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Real Estate

Kenya: Trends & Developments

Dentons Hamilton Harrison & Mathews

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Trends and Developments

Contributed by Dentons Hamilton Harrison & Mathews

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The real estate sector in Kenya has experienced a steady growth over the past two decades, driven by a number of factors, among them infrastructure development, stable GDP growth, and demographic trends such as rapid urbanisation and high returns as compared to traditional asset classes.

In 2017, the market was constrained by the tough operating environment that affected all sectors of the economy. This was fuelled by low credit as banks shied away from providing credit to investors as a result of the cap on the interest rates under the Banking (Amendment) Act 2016.

The amendments stipulated that a bank or a financial institution shall set the maximum interest rate chargeable for a credit facility in Kenya at no more than 4%, the base rate set and published by the Central Bank of Kenya. The law also prohibits any person from entering into an agreement or arrangement to borrow or lend directly or indirectly at an interest rate in excess of that prescribed by law.

The intent of the law was to make credit more available to low and middle income earners. However, this was not achieved, as banks became more cautious on lending, requiring stringent measures such as excellent credit standing before lending.

Furthermore, a prolonged electioneering period, which included a repeat presidential election after the Country's Supreme Court nullified the election of the president, also resulted in a dip in the economy and a marked decline in purchasing power.

The sector improved in 2018 and recovered, although it continues to be constrained by the low credit supply and oversupply leading to decreased rental yields in some sectors.

In every market, there are trends and developments in each sector that form the basis of any investor seeking entry into such market – for example, people seeking to buy homes identifying the developments that they should purchase. Kenya is no exception in this respect.

The real estate sector has for many years experienced a positive bubble in Kenya, meaning that investors have reaped very good returns.

At one point in time, analysts were looking out for the bubble to burst, which did not seem to happen. Even in 2017 when the country's economy took a dip – with sales in real estate being slow, especially with commercial offices – it did not reach a level where developers felt that they would be making a loss. It was understood that it was only a matter of time before the economy picked up.

Industrial Parks

This segment has experienced a movement away from traditional warehouse and industrial centres towards modern industrial parks set up away from traditional industrial areas. Some of these new centres are mixed-use, in keeping with the live-work-and-play concept.

Most of the warehouses and industrial areas in Nairobi, for instance, were concentrated in the industrial area of Nairobi County. Nairobi industrial area companies started their operations way back in the colonial period. The area holds the largest number of industries in the country. The Nairobi industrial area is significantly surrounded by low-income residential areas. The residents from these areas have always provided the required labour to the industries, this being a basic factor for production. Due to the growing size of the area, it has made it difficult to upgrade the existing structures. As a result, manufacturing and industrial companies are now seeking areas that are less congested, that are bigger in size and away from the hustle and bustle of the city.

Projects such as Tilisi and Tatu City, both of which are within easy reach of Nairobi County, have incorporated the concept of industrial parks. This concept is lucrative for existing manufacturing companies that are seeking to either exit from industrial areas or expand their business, and also for foreign investors seeking to establish themselves in the Kenyan market.

Our firm has represented Africa Logistics Properties limited (ALP), an integrated specialist property company that acquires, develops and manages modern logistics warehousing across East Africa. ALP is developing Kenya's first modern grade A logistics and distribution park on 50,000 sq m of leasable space in Northern Nairobi on a 22-acre site that is 25 km north of Nairobi's central business district, with close access to both the Thika superhighway and Eastern Bypass. We have represented ALP both in its acquisition of the property within Tatu City and in its subsequent sub-lease of the various portions of the land to various purchasers. We have also represented purchasers in the purchase of Tilisi.

Serviced Apartments and Hospitality

This is a concept that is increasingly gaining popularity with investors. Traditionally popular in the hotel sector, where serviced apartments or villas have always been available, it has now evolved to residential areas where serviced apartments are let for short, medium and long-term lets.

In October 2016, a report by Cytonn Investments indicated that serviced apartments in Nairobi outperformed hotels in occupancy and returns. The report said the average occupancy for serviced apartments was 90% and the revenue per room per night was KES12,700. This occupancy level was 29.6% higher than that of hotels, and 33.5% cheaper on average than a hotel room.

This concept will also see serviced apartments merging with hotels (dual branding) as people increasingly explore the concept of a 'home-away-from-home'.

In Kenya, serviced apartments were previously only common with expatriates. However, serviced apartments are now being let more generally, either for short-term lets as holiday getaways or for other purposes.

Popular areas within Nairobi include Upper Hill, Kilimani and Brookside Drive. Our firm is currently engaged in a development where serviced apartments will be run side-by-side with a branded hotel.

National Housing Development Fund

The Government of Kenya's Big Four Agenda aims, amongst other things, to provide affordable housing. Their target is to deliver 500,000 affordable housing units in five years to stop the growth of slums in major towns across the country. The current housing shortage stands at a deficit of over 2 million units annually.

The government introduced the national housing development fund, which should take effect in the coming months. The intention is to have persons who pay into the fund and who qualify for affordable housing to be able to utilise the fund to purchase an affordable house under the scheme.

To this end, the Government had tendered for houses to be constructed in areas that traditionally had 'old estates'. As such, there is potential for property developers to bid for such projects with the Government.

There is a lot of potential for developers to invest in affordable housing projects as nearly 61% of urban households live in slums.

For private investors, we have seen this approach to affordable housing by a developer, Karibu Homes, although some of the apartments are still expensive for low-income earners in Kenya.

Live-work-and-play Concept

This concept of live-work-and-play is gaining popularity, with investors appreciating that consumers are looking for a relaxing atmosphere to live in and also to be in close proximity to the cities where they work. It has been launched in Tatu City (within easy reach of Nairobi) and Garden City in Nairobi.

Other similar projects include Migaa and Vipingo Ridge in the coastal region of Kenya.

We are likely to see more of such projects, especially in areas that are on the outskirts of Nairobi such as Kiambu, Machakos and Ruiru. Konza Technopolis is another such ambitious project that investors can pursue.

Retail

The country has the second largest mall space in Africa after South Africa with 391,000 sq m. This market segment has increased growth fuelled by the entry of international retailers into the market that act as anchor tenants in the malls such as Garden City and Two Rivers; such retailers include Carrefour, Shoprite, KFC and Game. There has also been an increase in businesses and services offering online shopping, signalling a change from the traditional reliance on brick-and-mortar stores. In future, this may affect this market sector, especially in Nairobi where malls are currently saturated. As such, at the present time malls may not be a viable investment.

Smart Offices and Serviced Offices

Serviced offices are gaining popularity, as well as semi-fitted offices providing facilities such as partitions and kitchen facilities.

Smart offices are also a trend to watch out for, as more young entrepreneurs prefer an already set-up office where they get to share certain common services as opposed to setting up an office afresh.

Green and Solar Energy

Investors that are engaged in green, solar or other alternative green energies are in the right business, investment-wise. There has also been an uptake of the use of green building technology to save on energy costs. This was fuelled by government regulations requiring the installation of renewable energy devices in all new constructions, namely:

- the Energy (Solar Water Heating) Regulations, 2012 on 4 April 2012, as per Legal Notice No 43 of the Kenya Gazette;
- the Energy (Energy Management) Regulations, 2012 on 4 September 2012, as per Legal Notice No 102 of the Kenya Gazette; and
- the Energy (Solar Photovoltaic Systems) Regulations, 2012 on 4 September 2012, as per Legal Notice No 103 of the Kenya Gazette

As such, it is already mandatory for residential buildings that meet the required threshold to have solar water heating.

In this respect, one can see how a company that offers reasonably priced alternative energy can benefit in the present market.

Commercial Offices

There has been an increase in commercial office space within key urban areas in Kenya, particularly in Nairobi. This has resulted in over-supply of office spaces in the last two to three years. There are a number of office spaces not fully let up or sold in Nairobi and landlords are experiencing a situation where they are unable to procure tenants or purchasers. This is resulting in rental incentives for tenants or rental negotiations. Landlords are also increasingly more tolerant to negotiations in commercial leases – something that was hardly entertained a few years back – with most commercial leases being standard landlord-friendly for all tenants.

We have also seen market rent rebates and/or a freeze on rental increments on commercial offices. As such, commercial offices are in general not a very good option for investors at the moment.

Infrastructure

There has been and still is a lot of development of infrastructure in Kenya. We have seen the development of the standard gauge railway and roads. Roads within Nairobi County, such as Waiyaki Way and Ngong Road, are undergoing expansion and construction; Mombasa road is also set for expansion.

This has resulted, and will continue to result, in real estate development around these areas. For instance, there has been an increase in property prices in areas neighbouring Waiyaki Way and Ngong Road. These are places to look out for with regard to residential development. Areas near

Waiyaki Way are also a good investment area for industrial parks; Tilisi is one such project.

Agribusiness – Agriculture

The idea of having a 'side-hustle' is common in Kenya, as witnessed in the towns' neighbouring major urban areas. Serviced agriculture projects are offered for sale with an option for the sellers either to add fish ponds or greenhouses. Those choosing greenhouses plant vegetables such as capsicums.

This can be quite a lucrative business for low to medium income workers. Earnings for greenhouses on an eighth of an acre plot are in the region of KES250,000 per crop season; with two planting seasons in a year, a single plot earns KES500,000.

Residential Developments

This market sector has the highest demand with the deficit amounting to around 2 million units annually. Specifically, in affordable housing and student accommodation, the demand in the market is prevalent. This demand is fuelled by demographic factors such as an increased middle class and rural-urban migration. There has been an upsurge of apartments in certain areas of Nairobi and Mombasa counties targeting the middle class. This has also resulted in a number of unsold apartments. As such, this area may be not lucrative for the moment, depending on where an investor seeks to develop. For example, Kileleshwa is currently experiencing an over-supply of apartments for sale after targeting middle-income earners.

However, it would appear that, tied to the middle-income earners, a new concept of tenant purchase has emerged. This concept is based on an Islamic finance model. Basically, the purchase price is spread such that a deposit is paid and then high monthly instalments on the purchase price are spread within the first two years (ie, the construction period). Thereafter, for the next four years the purchasers pays a lower monthly instalment as they continue to live in the premises. As such, in six to eight years a purchaser would be able to own the premises and have the title transferred to them. It is a concept that is slowly being accepted by the market, with three investors having projects in the Kilimani, Parklands and South C areas of Nairobi.

National Land Information Management

This Government is engaged in the development of a land information management system. This will result in the digitisation of land records and the implementation of a cadastral data system. Digitalisation has been ongoing. This will with time result in completing property transactions in a faster and more efficient manner, and gradually eliminate the issue of missing or misplaced files at the land registry. A number of files at the land registry have already been digitised. We estimate that in the next few years, the country will be in a better place in terms of processes working under digitisation.

Conclusion

The IMF forecast for 2017 to 2020 suggests a GDP growth in sub-Saharan Africa of 5.30% a year. Kenya continues to be a country where investors are watching and are seeing a lot of potential and opportunities for investment.

Countries such as UAE, which had previously not been present in the Kenyan market, are now having presence in the country. UAE investors have been urged to follow in the footsteps of Majid Al-Futtaim Group and the Landmark Group by pursuing property opportunities in East Africa.

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