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Real Estate

Kenya
Trends and Developments
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Introduction

It is not possible to reflect on the possible real estate trends to watch out for in Kenya in 2020, without looking at the economy and the factors that have affected it. The year 2019 saw a decline in the rate of growth in the real estate sector, with similar deceleration occurring across various sectors of the economy, in comparison to the performance of these sectors in similar periods in 2018.

Despite various authorities giving an optimistic outlook at the start of 2019, the economy did not meet expectations of a better performance than in 2018. The year 2019 proved the existence of other long-standing challenges to the economy and surprised many by continuing the downward trend in growth that was seen in 2018, a year characterised by a repeat presidential election that was viewed as a major cause of disruption to business.

The Kenya National Bureau of Statistics (KNBS) in its gross domestic product quarterly reports for 2019 indicated that there was a decrease in the GDP in each quarter as compared to similar periods in 2018. The KNBS further reported an overall increase in both the consumer price index and in inflation rates. The World Bank in its Kenya Economic Update of April 2019 noted early on in the year that drought and ongoing subdued private sector investment was likely to drag down economic growth in the short term. In a recent economic outlook, the African Development Bank (AfDB) also noted that GDP was down from 6.5% in 2018 to 5.9% in 2019, which the AfDB attributed mainly to unfavourable weather and reduced government investment.

Stunted growth in the real estate sector was one of the outcomes of this decline in economic growth. The credit crunch experienced in 2019 was particularly detrimental to the real estate industry, which is significantly dependent on the availability of financing for both individuals and bodies corporate. The credit crunch which has prevailed for the past few years further strained the belts of both financiers and consumers and was particularly aggravated by the continuance of the interest rate capping introduced by the amendment to Kenya's Banking Act in 2016. The past year saw financial institutions continue to lend cautiously, due to the impact of the interest rate cap, which was only repealed in November 2019. Access to credit facilities from banks and other financial institutions remained relatively limited, especially for individuals and micro, small and medium enterprises, affecting the number of mortgages taken up in the last year. The intervention by the president, who dissented to the Finance Bill of 2019, which proposed the continuance of the interest rate cap, saw the repeal of the law that gave rise to the cap. The president stated that the interest rate cap had given rise to undesirable economic consequences and alluded to better cash flow in the economy, where lenders had the freedom to determine their profit margins.

In the real estate realm, the hard financial times were particularly seen to affect developers of commercial, retail and high-end residential properties, who were the hardest hit due to low demand and over-supply in the market. For example, a significant number of commercial and retail developments completed in the last few years have remained largely unoccupied for the initial years following completion, despite heavy investment in the marketing of these developments. The headlines in 2019 were also heavily ridden by reports of auctions by banks of residential homes where the owners were unable to service their loans. Significant commercial real estate assets were not spared either, with banks resorting to auctions of office blocks and malls.

In fact, questions were raised as to whether Kenya was facing a real estate bubble given the empty residential and commercial spaces that could be seen in counties that were previously vibrant in the property market.

As such, the year 2020 began with the spill-over effect of the decelerated economic growth of 2019 which also affected the real estate sector. However, despite the hard times faced by private owners and developers of land, opportunities for investment in 2020 are still there, provided that investors establish the right areas in which to invest prior to committing to a specific type of real estate investment. For instance, the Kenyan government's Third Medium Term Plan (MTP) of the Vision 2030, for the period 2018–2022 is likely to cause waves in the real estate market in the coming years. The plan places an expectation on investors to shift their focus and align their investment portfolio in order to benefit from this MTP.

The MTP has been themed "Transforming Lives: Advancing Socio-Economic Development through 'the Big Four'" and is popularly known as the "Big Four Agenda". The Big Four are: increasing the manufacturing share of gross domestic product (GDP); providing affordable housing; enhancing food and nutrition security; and achieving universal health coverage. The Big Four Agenda aims to strengthen the business environment, to attract both domestic and international investment for inclusive growth and development. A brief insight into the potential impact of the Big Four Agenda follows.

Highlights and Lowlights of the Real Estate Sector in 2019 and the Ripple Effect for Trends in Real Estate in 2020

Availability of credit for real estate investment

Access to credit remained a challenge in 2019 largely due to the interest rate cap which prevailed for most of the year. Lenders continued to shy away from lending to borrowers they assessed to be medium-to-high risk, thereby locking out the majority of potential mortgagors. The depressed state of the market also led to a rise in properties being put up for auction, as financiers sought to recover loans in default. Despite lenders being secured in this manner, auctioneers in turn reported difficulties in finding liquid buyers who could offer the reserve price, as compared to previous years where sales by auction were often concluded through bidding wars. Partly due to these and other similar challenges, increased restructuring of financial institutions occurred, with the merger of significant players in the banking industry being witnessed or proposed.

However, at the end of 2019, the interest rate cap that was introduced in the lending market in Kenya in 2016 was repealed. The move to repeal the legislation that created the cap was motivated by the need to encourage lending by banks and other financial institutions. Lenders are now at liberty to determine the level of interest that they shall impose on their loans to customers. As such, in 2020 and going forward, the mortgage market is expected to see a steep rise in the short run as lenders seek to recover from the effects of the four-year capping of interest rates. With more flexible lending, more innovative projects that may have been held in abeyance for lack of proper funding are likely to continue.

Residential

Development of residential housing, specifically apartment blocks and high-end townhouses, played a big role in the construction portfolio in the last year. Middle-income to high net worth individuals are the main targets of these units and are the focus of many property developers. In the near future, however, property developers need to make informed decisions on their target market because the focus on this group of consumers has gradually led to an oversupply of such units while there is low demand for the same. In 2020, property developers may opt to shift their focus to providing affordable housing, which is in high demand and constantly low supply, as discussed later in this article.

Kenya also continues to see a rise in gated communities and private cities. This is because these types of developments have, arguably, better urban planning, a more reliable supply of utilities and are more aesthetically pleasing. Despite some of these private cities being situated on the outskirts of urban centres, due to the greater availability of land and lower population pressure, consumers have been attracted by the promise of affordable standalone houses and communities structured in high detail. Consumers have continued to buy into the idea of such developments. The private cities, in particular, offer the full bouquet of land uses within one location and also offer options in terms of the cost of housing – with both low and high-density areas within the private city.

Mixed-use developments

The live-work-play model has continued to be the choice of developers and consumers have also adapted to the changing face of the market in favour of this type of development.

For residential developments and residential units within mixed-use developments, property developers continue to offer "off-plan" purchases which double up as financing for their projects, while purchasers benefit from discounted property prices. We see this as a trend that will continue in 2020 and going forward. Middle-income earners are becoming increasingly aware of the benefits of living on the outskirts of the city for the fresh air and all the good that comes with it, and then commuting to work. Areas such as Redhill and Vipingo have experienced and continue to experience a significant growth in this concept.

We also see the concept of mixed use as one that will continue to catch on for holiday resorts. Whereas holiday resorts under the mixed-use model, such as Vipingo Ridge, used to target the high-end income earners, the target market is now extending to middle-income earners. For instance, Vipingo Awali estate, being part of Vipingo Lifestyle City, also targets middle-income earners with units going for less than KES4 million, which is a reasonable price in a holiday resort. With the repeal of the cap on interest rates, more available financing will result in more borrowing and is likely to open up the market for holiday resorts.

Retail – malls, cafes, supermarkets

A few years ago there was an influx of malls in Kenya, especially in the urban areas. Retail outlets of both local and international brands were set up at a rapid pace, attracting investment in malls and similar shopping centres.

However, the conversion of property for retail purposes has in the past two years suffered a blow for various reasons. The unprecedented competition from online retailers who do not take up bricks-and-mortar stores continues to be a challenge to mall owners who are tasked with employing innovative methods to retain tenants in their establishments and attract clients to their malls. In practice, some of the changes that mall owners have begun to come to terms with are part of the trend towards short-term licences for some occupiers of the mall rather than the standard leases that would secure rent for them for more than five years at a time. In addition, the influx of malls within a relatively short period of time and in close proximity to each other also resulted in many units within malls being vacant.

As such, for 2020, we do not foresee that the construction of malls will be a trend for developers, especially in what are already mall-saturated areas, such as Nairobi and Mombasa counties.

Tourism and hospitality

Kenya remains one of the top tourist destinations in the world, with factors such as the favourable equatorial climate, wildlife and cultural diversity being major tourist attractions. In 2019, Kenya is reported to have received over two million international tourists. Local and East African tourists are also a key support to the sector and provide income for hotel operators during the off-peak season.

Due to the vibrancy of the tourism industry, there is high demand for both high-end and affordable accommodation options. Hotels and lodges take up a significant share of real estate assets in the country.

International names have also made their way onto the market, with brands such as Kempinski, Sheraton, Accor, Hilton and Best Western entering into and increasing their investment in the Kenyan hospitality industry.

Conventional hotels are facing stiff competition from short-stay apartments with private property owners having increased ability to offer their premises for rental through online applications such as Airbnb. In most cases, corporate hoteliers have higher costs in running their facilities and therefore have higher accommodation rates, leading to imbalanced competition for similar clientele.

As such, there is room for growth in the hospitality industry and this could be a lucrative trend in 2020 and going forward, especially for individuals looking for "home-away-from-home" accommodation with all the amenities of a hotel.

The first project of its kind in Kenya – a "halal resort" in Watamu, known as Sands of Darakasi – is under construction. It appears that there is room for growth in Kenya in respect of halal resorts or holiday homes, with Kenya having a significant population that can be tapped for such projects.

Technology – data centres, technology hubs, etc

Kenya has plans to set up a technological hub approximately 60km from the capital. This hub is a project of the Kenyan government, has been dubbed "Konza City", and is intended to cover 5,000 acres, although this project has been stalled for a while now.

Other land uses related to technology include data centres where development is mostly in the early stages and there is potential and demand for similar enterprises.

Rent-to-own projects

The concept of rent-to-own properties, at what is termed "zero interest", is one that was started a little over two years ago. It has caught on in Kenya and continues to attract a good pool of middle-income earners. The concept is hinged on instalment payments, which tend to be high in the first two years (being the construction period). Once the building is completed, for the next four years purchasers who have already taken possession of the apartment continue to live in the apartment and pay reduced-instalment payments. This real estate investment continues to attract a lot of interest in 2020.

The Real Estate Sector and the Big Four Agenda as a 2020 Trend

Background

As mentioned previously, in the latter part of the past decade, Kenya's president announced four key pillars dubbed the "Big Four Agenda" which the government intends to focus on for the remainder of the president's tenure and which the current government hopes will support the remaining phases of Kenya's Vision 2030. To restate, the pillars of the Big Four Agenda are: food security; affordable housing; enhancing manufacturing; and affordable healthcare.

During the launch of the Big Four Agenda, the government stated its plan to leverage private-sector investments through Public Private Partnerships (PPPs) with the promise of attracting and engaging the private sector on the implementation of projects under the Big Four initiatives and other priority programmes and projects. Since the launch of the Big Four Agenda, the private sector has sought to plug into these initiatives, with several incentives being put in place via each subsequent Finance Act.

In support of the Big Four Agenda, several foreign governments have so far begun or promised funding for projects in the country linked to this and are also encouraging their nationals to invest in Kenyan industries and projects.

The real estate sector has not been left out in benefiting from the Big Four Agenda. Land and other resources from the sector are required in one form or another for the realisation of the aims of these national development plans. The identification of land for the purposes of these plans has already begun, with public land being allocated and the repatriation of private land being required in some instances.

Here, the key features of the Kenyan real estate sector are highlighted, with the contribution of the Big Four Agenda in mind.

Agriculture

Food security is presently a global concern, largely due to the detrimental effects of climate change. The Kenyan economy continues to rely heavily on its agricultural sector for food security as well as for international trade and foreign exchange reserves. Both the government and the private sector continue to invest in agriculture but with efforts being made towards better and more sustainable practices. One example of this is a rise in the development of greenhouses on a large-scale basis.

Furthermore, investors continue to enter the market, profiting from their ability to leverage small-scale farmers across the country to work together. Various investors have come in to provide the logistical muscle and know-how to reach end-users not only in the local market, but also in the international market. This has rejuvenated the agricultural sector in Kenya, led to an increase in farming across the different scales and has encouraged food production by farmers, whether their land is farmer-owned or leased land.

The increase in ease of access to the full supply chain from farmers to end-users has also necessitated the development of more warehousing that is suitable for players in the agricultural sector. This has seen the development of large-scale go-downs with modern facilities, most of which are situated within industrial parks developed adjacent to the cities and largely bordering Nairobi. It is likely that demand for warehouses will be felt across the various counties, specifically near towns with a large capacity for agricultural produce, as counties seek to enhance food security. Enhanced food storage is further boosted by sustainable food processing due to better preservation.

Manufacturing

Industrial areas in Kenya are mostly within or adjacent to the central business districts. There has been increasing pressure, however, to designate industrial zones in areas outside towns.

To enhance manufacturing as part of the Big Four Agenda, the pillar encompasses a "Buy Kenya" policy. The aim is to support locally manufactured goods, thereby creating employment within the country. To promote this, the government has pledged to take several actions. These include making it easier to do business in Kenya and requiring local content in certain production areas. Legislation has already been enacted or drafted in line with these pledges. This includes legislation for tax-friendly manufacturing zones within the country, eg, the legal framework that has been put in place for special economic zones.

Affordable housing

Following Kenya's latest census in 2019, the population has been estimated at over 47 million people, signifying an increase of nine million people on the previous census undertaken a decade earlier. The increased numbers have especially put pressure on urban areas of the country with the population of Nairobi increasing by over a million people. The result of this is an ever-increasing demand for housing in the highly populated parts of the country.

In recent years, there has been a lot of investment by private developers in the construction of housing for sale. There has been a mixed bag of fortunes for developers in terms of realising a decent return on their investment. Part of the issue has been the inability of consumers to obtain financing to acquire real estate assets – an issue covered earlier in this article. Another aspect of the issue is that consumers, especially in the middle and upper-income brackets, have been spoilt for choice due to the high supply of new housing developments, which has continued to increase.

In light of the above, property developers should note that the demand in the market has now changed. For this reason, in order to thrive in this new market, they may need to prioritise the social need for housing (which supports the government's objective of securing affordable shelter), rather than the profits they would like to make per sale.

This shift in approach means that developers may need to adapt to lower profit margins per unit in exchange for more sales, since it is reported that the affordable housing segment has a deficit of 150,000 units each year with only about 50,000 units being constructed annually.

This development is a shift from the trend in Kenya's property market for the past five years, which mostly focused on the upcoming middle and upper-class market.

Some developers are already actively undertaking affordable housing projects and new houses are expected to be handed over in December 2020.

Universal healthcare

The fourth arm of the Big Four Agenda is the realisation of universal health coverage. As the government focuses on the development of public hospitals and dispensaries across the country, there has also been an increase in private sector investment in healthcare. Investors in the healthcare sector have sought to increase their capacity to handle the volume of patients either through the creation of satellite clinics or the expansion of existing hospital sites. There has also been interest from foreign investors to set up medical facilities in Kenya, especially on the part of countries that Kenyans have in the past frequented for medical services. Other novel developments for the Kenyan market in the last few years have been the establishment of medical research labs as well as cold warehousing for medical supplies.

Conclusion

Overall, the economy's performance in the past year has been sub-par, but there is hope that, with the introduction and implementation of policy and legislation aimed at creating higher levels of growth in the economy, investors will have a better chance of realising a return on their investments in the future, specifically in the real estate sector.

Players in the real estate sector are optimistic about growth in 2020 and in the decade as a whole. The sector has potential for growth, with the expansion of urban areas in the counties offering additional opportunities to property developers and other investors in the Kenyan real estate market. In addition, the government of Kenya, both at a national and county level, is keen to pursue various partnerships – including public private partnerships – which should support development and financing for the real estate sector, especially affordable housing and infrastructure.

Proper market research is critical to ensure that investors reap the desired benefits from the real estate sector in Kenya, and investors should be prepared to undertake a market or feasibility analysis before investing in any of the possible trends for 2020, or generally, in Kenya.

With the COVID-19 pandemic affecting countries around the world, this is also likely to have a negative impact generally on any investment in Kenya.

Dentons Hamilton Harrison & Mathews has a well-established local and global presence, with two offices in Kenya – in Nairobi and Mombasa – and following its partnership with Dentons, the largest law firm in the world, access to over 180 office locations globally and more than 1,100 real estate lawyers worldwide. The firm has a robust dedicated real estate practice team consisting of five partners and ten associates who provide advice on various aspects of real estate transactions. The team provides advisory and transactional support in construction, real estate developments and structuring, tax, joint ventures, planning and environmental laws, fractional ownership and franchising within the hospitality industry. In addition, the firm offers a wide range of practice knowledge and services in business-related areas, including banking and finance, insolvency and debt restructuring, infrastructure and projects, regulatory compliance and corporate structuring. Some of the firm's key clients include government and state corporations, hotels, and corporate and construction companies.

Authors

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