

Cytonn Kenya's REITs H1'2023 Report

**"Strategic Financial Sustainability of Kenyan REITs Redefining
Real Estate Investment"**

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I. Introduction to Cytonn

About Us

Cytonn Investments is an alternative investment manager, with real estate development capability, and a primary focus on private equity and real estate investments in the high growth Kenyan Region. Cytonn has a unique strategy of coupling two compelling demand areas - the lack of high yielding investment products and the lack of institutional grade real estate. We provide high yielding investment instruments to attract funding from investors, and we deploy that funding to largely pre-sold investment grade real estate. With offices in Kenya and Washington, DC - USA, we are primarily focused on offering alternative investment solutions to global and local institutional investors, individual high net-worth investors, and diaspora investors interested in the East-African region. Real estate investments are made through our development affiliate, Cytonn Real Estate, where we currently have over Kshs. 82 billion (USD 820 mn) of projects under mandate across ten projects. In private equity, we invest in banking, education, and hospitality.

82

Over Kshs. 82 billion worth of projects under mandate

3

Three offices across 2 continents

500

Over 500 staff members, including Cytonn Distribution

10

10 investment ready projects in real estate

A unique franchise differentiated by:

Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

Committed Partners

Strong global and local partnerships in financing, land and Cytonn Real Estate, our development affiliate

Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

WE SERVE THREE MAIN CLIENT SEGMENTS:

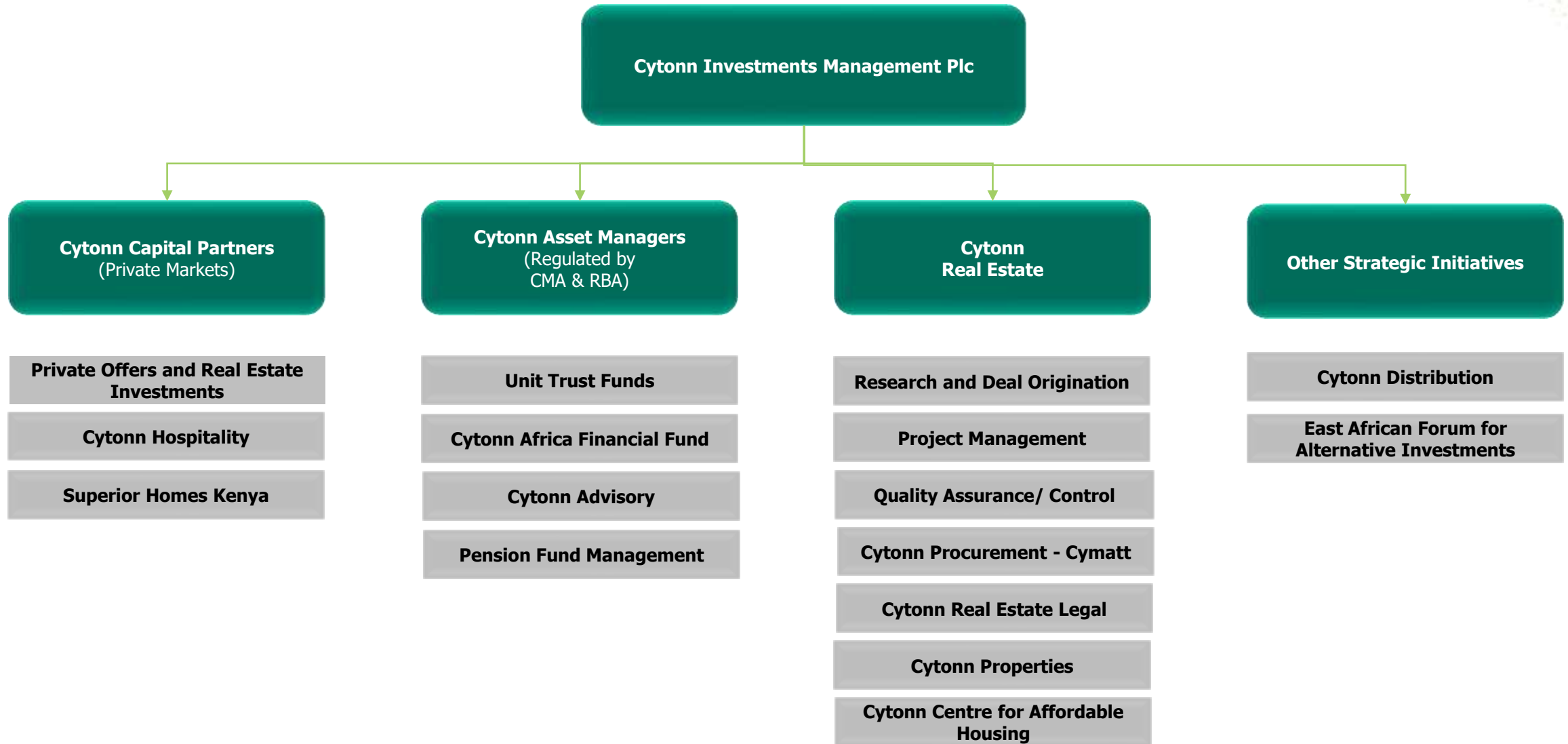
- High Net-worth Individuals through Cytonn Private Wealth. This is done through our captive Distribution Network
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional Clients. These clients are served from our Investment & Fundraising Team

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate, and Real Estate Related Businesses
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions



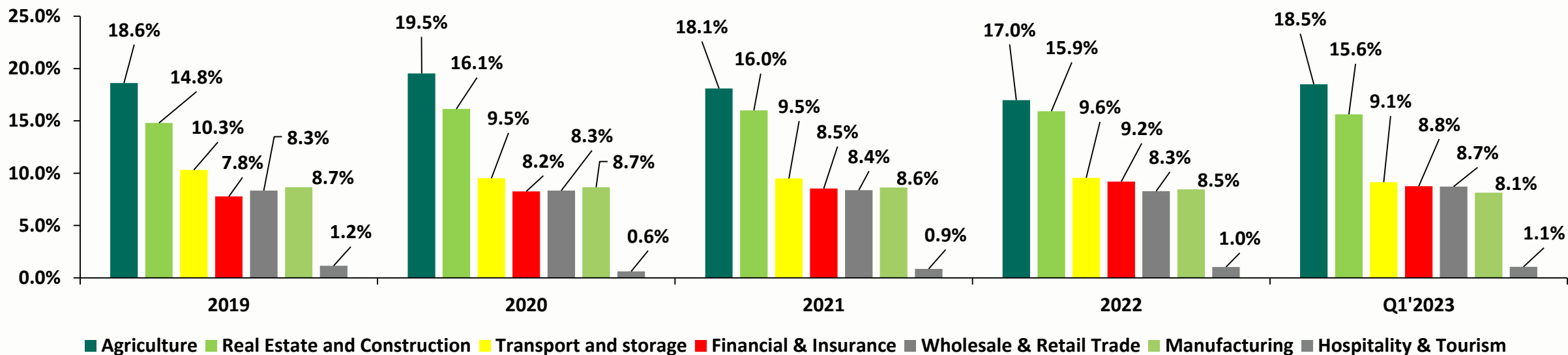
Our Business Structure



II. Overview of Real Estate in Kenya

Sectoral Contribution to GDP

Cytonn Report: Real Estate and Construction Sectors Contribution to GDP in Comparison with Other Sectors (FY'2019-Q1'2023)



*Source: KNBS

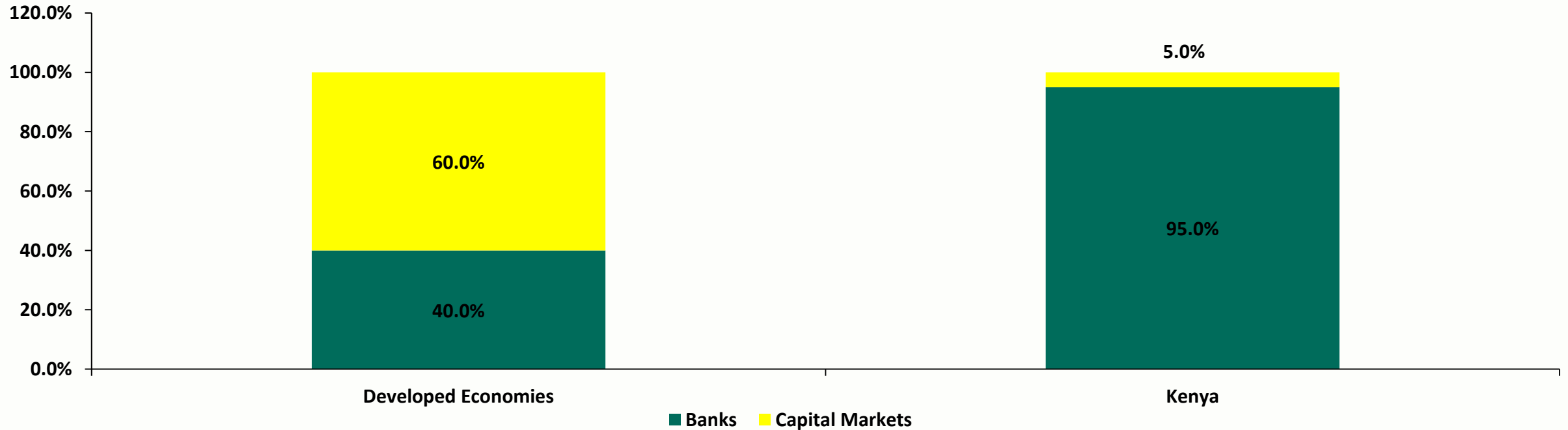
- The Real Estate and Construction sector contributed 15.6% of the country's Gross Domestic Product (GDP) in Q1'2023, being the second largest contributor in Kenya's economy. This is attributed to rapid urbanization and population rates which stood at averages of 3.7% and 1.9% respectively as of 2021, against the global averages of 1.6% and 0.9, driving the demand for developments
- The performance was however a 0.3% points decline from the 15.9% recorded in 2022, attributable to decreased property transaction volumes in the market, coupled with rising construction costs on the back of elevated inflation pressures, with the average construction cost in 2023 coming at Kshs 41,600 per SQM, a 20.1% increase from Kshs 34,650 per SQM recorded in 2022

Funding Gap in the Real Estate Sector

There needs to be alternative financing to meet the funding gap to Real Estate development in Kenya

- Despite the existing demand in the Real Estate market, there exists limited funding options for developers. Banks in Kenya are the primary source of funding for Real Estate development, providing nearly 95.0% of funding for [construction](#) activities as opposed to 40.0% in developed countries

Cytonn Report: Construction Financing in Kenya Vs Developed Economies



*Source: World Bank, Capital Markets Authority

III. Overview of REITs Sector in Kenya

Kenyan REITs Sector Overview

There are four authorized REITs in the Kenyan market, all of which are structured as closed-ended funds

Cytonn Report: Authorized REITs in Kenya						
	Issuer	Name	Type of REIT	Listing Date	Market Segment	Status
1	ICEA Lion Asset Management (ILAM)	Fahari	I-REIT	October 2015	Main Investment Market	Trading
2	Acorn Holdings Limited	Acorn Student Accommodation (ASA) – Acorn ASA	I-REIT	February 2021	Unquoted Securities Platform (USP)	Trading
3	Acorn Holdings Limited	Acorn Student Accommodation (ASA) – Acorn ASA	D-REIT	February 2021	Unquoted Securities Platform (USP)	Trading
4	Local Authorities Pension Trust (LAPTrust)	Imara	I-REIT	November 2022	Main Investment Market: Restricted Sub-segment	Restricted

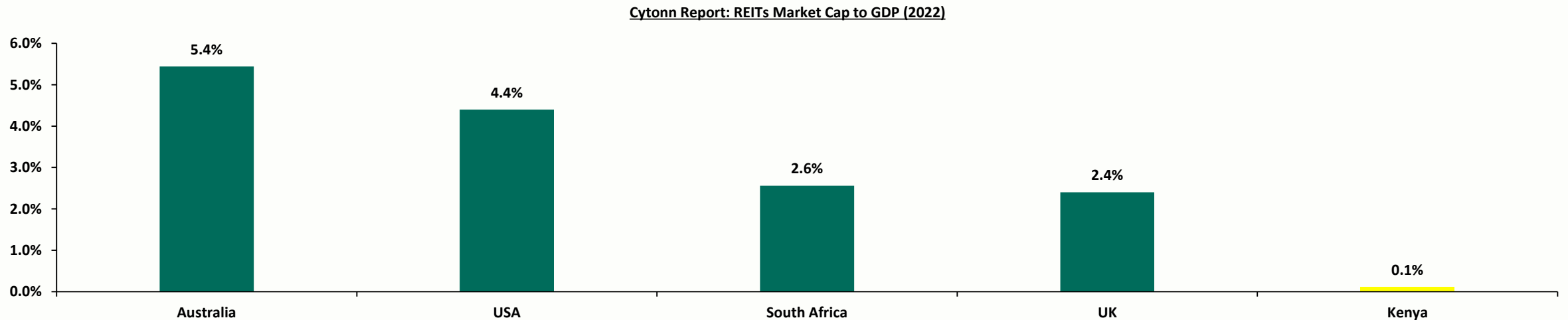
*Source: Nairobi Securities Exchange, Capital Markets Authority

- The Real Estate Investment Trusts (REITs) regime in Kenya was formulated by the Capital Markets Authority during 2013
- ILAM Fahari I-REIT is the only one listed and trading on the Nairobi Securities Exchange (NSE) Main Investment Market, allowing its units to be transferred through the exchange. Acorn Student Accommodation (ASA) I-REIT and D-REIT are not listed, but are instead traded on the Unquoted Securities Platform (USP); an over-the-counter market segment of the NSE. Additionally, LAPTrust Imara I-REIT is listed on the NSE's Main Investment Market, under the Restricted Sub-Segment, with open trading of the securities restricted for a three-year period from March 2023

Kenyan REITs Sector Overview

Kenyan REITs market capitalization remains low in comparison to other countries

- However, the performance of the REITs market in Kenya has been marked by a moderate trajectory, influenced by a range of contributing factors since REITs regulations were introduced in 2013. The dismal performance is attributable to factors such as; i) inadequate investor knowledge of the investment instrument, ii) lengthy approval procedures for REITs creation, iii) high minimum capital requirements of Kshs 100.0 mn for trustees, and, iv) minimum investment amounts set at Kshs 5.0 mn, among others which continue to limit the performance of REITs in Kenya. The graph below compares Kenya's REIT market capitalization to GDP of other countries;



IV. Themes that shaped the REITs sector in H1'2023

Themes that Shape the REIT Sector - Regulations

Any income that REITs distribute to their investors (unitholders) are not taxed

1. Regulation:

a) Exemption from Income Tax Act- The [Income Tax Act's](#) Section 20 (1) (c) and (d) state that REITs and companies that REITs invest in do not have to pay the regular 30.0% Income Tax Rate (ITR) upon being registered with the Commissioner of Kenya Revenue Authority (KRA). Furthermore, any income that REITs distribute to their investors (unitholders) are not taxed. However, this tax exemption does not cover the withholding tax imposed on interest income and dividends received by unitholders who are not exempted according to the first schedule of the ITA. The rates for this withholding tax are outlined in paragraph 5 of the third schedule of the Income Tax Act.

b) Capital Gains Tax (CGT) exemptions- A capital gain occurs when the value at which a unit is transferred exceeds the adjusted cost of that unit. The difference between these values is subject to a tax rate of 15.0%. Therefore, any profit gained by a promoter or investors of a REIT from transferring property into the REIT is now subject to CGT at the [revised rate](#) of 15.0%, replacing the previous rate of 5.0% starting from 1 January 2023. Moreover, individuals who hold units in a REIT and decide to sell their ownership stake are also obligated to pay CGT. This requirement emerged due to an amendment to Section 34(1)(j) of the Income Act via the Finance Act 2022. However, within the REIT industry, there are certain scenarios that qualify for exemptions from CGT:

i. Transfers of property from life insurance companies to a REIT are exempt from CGT, as outlined in Section 19 (6B) of the

Themes that Shape the REIT Sector ...

A direct transfer of property from the REIT promoter or investors is not subject to VAT

Regulation Continuation:

- ii. Indirect transfer of property into a REIT when the promoter first transfers properties to a Special Purpose Vehicle (SPV). Subsequently, the shares of the investee company held by the SPV are transferred to the REIT. This is considered a restructuring, as the property transfer does not involve a third party. This exemption is based on Paragraph 13 of the Eighth Schedule to the ITA. However, CGT is applicable on gains made during the transfer of shares from the investee company to the REIT Trustee,
- iii. Payments received by unit holders or shareholders in a REIT for unit redemption or share sale are exempt from CGT in accordance with section 20 (2) of the ITA,
- iv. Gains realized by the REIT from the sale of properties, whether directly or through an SPV, are also exempt from CGT.

c) Exemption from Value Added Tax (VAT)- The [Finance Act 2021](#) reintroduced a significant change regarding the exemption from Value Added Tax (VAT) for transactions involving the transfer of assets to REITs and asset-backed securities. This exemption had previously been removed by the [Tax Laws Amendment Act No. 2 of 2020](#). According to Paragraph 33 of Part II of the First Schedule to the [VAT Act 2021](#), a direct transfer of property from the REIT promoter or investors is not subject to VAT. However, if the transfer of assets to the REIT is done indirectly, through the initial transfer of assets to the investee company, VAT will be applicable. Importantly, the transfer of shares from a REITs SPV to the REIT trustee will be exempt from VAT, even if the initial asset transfer involved VAT.

Themes that Shape the REIT Sector- Acquisitions

Starting from 1 January, 2023, any transfers occurring in REIT sector is subject to stamp duty

d) Adjustment in Stamp Duty- As per the regulations set out in section 96A of the [Stamp Duty Act](#), when the properties within a Development REIT (D-REIT) are completed and start to generate stable income, any later transfer of these stabilized properties from the D-REIT to the Income REIT (I-REIT) is not subject to stamp duty. However, it is important to highlight that this exemption was only applicable to transactions completed before 31 December 2022. Consequently, starting from 1 January, 2023, any transfers occurring is subject to stamp duty in accordance with section 96A subsection 4 of the act.

2. Acquisitions

- i. LAPTrust Imara I-REIT possess a diversified portfolio of properties which include; i) Pension Towers, Metro Park, and CPF House which are commercial office buildings located in Nairobi CBD, ii) Retail centre Freedom Heights mall located in Lang'ata, iii) Nova Pioneer which is a purpose built education facility located in Eldoret, iv) Freedoms Height residential apartments and serviced plot located in Lang'ata, and, v) Man apartments located in Kilimani,
- ii. ILAM Fahari I-REIT manages and operates several properties under their portfolio which include: i) a mixed used development (MUD) Greenspan Mall located in Donholm, Nairobi, ii) 67 Gitanga Place which is a prime office property located in Lavington, and, iii) Bay Holdings and Highway House which are industrial properties located in Industrial Area and Mombasa Road area respectively,
- iii. Acorn Student Accommodation (ASA) I-REIT has five completed student housing properties with 3,003 beds under their management serving up to 128 universities and colleges. These properties include; Qwetu Jogoo Road, Qwetu Ruaraka, Qwetu

Themes that Shape the REIT Sector - Acquisitions

ASA D-REIT is currently developing student accommodation properties through debt and equity financing

WilsonView in Lang'ata, Qwetu Parklands, and Qwetu Aberdare Heights I along Thika Road next to United States International University Africa (USIU-A). On the other hand, Acorn D-REIT boasts of four properties which are currently operational and six other properties under development bringing to a total of ten properties with 10,060 beds under its portfolio. Operational properties include; Qwetu Hurlingham, Qwetu Abedare Heights II, Qwetu Karen, Qejani Karen whereas properties under development include; Qwetu Chiromo, Qejani Chiromo, Qejani JKUAT next to Jomo Kenyatta University of Agriculture and Technology, Qejani Hurlingham, Qwetu KU, and Qejani KU next to Kenyatta University,

- iv. During H1'2023 period, the ASA I-REIT and ASA D-REIT entered into a legally bidding agreement for the acquisition of Qwetu Hurlingham, along Arwings Kodhek Road. The property commenced operations in January 2022 and caters to serve tertiary-education students within Hurlingham area and surrounding regions, primarily targeting Daystar University, University of Nairobi (UoN) School of Medicine, Riara University and Strathmore University students. The transaction is scheduled to be finalized in Q3'2023. For more information see [Cytonn Monthly – July 2023](#)

3. Capital Raising

- i. Through injection of [Kshs 4.3 bn equity](#) raised from investors and [Kshs 6.7 bn debt](#) secured from Absa Bank Kenya PLC in February 2023, ASA D-REIT is currently developing student accommodation properties across Kiambu and Nairobi countries at a total cost of Kshs 11.0 bn for the next three years. For more information see [Cytonn Monthly – July 2023](#)

Themes that Shape the REIT Sector - Capital Raising

Capital Raising in Kenya's REITs sector Continuation

- ii. In March 2023, Kenya's long-standing pension scheme, the Local Authorities Pension Trust (LapTrust) [listed](#) the inaugural Income-Real Estate Investment Trust (I-REIT) by a pension fund on the NSE, a ceremony presided over by President William Ruto. The I-REIT dubbed '*LAPTrust Imara I-REIT*', holds profound importance for government pension schemes and the broader Kenyan capital markets, presenting investors with an exceptional chance to participate in a diversified collection of income-generating Real Estate assets. For more information, see our [Cytonn Monthly-October 2022](#)
- iii. During the same period, [CMA](#) collaborated with key market stakeholders, including the Sanduku Investment Initiative, the Association of Pension Trustees and Administrators of Kenya (APTAK), and the Nairobi Securities Exchange (NSE), to establish the Kenya National REIT (KNR). With a focus on affordable housing and infrastructure, this initiative falls under the purview of the Sanduku Investment Initiative. For more information, see our [Cytonn weekly #06/2023](#), and,
- iv. Additionally during this period, ILAM Fahari I-REIT [proposed](#) the sale of two properties valued at Kshs 200.4 mn, as part of its strategy to divest non-core assets and reorganize its operations. The properties earmarked for sale include Highway House, a three-story industrial building situated off Mombasa Road in Nairobi, currently vacant following the departure of the former tenant, and Bay Holdings, fully leased to Imperial Bank, Packard Limited, and Architecture Supply Limited, located in Nairobi's Industrial Area. The sale process is anticipated to conclude by December 2023. This restructuring will lower the fund's investment property value from Kshs 3.2 bn to Kshs 2.9 bn but significantly augmenting its cash holdings. In terms of new acquisitions, Fahari has yet to initiate property purchases but is actively considering the development of a portion of the vacant land at Greenspan Mall.

V. Performance of the REITs in H1'2023

Kenya REITs Sector H1'2023 Metrics

ILAM Fahari I-REIT's Net Operating Income declined slightly to Kshs 86.0 mn in H1'2023, from Kshs 86.2 mn in H1'2022

- The tables below highlight the performance of the Kenyan REITs sector, showing the performance using several National Association of Real Estate Investments Trusts (NAREIT) approved metrics, and the key take-outs;

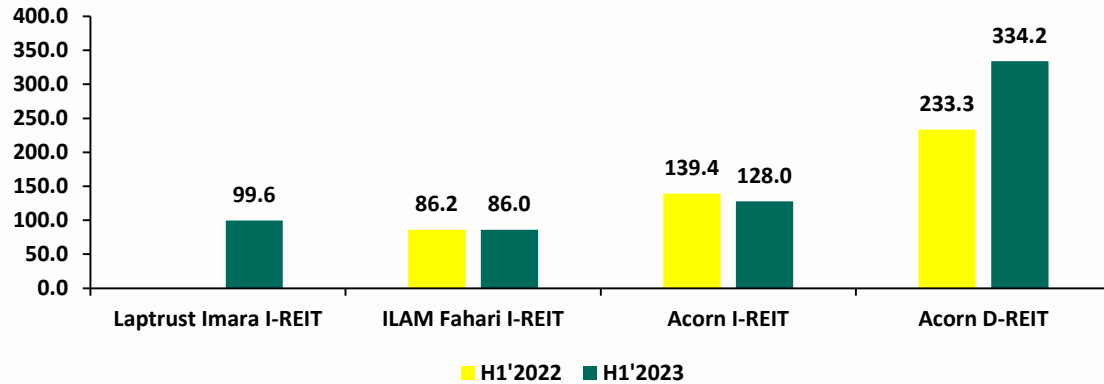
Cytonn Report: Leverage & Liquidity ratios of Kenyan REITs													
	Laptrust Imara I-REIT	ILAM Fahari I-REIT			Acorn I-REIT			Acorn D-REIT					
	H1'2023	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y change
Operating Metrics													
Net Operating Income (NOI)	99.6	86.2	86.0	(0.2%)	139.4	128.0	(8.2%)	233.3	334.2	43.2%	458.9	647.9	41.2%
Profitability Metrics													
Funds from Operations	99.6	86.2	86.0	(0.2%)	188.8	149.8	(20.7%)	233.3	334.2	43.2%	508.3	669.7	31.7%
Adjusted FFO	99.6	82.8	84.4	2.0%	188.8	149.8	(20.7%)	233.3	334.2	43.2%	505.0	668.1	32.3%
Cash Available for Distribution (CAD)	99.6	86.2	86.0	(0.2%)	144.1	92.8	(35.6%)	-	-	-	230.3	278.5	20.9%
Cash Amounts Distributed	0.0	0.0	0.0		64.0	87.0	35.9%	-	-	-	64.0	87.0	35.9%
Valuation Metrics													
Net Asset Value (NAV)	7,024.3	3,538.9	3,392.8	(4.1%)	4,720.4	6,341.9	34.4%	5,575.6	6547.7	17.4%	13,834.8	23,306.6	68.5%

Kenya REITs Sector H1'2023 Metrics

Acorn D-REIT Net Operating Income (NOI) recorded a 43.2% growth to Kshs 334.2 mn in H1'2023, from Kshs 233.3 mn in H1'2022

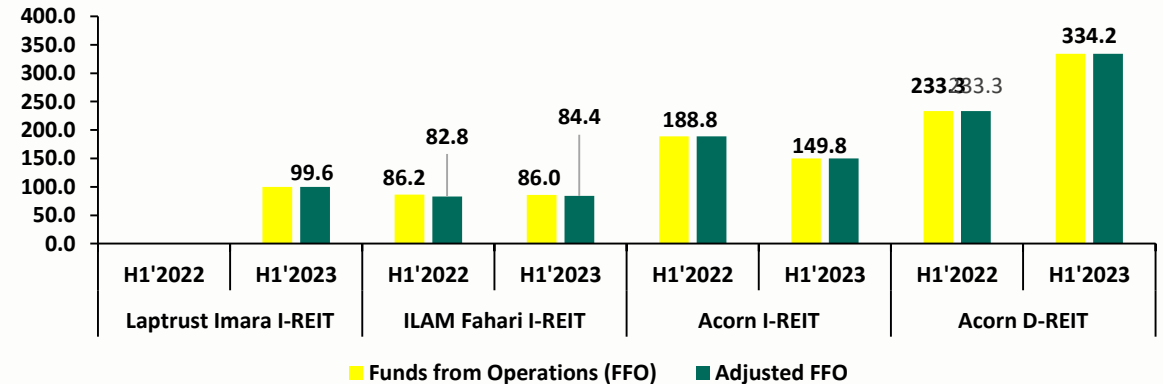
Operating Metrics

Cytonn Report: Kenyan REITs Net Operating Incomes (Kshs mns)



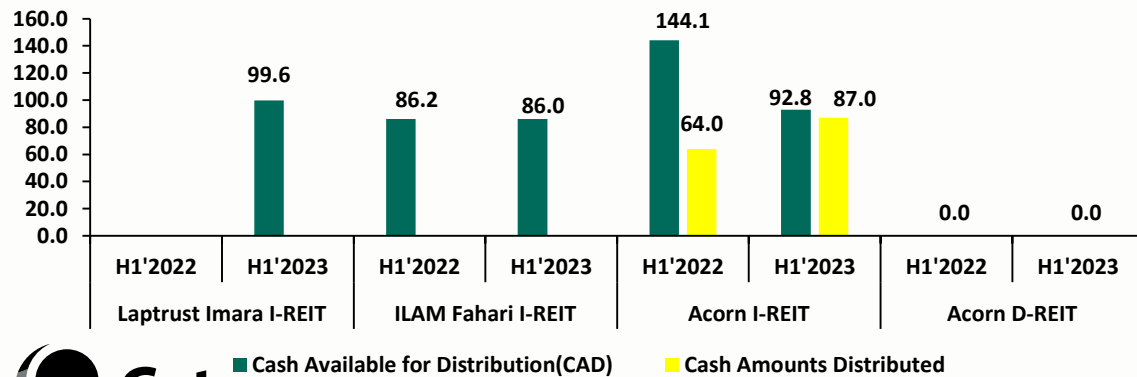
Profitability Metrics

Cytonn Report: Kenyan REITs Profitability Metrics (Kshs mns)



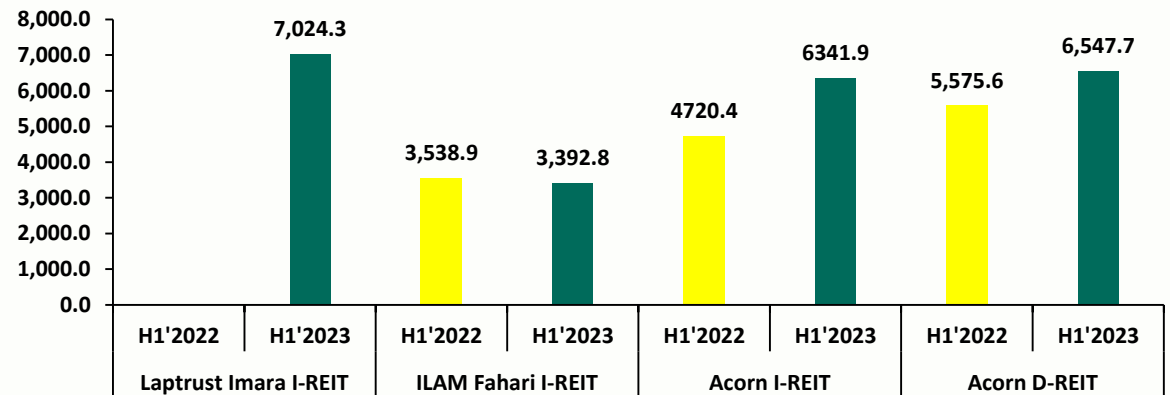
Profitability Metrics

Cytonn Report: Kenyan REITs Profitability Metrics (Kshs mns)



Valuation Metrics

Cytonn Report: Kenyan REITs Net Asset Values in mns



■ Cash Available for Distribution (CAD) ■ Cash Amounts Distributed

Kenya REITs Sector H1'2023 Metrics

Combined NOIs of Kenyan REITs recorded a 41.2% growth to Kshs 647.9 mn in H1'2023 from Kshs 458.9 mn in H1'2022

Key takeaways from the tables include:

- i. Combined Net Operating Incomes (NOI) of Kenyan REITs recorded a 41.2% growth to Kshs 647.9 mn in H1'2023, from Kshs 458.9 mn in H1'2022. The performance during the period was mainly supported by a 43.2% growth in the reported net operating income of Acorn D-REIT, to come in at Kshs 334.2 mn from Kshs 233.3 mn realized in H1'2022 respectively. In addition, LAPTrust Imara I-REIT reported a significant NOI at Kshs 99.6 mn, which further contributed to the positive performance,
- ii. Combined Funds from Operations (FFO) of Kenyan REITs increased by 31.7% in H1'2023 to Kshs 669.7 mn from Kshs 508.3 mn in H1'2022, whereas Adjusted FFOs for Kenyan REITs also increased by 32.3% to Kshs 668.1 mn in H1'2023 from Kshs 505.0 mn in H1'2022. This was on the back of significant increases in the reported NOIs during the period. The performance was however weighed down by an 8.2% decrease in the NOI of Acorn I-REIT to Kshs 128.0 mn from Kshs 139.4 mn in H1'2022, which consequently led to a 20.7% decrease in the I-REIT's FFOs and Adjusted FFOs to Kshs 149.8 mn from Kshs 188.8 mn in H1'2022 respectively,
- iii. The REITs combined Cash amounts available for paying dividends to REIT investors which we measured using the Cash Available for Distribution (CAD) metric increased by 20.9% in H1'2023 to Kshs 278.5 mn from Kshs 230.3 mn in H1'2022. The performance was propelled by Laptrust Imara I-REIT's distributable earnings which stood at Kshs 99.6 mn, despite a notable decline in Acorn I-REITs distributable earnings. Acorn I-REIT's distributable earnings declined by 35.6% to Kshs 92.8 mn from Kshs 144.1 mn in H1'2022,
- iv. Notably, only Acorn I-REIT's REIT manager recommended an interim dividend of Kshs 0.30 per unit, with the total cash distributed in H1'2023 amounting to Kshs 87.0 mn. Conversely, ILAM Fahari I-REIT, LAPTrust Imara I-REIT, and Acorn D-REIT REITs managers did not recommend interim dividends for the period H1'2023, and,
- v. Combined Net Asset Values for Kenyan REITs increased by 68.5% to reach an all time high of Kshs 23,306.6 mn in H1'2023, from Kshs 13,834.8 mn in H1'2022. This was attributable to 34.4% and 17.4% growths in the net asset values of Acorn I-REIT and Acorn D-REIT's to Kshs 6,342 and Kshs 6,547.7 mn in H1'2023 from Kshs 4,720.4 and Kshs 5,575.6 mn in H1'2022 respectively

Kenya REITs Sector H1'2023 Metrics

Majority of Kenyan REITs remained ungeared in H1'2023, with the exception of Acorn D-REIT

The tables below makes a comparison of the leverage and liquidity ratios of all four Kenyan REITs during H1'2023 and H1'2022;

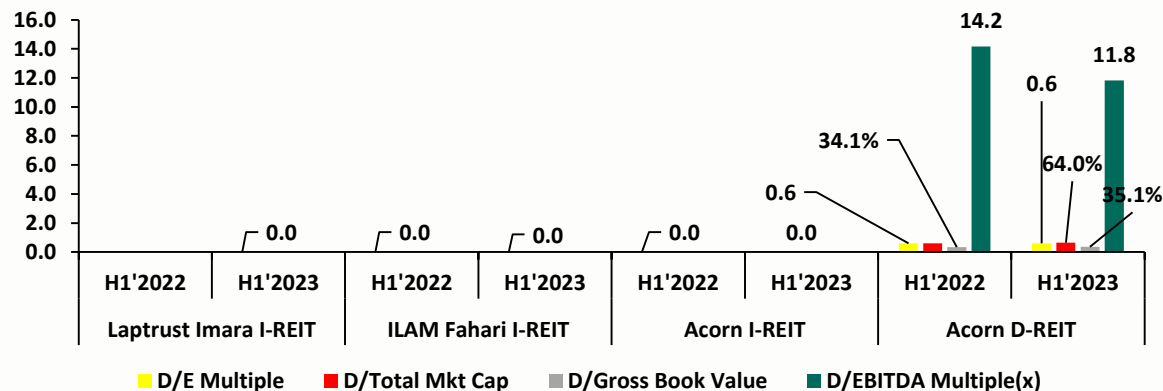
Cytonn Report: Leverage & Liquidity ratios of Kenyan REITs												
	LAPTrust Imara I-REIT	ILAM Fahari I-REIT			Acorn I-REIT			Acorn D-REIT			H1'2022 Weighted Average*	H1'2023 Weighted Average**
	H1'2023	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y Change		
Leverage Ratios												
Debt to Equity	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.6x	0.6x	1.0x	0.3x	0.2x
Debt to Total Market Cap	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	59.3%	64.0%	4.7%	29.2%	19.3%
Debt to Gross Book Value	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	34.1%	35.1%	1.0%	16.8%	10.6%
Debt to EBITDA Multiple	0.0x	0.0x	0.0x	0.0%	0.0x	0.0x	0.0%	14.2x	11.8x	(16.6%)	7.0x	3.6x
Debt Service Coverage	0.0	0.0	0.0	0.0%	0.0	0.0	0.0%	6.8%	8.1%	1.3%	3.3%	2.5%
Implied Cap Rate	1.4%	9.6%	12.3%	2.6%	3.1%	2.0%	(1.2%)	2.5%	3.2%	0.8%	3.4%	2.7%
*Market cap weighted as at 30/06/2022												
**Market cap weighted as at 30/06/2023												

Kenyan REITs Sector H1'2023 Metrics

Acorn D-REIT'S debt to EBITDA multiple decreased to 11.8x in H1'2023, from 14.2x in H1'2022

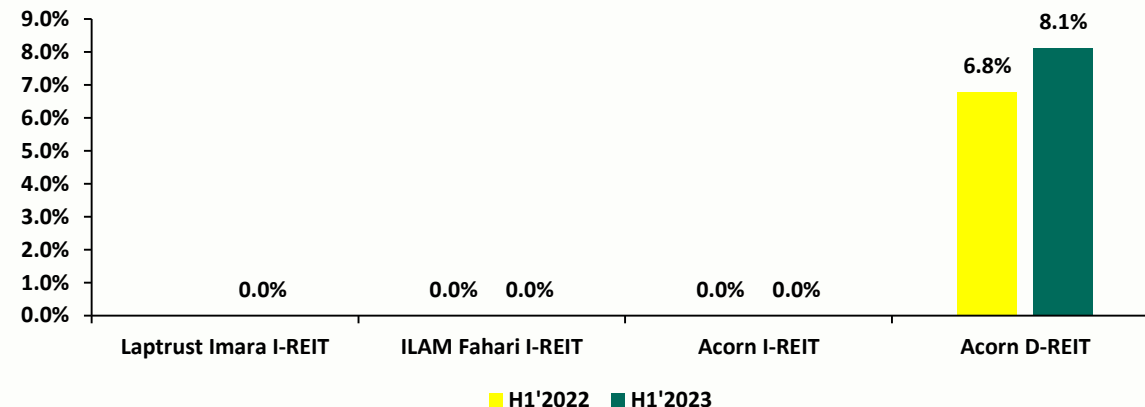
Leverage Ratios

Cytonn Report: Kenyan REITs Leverage Ratios (%)



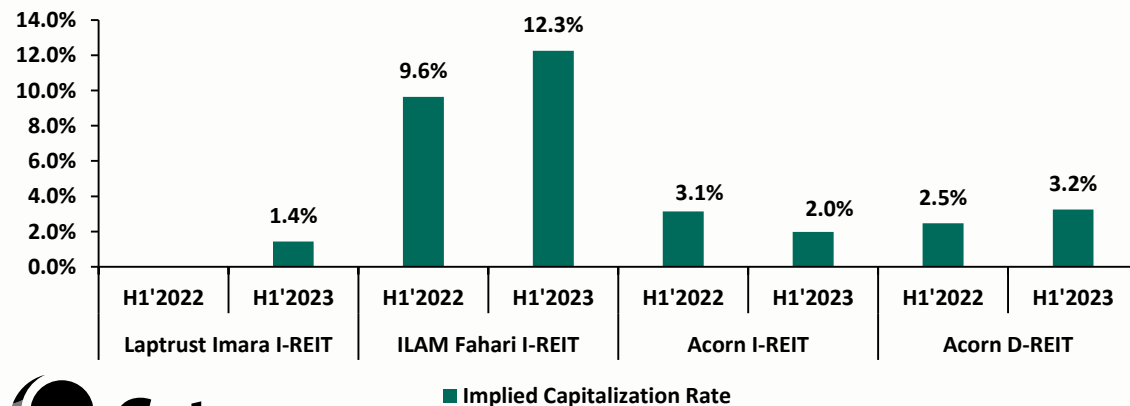
Liquidity Ratios

Cytonn Report: Kenyan REITs Liquidity Ratios



Valuation Metrics

Cytonn Report: Kenya REITs Valuation Metrics



Kenya REITs Sector H1'2023 Metrics

In H1'2023, ILAM Fahari traded at the highest implied capitalization rate of 12.3%

Key takeaways from the tables include:

- i. Majority of the REITs remained ungeared during H1'2023, with their leverage ratios remaining at zero except Acorn D-REIT. Acorn D-REIT debt ratios increased in H1'2023 on account of a 19.5% growth in its long-term borrowings to Kshs [3.9](#) bn from Kshs [3.3](#) bn in H1'2022,
- ii. Notably, Acorn D-REIT's Debt to EBITDA Multiple reduced to 11.8x in H1'2023, from 14.2x recorded in H1'2022. This was on the back of a faster growth in the REIT's EBITDA compared to its long-term borrowings. Acorn D-REIT EBITDA in H1'2023 increased by 42.3% to Kshs 334.2 mn from Kshs 233.3 mn in H1'2022, compared to a 19.5% growth in the REIT's long-term debt, and,
- iii. ILAM Fahari I-REIT traded at the highest implied capitalization rate of 12.3%, indicating that it offers a higher return on investment compared to all other REITs. Contrarily, LAPTrust Imara I-REIT had the lowest implied capitalization rate of 1.4%. However, despite the performance, we expect that the LAPTrust Imara I-REIT performance will improve gradually, considering that the REIT is still in its initial year of operation.

Kenyan REITs Sector H1'2023 Metrics

Only Acorn I-REIT REIT paid out an interim dividend of Kshs 0.30 per unit

- The table below presents a summary of key valuation metrics of Kenyan REITs in H1'2023;

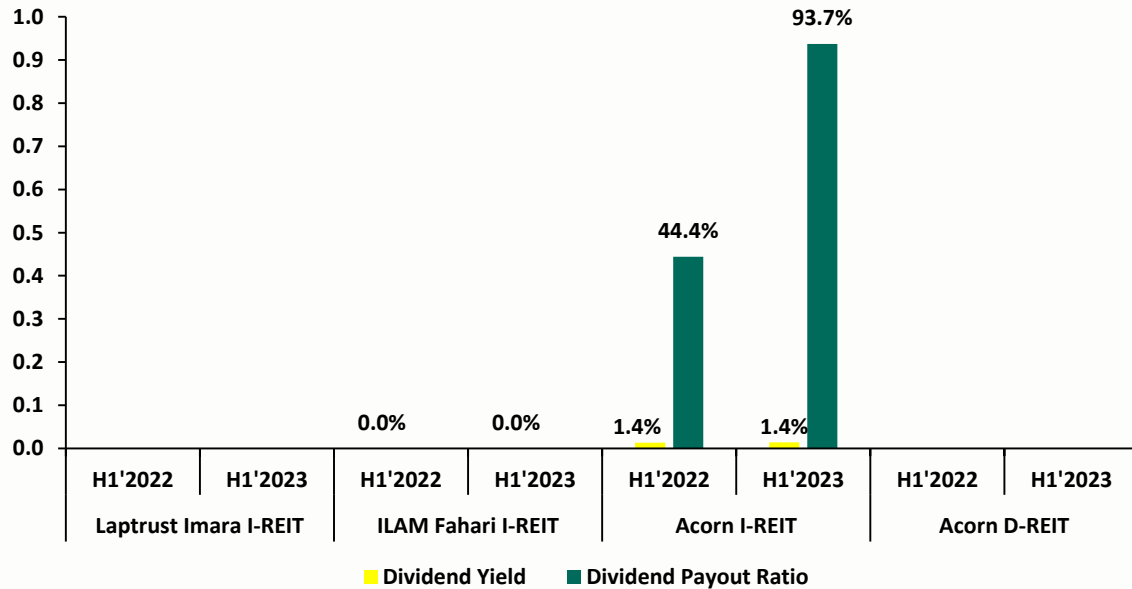
Cytonn Report: Valuation Metrics for Kenyan REITs										
	LAPTrust Imara I-REIT	ILAM Fahari I-REIT			Acorn I-REIT			Acorn D-REIT		
	H1'2023	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y Change	H1'2022	H1'2023	y/y Change
Price/FFO per share multiple	69.5x	13.1x	12.7x	3.0%	24.7x	41.6x	68.8%	23.9x	18.5x	(22.7%)
Dividend Yield	-	0.0%	0.0%	0.0%	1.4%	1.4%	0.1%	-	-	-
Dividend Coverage/Payout Ratio	0.0	0.0%	0.0%	0.0%	44.4%	93.7%	49.3%	-	-	-
NAV per share	20.3	19.6	18.7	(4.1%)	21.2	22.0	3.7%	23.9	25.3	6.0%

Kenya REITs Sector H1'2023 Metrics

Acorn D-REIT dividend payout came in at 93.7%, compared to 44.4% in H1'2022

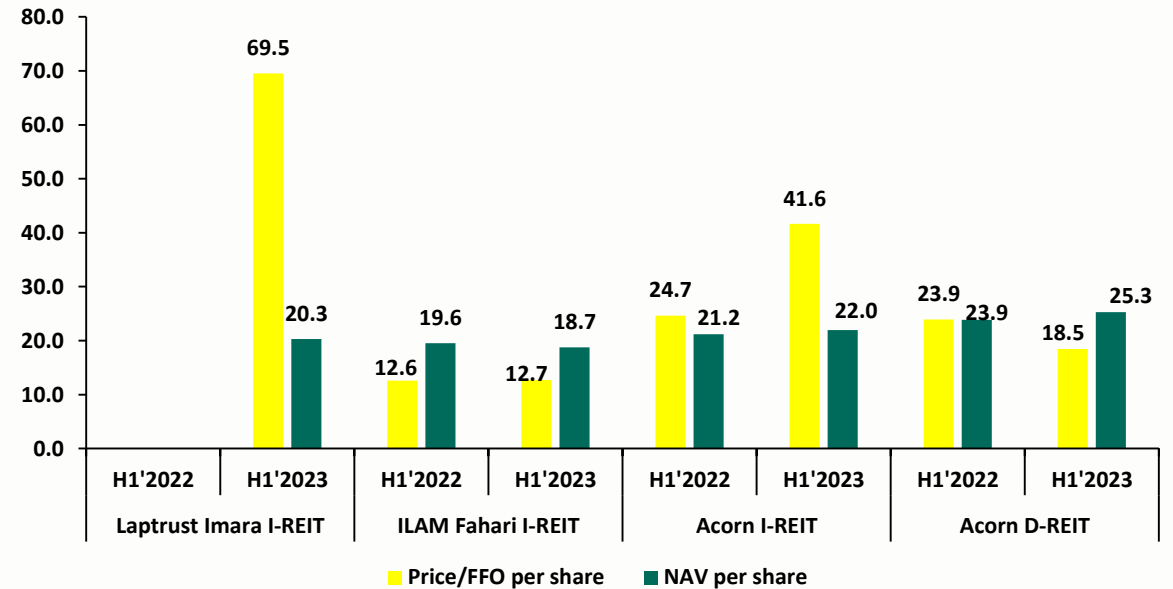
Valuation Metrics

Cytonn Report: Kenya REITs Valuation Metrics



Valuation Metrics

Cytonn Report: Kenya REITs Valuation Metrics



N.B

- Price/FFO per share multiple (x)
- NAV per share (Kshs)

Kenyan REITs Sector H1'2023 Metrics

The listed banks recorded a 22.1% weighted average growth on RoaE, 0.2% higher than the 21.9% Q1'2022

Key takeaways from the tables include;

- LAPTrust Imara I-REIT units are trading at a premium relative to its peers, with a price to FFO per share multiple of 69.5. Comparatively, ILAM Fahari I-REIT units are trading at a discount with a price to FFO per share multiple of Kshs 12.7,
- Acorn I-REIT dividend yield currently stands at 1.4%. ILAM Fahari I-REIT, LAPTrust Imara I-REIT and Acorn D-REIT did not pay any dividends during the period. Distinctly, Imara LAPTrust Imara I-REIT has not issued any dividend distributions since it began its operation earlier this year, and Acorn D-REIT is yet to issue dividends since it began its operations in 2021. The initial strategic priority for Acorn D-REIT was centered around property development and exit upon successful stabilization. Due to this, it was envisioned that the initiation of dividend distributions for the D-REIT commence after the completion of its third year of operations,
- Imara LAPTrust Imara I-REIT, ILAM Fahari and Acorn D-REIT REIT did not pay out dividends during H1'2023 This was on account of REIT managers not recommending interim dividend distributions for LAPTrust Imara I-REIT and ILAM Fahari respectively, and Acorn D-REIT's three-year grace period in relation to paying out dividends. Conversely, Acorn I-REIT dividend payout came in at 93.7%, in line with REITs regulation in Kenya which require that REITs distribute at least 80.0% of their net profits after tax as dividends, and,
- Acorn D-REIT recorded the highest NAV per share at Kshs 25.3, and, ILAM Fahari had the lowest NAV per share at Kshs 18.7. Notably, all REITs share prices are in line with their NAV per shares, with the exception of ILAM Fahari I-REITs shares that are trading at a discount its NAV per share.

VI. Conclusion & Outlook for the REITs Sector

Conclusion, Recommendations & Outlook for the sector

The performance of the REITs market in Kenya has been marked by a moderate trajectory since inception

- The performance of the REITs market in Kenya has been marked by a moderate trajectory, influenced by a range of contributing factors. Noteworthy, despite the overall challenges, there are positive indicators within the Kenyan REIT landscape. Notably, net operating incomes have displayed growth, reflecting improved financial performances. Additionally, leverage ratios for most REITs remained strikingly low, as majority of the REITs remain ungeared with most leaning towards short-term debt to sustain their operations. We anticipate that this trend will continue to persist going forward, in line with REITs fear of overexposure to interest rates, particularly in the current rising interest rates environment. In support of this, we expect to see more developments along financial sustainability commitment as demonstrated by key sector players such as Acorn Holdings, through the issuance of its [green bond](#). Additionally, we anticipate that the recent regulatory proposition by the Capital Markets Authority (CMA) to [reduce](#) minimum investment amounts for professional investors to Kshs 10,000 will invigorate interest in the sector, potentially attracting a broader investor base.
- Based on our research and analysis, we make the following recommendations to enhance the REITs sector through a more informed and strategic approach:
 - i. Enhancing Stakeholder Education:** All key stakeholders need to be educated on the REIT structure. within governmental bodies. For instance, there have been reported challenges pertaining to the challenge of acquiring a KRA PIN due to an agency's unfamiliarity with the intricacies of the REIT structure. As such, addressing this informational gap is crucial to streamline administrative processes,
 - ii. Expanding Legal Framework:** In South Africa, REITs legal and operational framework allow for different legal entities to establish REITs as opposed to Kenya where the same is limited to trusts only. In light of this, it is prudent to introduce flexibility in the legal entities permissible for REIT establishment. While Kenya currently allows only trust-based formations, broadening the scope to encompass companies, partnerships, and trusts would promote diversity and cater to different organizational preferences,

Conclusion, Recommendations & Outlook for the sector

We retain a NEUTRAL outlook for the Kenyan REITs sector going forward

iii. Introduce Hybrid REIT Vehicles: Currently, investors have to subscribe to both of the separate REIT classes, forcing them to pay duplicate costs, due to the nature of exclusivity of the two. A hybrid REIT would provide investors integrated returns, by combining the higher return from development while reducing risk exposure through the relatively stable income component of the I-REIT. In addition, an IPO with such a hybrid REIT vehicle would eliminate the duplicated costs of running two separate REITs, thereby improving subscriptions by investors. Introducing a hybrid REIT within a unified structure would thus enable investors to capitalize on the strengths of both investment types, potentially leading to more balanced risk-reward profiles,

iv. Gradual Public Listing Requirement: Recognizing the concerns of companies regarding an immediate transition to public listing, we advocate for a gradual, phased approach. Allowing REITs an initial period of private operation before enforcing mandatory public listing will serve to facilitate a smoother transition and conforms to the comfort thresholds of corporate entities,

v. Inclusive Corporate Trusteeship: A pivotal change involves the incorporation of Corporate Trustees, akin to the practices in the pension market. Furthermore, we recommend the reduction of the minimum capital requirement which currently stands at Kshs 100.0 mn, as this financial threshold currently confines trusteeship options to banking institutions exclusively,

vi. Introduce Tokenization of REITs: Introducing the concept of tokenization for REITs presents an innovative solution and has the potential to amplify market participation. This would facilitate the ownership of REIT units in smaller denominations, even as low as Kshs 100.0, and,

vii. Diminishing Entry Barriers: Reconsideration of the steep Kshs 5.0 mn minimum for D-REITs is vital to eliminate entry barriers that inadvertently limit individual market entry. A revised minimum could promote a more inclusive investment landscape.

- In conclusion, the potential of REITs remains promising despite the challenges faced by the Kenyan market. Serving as a means to amplify liquidity and diversify financing within the Real Estate sector, REITs provide an alternate avenue for development funding, while offering the potential to generate returns for investors. While Kenya's REIT journey has been marked by hurdles, the proposed changes in investment thresholds and the demonstrated resilience within the financial metrics of certain REITs suggest a potential resurgence in the sector.

VII. Appendix

Kenyan REITs H1'2023 Earnings Notes

I. ILAM Fahari I-REIT

ILAM Fahari I-REIT Summary of Performance – H1'2023

Below is a summary of the ILAM Fahari I-REIT's H1'2023 Performance;

Ratios Summary	H1'2022	H1'2023	Δ (H1'22/ H1'23) (% points)
ROA	2.3%	2.4%	0.1%
ROE	2.4%	2.5%	0.1%
Debt Ratio	4.0%	4.9%	0.9%
PBT Margin	51.2%	48.4%	(2.8%)
Rental Yield	5.3%	6.1%	0.8%

Figures in Kshs bn Unless Stated Otherwise

Balance Sheet	H1'2022	H1'2023	Δ (H1'22/ H1'23)
Total Assets	3.7	3.6	(3.3%)
Total Equity	3.5	3.4	(4.1%)
Total Liabilities	0.1	0.2	(16.8%)

Figures in Kshs mn Unless Stated Otherwise

Income Statement	H1'2022	H1'2023	Δ (H1'22/ H1'23)
Rental Income	171.8	179.5	4.5%
Income from Other Sources	14.5	16.5	13.7%
Operating Expenses	100.1	110.0	9.8%
Profit Before Tax	86.2	86.0	(0.2%)
Basic EPS (Kshs)	0.5	0.5	(0.2%)

Key Highlights in H1'2023:

- During the H1'2023 period, the REIT manager ILAM did not recommend an interim dividend, and,
- In April 2023, the REIT manager ILAM paid the first and final dividend of Kshs 65 cents per unit with respect to the 2022 fiscal year

Financial Statements Extracts

ILAM Fahari I-REIT recorded a 0.2% decline in profits earned to Kshs 86.0 mn, from Kshs 86.2 mn in H1'2022

- The basic earnings per unit came in at Kshs 0.65 in H1'2023, remaining relatively unchanged from H1'2022. The performance was mainly due to a 0.2% decline in ILAM Fahari's net earnings to Kshs 86.0 mn in H1'2023, from Kshs 86.2 mn recorded in H1'2022. The overall performance was mainly weighed down by a 9.8% increase in the total operating expenses to Kshs 110.0 mn in H1'2023, from Kshs 100.1 mn in H1'2022, which outpaced the 6.3% growth in total operating income to kshs 194.4 mn in H1'2023 from Kshs 182.9 mn in H1'2022,
- Rental income grew by 4.5% to Kshs 179.5 mn in H1'2023, from Kshs 171.8 mn recorded in H1'2022, mainly due to rent escalations in line with the lease agreements with Greenspan Mall's anchor tenant, Naivas Supermarket, as well as other tenants, coupled with the management working on a leasing strategy to increase occupancy levels,
- The rental yield increased by 0.8% points to 6.1% in H1'2023 from 5.3% in H1'2022 attributable to the 4.5% growth in rental income relative to the 10.6% decline in investment property value to 3.3% in H1'2023 from 3.3% in H1'2022,
- Total assets reduced by 3.3% to Kshs 3.6 bn in H1'2023 from Kshs 3.7 bn in H1'2022, as a result of 10.6% decline in investment property to Kshs 2.9 bn from Kshs 3.3 bn in H1'2022, coupled with a 33.8% decline in investment securities to Kshs 192.2 mn in H1'2023, from Kshs 290.2 mn recorded in H1'2022,
- During the H1'2023 period, the REIT manager ILAM did not recommend an interim dividend, and,
- In April 2023, the REIT manager ILAM paid the first and final divided of Kshs 65 cents per unit with respect to the 2022 fiscal year,
- The current dividend yield stands at 10.7%, as at 18th August 2023
- For more information, please see our [ILAM Fahari I-REIT H1'2023 Earnings Notes](#)

II. Laptrust Imara I-REIT

Laptrust Imara I-REIT Performance – H1'2023

- Laptrust Imara I-REIT was authorized by the Capital Markets Authority (CMA) on 1st November 2022. Laptrust Imara I-REIT holds several properties across the country including; Pension towers, CPF House, Metro Park, Freedom Heights mall, Freedom Heights serviced plot, Man apartments and Nova Pioneer in Eldoret
- Below is a summary of the Laptrust Imara I-REIT's H1'2023 Performance;

Key Highlights in H1'2023:

- The REIT Manager Laptrust Imara did not declare any interim dividend during the period, as a result of the ongoing transition period. Since the REIT is in its first year of operation, the decision was meant to allow the REIT to settle into its operations and ensure efficiency, and,
- On 22nd March 2023, Laptrust Imara I-REIT was [listed](#) on the Restricted Sub Segment of the Main Investment Market segment of the Nairobi Securities Exchange (NSE)

- Below is a summary of the Laptrust Imara I-REIT's H1'2023 Performance;

<i>Figures in Kshs bn unless stated otherwise</i>	
Balance Sheet	H1'2023
Total Assets	7.3
Investment Property	6.9
Total Equity	7.0
Total Liabilities	0.3

<i>Figures in Kshs mn unless stated otherwise</i>	
Income Statement	H1'2023
Rental Income	167.1
Income from Other Sources	36.2
Total Operating Income	203.3
Operating Expenses	103.6
Profit/Loss	99.6
Basic EPS (Kshs)	0.3

Ratios Summary	H1'2023
ROA	1.36%
ROE	1.42%
Debt Ratio	4.2%
Operating Expense to Total Income Ratio	51.0%
Operating Expense to Investment Property Ratio	1.5%
PBT Margin	59.6%
Rental Yield	2.4%
Annualized Rental Yield	4.9%

Financial Statements Extracts

Laptrust Imara I-REIT recorded Kshs 99.6 mn in net earnings, and Kshs 203.3 mn in total operating income for the period H1'2023

- The basic earnings per unit came in at Kshs 0.3 in H1'2023. The performance was driven by Kshs 99.6 mn recorded in net earnings in H1'2023, and Kshs 203.3 mn in total operating income,
- Rental and related income for the REIT stood at 167.1 mn in H1'2023, implying a gross rental yield of 2.4% on interest earning assets. This was attributed to lower rental and related income realized in H1'2023 coming in at Kshs 167.1 mn, while investment property came in at Kshs 6.9 bn. Annualized rental yield stands at 4.9%,
- Interest income in the period under review came in at Kshs 3.6 mn attributable to the high interest rates being experienced in the market currently,
- Total operating expenses for the REIT came in at Kshs 103.6 mn in H1'2023, attributed to Kshs 69.5 mn incurred in property expenses and Kshs 34.1 mn in fund operating expenses. Notably, utility expenses came in at Kshs 25.3 mn, whereas property valuation fees stood at 14.5 mn, accounting for 57.2% of the total property expenses in H1'2023,
- Trustee fees in H1'2023 stood at Kshs 21.6 mn, accounting for 63.3% of the total fund operation expenses. Key to note, expenses made up 51.0% of the total operating income,
- Total assets for the REIT stood at Kshs 7.3 bn in H1'2023, comprising of Kshs 6.9 bn in investment property, Kshs 0.3 bn in cash and cash equivalents, and Kshs 0.1 bn in trade and other receivables, and,
- Total liabilities in H1'2023 came in at Kshs 308.1 mn in H1'2022 wholly attributable to trade and other payables. For a more comprehensive analysis, please see our [Laptrust Imara I-REIT H1'2023 Earnings Note](#).

III. Acorn REITs

Acorn REITs Performance – H1'2023

- Acorn Holdings released their H1'2023 financial results for the Acorn D-REIT and I-REIT, which invests in purpose-built student accommodation (PBSA). The Development Real Estate Investment Trust (D-REIT) finances the development of Purpose-Built Student Accommodation (PBSA) housing projects and later exit the projects to the Investment Real Estate investment trust (I-REIT) through legally bidding acquisition agreement. Rental incomes and other sources of income play a significant role in driving the investments and operations of the REITs

Key Highlights in H1'2023:

- Acorn I-REIT declared an interim dividend of Kshs 87.0 mn representing a 35.9% increase compared to Kshs 64.0 mn in H1'2022 interim dividend,
- For the D-REIT, the Board of Trustees did not recommend the payment of a dividend, and,
- Additionally, on 2nd May 2023, Acorn I-REIT paid a final dividend of Kshs 0.50 per unit, adding to the interim dividend of Kshs 0.27 per unit with respect to FY'2022, bringing the total full year distribution to Kshs 192.3 mn, representing 99.0% of the REIT's distributable income.

(All values in Kshs bns unless stated otherwise)

Cytonn Report: Acorn REITs Balance Sheet						
	Acorn I-REIT			Acorn D-REIT		
	H1'2022	H1'2023	Change	H1'2022	H1'2023	Change
Total Assets	4.9	7.3	51.0%	9.7	11.3	16.1%
Investment Property	4.4	6.6	47.9%	9.3	10.5	13.3%
Total Equity	4.7	6.3	34.4%	5.6	6.5	17.4%
Total Liabilities	0.1	1.0	623.3%	4.1	4.7	14.2%

Acorn REITs Performance – H1'2023

Below is a summary of the Acorn's D-REIT and I-REIT H1'2023 performances:

(All values in Kshs mns unless stated otherwise)

Cytonn Report: Acorn REITs Income Statement						
	Acorn I-REIT			Acorn D-REIT		
	H1'2022	H1'2023	Change	H1'2022	H1'2023	Change
Rental Income	185.9	324.8	74.7%	138.9	162.0	16.6%
Income from Other Sources	0.2	0.3	53.4%	0.0	0.02	-
Total operating income	186.0	325.0	74.7%	379.5	515.6	35.9%
Operating Expenses	115.5	197.0	70.6%	146.2	181.4	24.1%
Finance costs	0.06	45.6	71,087.5%	128.3	166.1	29.4%
Profit Before Tax	123.2	113.3	(8.0%)	105.3	170.2	61.7%
Basic EPS (Kshs)	0.55	0.39	(29.0%)	0.45	0.66	45.9%

Cytonn Report: Acorn Ratios Summary						
	Acorn I-REIT			Acorn D-REIT		
	H1'2022	H1'2023	% Points Change	H1'2022	H1'2023	% Points Change
ROA	2.5%	1.5%	(1.0%)	1.1%	1.5%	0.4%
ROE	2.6%	1.8%	(0.8%)	1.9%	2.6%	0.7%
Debt Ratio	2.8%	13.5%	10.7%	42.5%	41.9%	(0.7%)
Operating Expense to Total Income Ratio	62.1%	60.6%	(1.5%)	38.5%	35.2%	(3.3%)
Operating Expense to Investment Property Ratio	2.6%	3.0%	0.4%	1.6%	1.7%	0.1%
PBT Margin	66.3%	34.9%	(31.4%)	27.7%	33.0%	5.3%
Rental Yield	4.2%	5.0%	0.8%	1.5%	1.5%	0.0%
Annualized Rental Yield	8.6%	10.1%	1.5%	3.0%	3.1%	0.1%
Distribution Per Unit	0.29	0.30	4.9%	0.16	0.35	113.0%
Payout Ratio	52.0%	76.8%	24.8%	36.5%	53.3%	16.8%

Financial Statements Extracts

Acorn I-REIT recorded profits of Kshs 113.3 mn in H1'2023, from Kshs 123.2 mn

- Key takeout's include;

Acorn I-REIT

- The basic earnings per unit for the Acorn I-REIT decreased by 29.0% to Kshs 0.39, from Kshs 0.55 in H1'2022, driven by a 8.0% decrease in the I-REIT's profits which came in at Kshs 113.3 mn, from Kshs 123.2 mn in H1'2022. The decrease in profits was attributable to a significant increase in finance costs to Kshs 45.6 mn in H1'2023 from Kshs 0.06 mn coupled with a 70.6% increase in total operating expenses to Kshs 197.0 mn from Kshs 115.5 mn in H1'2022,
- Total operating expenses came in at Kshs 197.0 mn in H1'2023, a 70.6% increase from Kshs 115.5 mn in H1'2022. This was mainly driven by increase in; i) administrative expenses by 78.5% to Kshs 120.7 mn in H1'2023 from Kshs 67.6 mn in H1'2022, and, ii) fund-operating expenses by 59.4% to Kshs 76.3 mn in H1'2023 from Kshs 47.8 mn in H1'2022,
- Total assets for the I-REIT increased by 51.0% to Kshs 7.3 bn in H1'2023, from Kshs 4.9 bn in H1'2022. The increase in assets was mainly on the back of a 47.9% increase in investment property, coming in at Kshs 6.6 bn, from Kshs 4.4 bn in H1'2022 as it acquired the Qwetu Aberdare Heights I in October 2022, and,
- Total liabilities for the I-REIT increased by 623.3% to Kshs 1.0 bn in H1'2023, from Kshs 0.1 bn in H1'2023 as a result of increase in payables to Kshs 172.3 mn in H1'2023, from Kshs 136.6 mn in H1'2022.

Financial Statements Extracts

Acorn D-REIT recorded profits of Kshs 170.2 mn in H1'2023, from 105.3 mn in H1'2022

Acorn D-REIT

- The basic earnings per unit for the Acorn D-REIT increased by 45.9% to Kshs 0.66 in H1'2023 from Kshs 0.45 in H1'2022. This was mainly driven by a 16.6% increase in the rental income to Kshs 162.0 mn, from Kshs 138.9 mn in H1'2022, coupled with a 47.0% increase in fair value of investment properties to Kshs 353.6 mn, from Kshs 240.6 mn in H1'2022,
- The total operating expenses for the D-REIT increased by 26.6% to Kshs 181.4 mn in H1'2023 from Kshs 146.2 mn in H1'2022. This was driven by an increase in the; i) administrative expenses by 45.0% to Kshs 77.1 mn in H1'2023 from Kshs 53.2 mn in H1'2022, and, ii) fund-operating expenses by 12.1% to Kshs 104.3 mn in H1'2023 from Kshs 93.0 mn in H1'2022,
- Total assets for the D-REIT increased by 16.1% to Kshs 11.3 bn in H1'2023, from Kshs 9.7 bn in H1'2022. The increase in assets was mainly on the back of increased investment property with the D-REIT, coming in at Kshs 10.5 bn, an 13.3% increase from Kshs 9.3 bn in H1'2022,
- Total liabilities for the D-REIT increased by 14.2% to Kshs 4.7 bn, from Kshs 4.1 bn in H1'2022 largely driven by; i) 19.5% increase in long-term borrowings which came in at Kshs 3.9 bn in H1'2023 from Kshs 3.3 bn in H1'2022, and ii) 28.0% increase in trade and other payables to Kshs 504.1 mn from Kshs 393.8 mn in H1'2022
- For a more comprehensive analysis, please see our, and [Acorn Holdings H1'2023 Earnings Note](#)

Feedback Summary

During the preparation of this Cytonn Kenya's REITs H1'2023 Report, we shared with the subject companies the metrics that were used in the Report for their confirmation and verification

- Below is a summary of the REITs we were able to acquire feedback from and those that went unresponsive:

Bank	Metrics Shared	Sent Feedback
Laptrust Imara I-REIT	Yes	Yes
ILAM Fahari I-REIT	Yes	Yes
Acorn I-REIT	Yes	Unresponsive
Acorn D-REIT	Yes	Unresponsive

Thank You!

For More Information

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