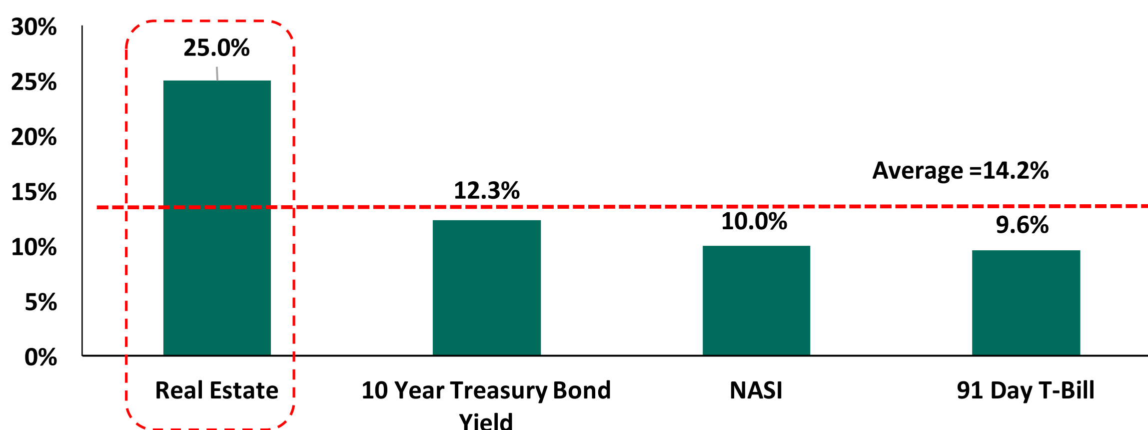
According to the World Bank report, Africa's Cities: Opening Doors to the World, African cities face three main constraints to urban development and these create daily challenges for residents. These are;

- **Crowded cities that are not growing economically** - Mainly investments in infrastructure, industrial, commercial structures and affordable formal housing are growing at a slower rate compared to the urbanization rate of 4.0% annually
- **Disconnected cities** — Most cities have developed as collections of small and fragmented neighborhoods, lacking reliable transportation, limiting job opportunities and preventing firms from enjoying economies of scale
- **Costly for households and firms** — High nominal wages and transaction costs that deter investors and trading partners, especially regionally and at internationally level

In the report, the disaster risk profiles developed for four African Cities i.e. Dar es Salaam, Nairobi, Addis Ababa and Kigali, putting into consideration the economic value of building stock and its distribution across the city at 1 Square Kilometre area, Nairobi real estate ranked second at $9 billion after Tanzanian capital Dar es Salaam's at $12 billion, while Addis Ababa ranked third at $6 billion, and Kigali fourth at $2 billion. However, Nairobi has the highest replacement value for its built-up area ahead of Dar es Salaam, Addis Ababa and Kigali. More so, growth remains steady in Nairobi, making the Kenyan capital more lucrative in terms of return on investment as compared to Dar es Salaam where rent have been steadily declining. The report further highlighted the African cities Urbanization rate at 4.0%, being driven by the rural – urban migration with people seeking better living standards. This therefore necessities improving the living standards by formalizing land markets, instituting effective urban planning and making coordinated infrastructure investments.

According to Knight Frank Wealth Report, Kenya is witnessing a property market boom, which is supported by developments such as master planned communities that are being ranked as a commercial hub. The initiatives continue to support real estate return in the country, since real estate has remained the best performing asset class compared to traditional asset classes over the last five years, as shown by the graph below:

<u>Returns from Various Asset Classes over the last 5 Years</u>



Source: Cytonn Investments

Other highlights in the real estate sector this week include;

1. The opening of Two Rivers Mall along Limuru Road, increasing Nairobi's retail space supply by approximately 700,000 sqft. The mall whose location is in close proximity to affluent neighborhoods of Runda, Nyari and Gigiri will host more than 150 local and international brands,
2. E-Farm Housing Co-operative Society has deepened its investment portfolio with the acquisition of 300 acres of land in Embu as part of its growth and diversification plan targeting investors who want to invest in agribusiness,
3. Deyaar, one of United Arab Emirates (UAE's) largest property development companies, has announced its one-day fair in Nairobi on February 25th where buyers can place orders for apartments on the firm's upcoming Atria project. This is a move in support its strategy of diversifying all over the world,
4. Kenyatta University Don Paul Gachanja, reported that US fund, Africa Integra, is set to start building Kenyatta University hostels from mid-year in a bid to curb the accommodation shortage. The US fund won the tender to lead the public private partnership (PPP) investment in 2014. We remain skeptical about the deliverability of this project as the Integra Fund has no track record of delivering such kind of projects, the source of funds to finance the project remains unclear and also the exit strategy,
5. The High Court has stopped the Kenya Revenue Authority (KRA, or its agents, servants, or employees from implementing laws that will see capital gains tax paid before transactions are completed following a lawsuit by the Law Society of Kenya (LSK). For more information on this, see our legal teams' analysis on the same. Capital Gains Tax Note

The real estate sector remains vibrant driven by sustained demand for housing, increased financing from the financiers, and infrastructural development that will spur economic growth.

Effect of the Election on the Real Estate Environment in Kenya

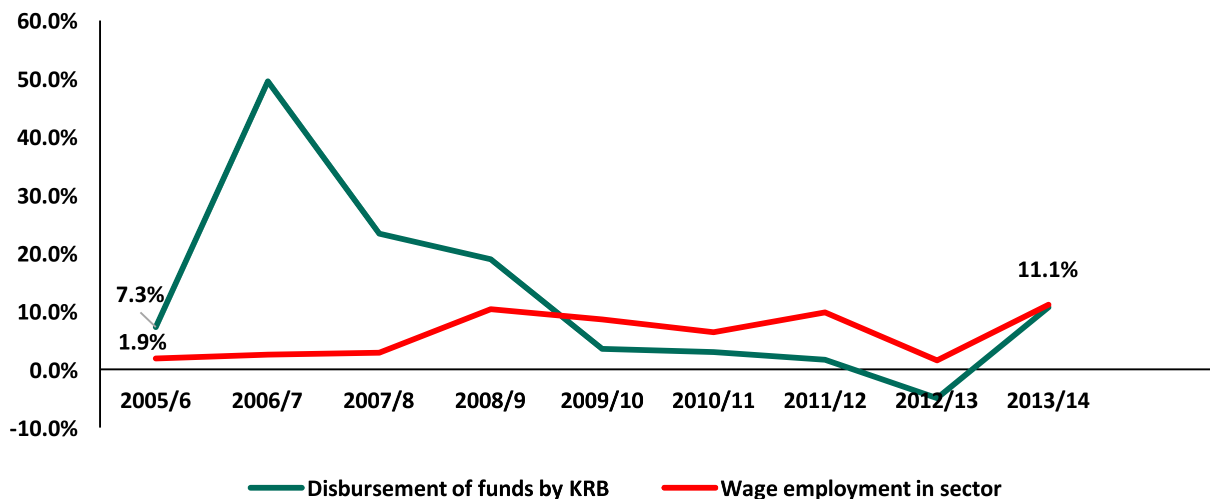
In our 2017 outlook, we covered the various factors likely to influence the performance of the real estate sector in Kenya and the expected performance for each theme. We also stated that we have a positive outlook for real estate in Kenya in 2017 driven by demographics, high demand for real estate products especially housing units and increased infrastructural development. The above factors will benefit developers who invest in research and matched the right products to the right markets. See Cytonn Real Estate Annual Market Outlook 2017

This week we turn our focus to the upcoming general election and the election season and the effect it could have on the performance of real estate sector in Kenya. We start by analysing key activities that will

characterize the election season that is, (i) Infrastructural development, (ii) Increased expenditure in the economy, (iii) Enforcement and passing of new regulations, (iv) Constrained performance of other asset classes, and (v) Political uncertainty. We then correlate the above events to the real estate investment climate stating whether we expect each factor to influence the real estate market positively or negatively. We conclude by giving our expectations of the effect the 2017 elections will have on real estate market in Kenya and recommendations for investors to consider.

1. Infrastructural Development

The election period is characterised by increased construction activity due to rolling out of several CDF (Constituency Development Fund) and infrastructural projects as incumbent leaders seek re-election by selling a track record to endear themselves to the electorate. In 2007, for example, the funds allocated by the Kenya Roads Board increased by 49.5% compared to 7.3% in 2006 while wage employment in the building and construction sector increased by 2.5% in 2007 compared to 1.9% increase in 2006. These funds are allocated to construction and rehabilitation of roads, bridges, electricity, water and sewer connection. This has a **positive** effect on the real estate sector in the mid to long-term.



Source: Kenya National Bureau of Statistics

2. Increased expenditure in the economy

In election periods, typically, we have witnessed an increase in expenditure as a result of increased in money supply. This is due to increased spending on social projects and campaigning by election aspirants. In 2007, Broad Money Supply increased by 20.4% compared to a 16.6% increase in the previous year, while in year ending 2012, money supply increased by 17.2% compared to a 14.1% increase in the year ending 2011. In our opinion, increased liquidity is a recipe for increased investment in the real estate sector and hence leads to an increase in property values. This has a **positive** effect on the real estate sector.

3. Implementation of favorable policies

The incumbent government is likely to enforce populist regulations that will have a positive impact on economic development. Currently, the country has a huge housing deficit approximated at about 2,000,000 units and it continues to grow close to 200,000 units annually. This is mainly caused by high development

costs, and the fact that most development is done by the private sector who are mainly profit-oriented. The government has already enforced various policies to boost real estate development including (i) scrapping of NEMA and NCA fees, (ii) Tax incentives for mass development, and (iii) Issuance of title deed to streamline land ownership. This will result in lower costs for development and possibly make housing affordable. This will have a **positive** effect on the real estate sector.

4. Political Uncertainty

Investors have a tendency to take a wait and see approach during the election period. This may be attributed to the uncertainty of the transitioning to a new government as well as the possibility of political instability and violence following disputed elections. This is likely to have the following effects;

i. Low credit advancement- According to KNBS, there was a 4.5% growth in the value of bank loans advanced to the building and construction sector in 2007, compared to a 41% growth in the preceding period. In 2013, credit advancement grew by 2.3% compared to a 36.2% growth in 2012. This can be attributed to low credit demand from home-buyers as well as reduced willingness of financial institutions to issue credit as they wait to see the outcome of the elections. While few home-buyers rely on mortgages and bank loans, low credit generally has a **negative** effect on real estate development and uptake
ii. Slow real estate activity- In 2007, the contribution of real estate to the country's GDP declined marginally by 0.05% from 6.178% to 6.175%, while in 2012, the same declined by 1.6% from 6.2% contribution to GDP in 2011 highlighting reduced real estate activity during that period. This could be attributed to slower uptake due to market uncertainty. According to Hass Consult, the housing market generally experienced a slow down during Q1 2013 as purchasers held off from concluding house moves with townhouses and apartments recording a 1.5% and 0.2% fall in prices, respectively during that period. Asking rents only increased by 1.9% from Q4/2012 compared to 4.4% increased recorded the previous quarter. A slow-down in real estate uptake in 2017 will have a **negative** effect on the performance of the sector.

5. Constrained performance of other asset classes

In 2016, the equities market recorded poor performance with NASI losing 8.5% as a result of decline in large cap stocks. In addition, NASI has lost 5.8% YTD. In our view, the market is likely to remain flat or decline in 2017 as highlighted in our Cytonn Weekly #3/2017. Real estate will thus be positioned as (i) a safe and stable haven for investors through stable yields and prospects of long-term capital appreciation and (ii) a hedge against interest rate and inflation risk. This will have a **positive** effect on real estate.

Table showing list of activities and the effect they will have on the real estate investment market in 2017:

Activity	2017 Projections	Outcome
Increased expenditure in the economy	• Increased money supply • Increased spending on social projects • Increased inflation which may result in higher construction costs	Neutral
Infrastructure development	• Increased infrastructural development • Increased allocation of funds for development and rehabilitation of access ways • Launching of projects eg the SGR railway	Positive
Implementation of favourable policies for development	• Enforcement of regulations by incumbent government • Issuing of favourable regulations or relaxation of guidelines by county governments to enable development • Issuance of title-deeds	Positive
Uncertainty	• Low credit advancement and uptake • Slow real estate uptake due to wary home-buyers and investors	Negative
Performance of other asset classes	• Poor performance of stocks • Investment in real estate and other alternative investments	Positive

In our view, the real estate market will remain largely stable in 2017. There is likely to be a slowdown in transaction volumes being witnessed in the 2nd and 3rd quarter just at the run up to the election date. On the other hand, developers are likely to rush to get approvals for developments ahead of elections to avoid possible delays and inconveniences that may result during the transition period, should a new government win the election. In 2007, for example, the value of building approvals in Nairobi alone increased by 182.7% to Ksh 59.7 Bn from 21.1 Bn in 2006, while in 2012, the value increased to Kshs 135.0 Bn, a 19.7% growth from Kshs 112.0 Bn, compared to the 17.4% growth in the previous period.

Therefore, if calm elections are held we are likely to not only witness increased investment and rolling out of projects but also increased prices, selling and marketing of real estate as the economy stabilises, after the elections. It is hence the right time to invest for a discerning investor both for the long run and short run as the market tries to adjust to the electioneering period for gains immediately after and in the longer run for capital appreciation.