Real Estate Investment Trusts (REITs) Progress Update in Kenya, & Cytonn Weekly #07/2024

Executive Summary:

Fixed Income: During the week, T-bills were oversubscribed for the seventh consecutive week, with the overall oversubscription rate coming in at 177.8%, albeit lower than the oversubscription rate of 213.0% recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 26.2 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 654.1%, lower than the oversubscription rate of 867.6% recorded the previous week. The subscription rates for the 182-day paper increased to 112.3% from 94.5% recorded the previous week while the subscription rates for the 364-day paper decreased to 52.8% from the 69.7% recorded the previous week. The government accepted a total of Kshs 39.7 bn worth of bids out of Kshs 42.7 bn of bids received, translating to an acceptance rate of 92.9%. The yields on the government papers remained on an upward trajectory, with the yields on the 364-day, 182-day, and 91-day papers increasing by 6.1 bps, 8.2 bps, and 5.0 bps to 16.9%, 16.7%, and 16.6%, respectively;

In the primary bond market, The Central Bank of Kenya released the auction results for the newly issued infrastructure bond IFB1/2024/8.5 with a tenor to maturity of 8.5 years. The bonds were oversubscribed with the overall subscription rate coming in at 412.4%, with the government receiving bids worth Kshs 288.6 bn against the offered Kshs 70.0 bn. The government accepted bids worth Kshs 240.9 bn, translating to an acceptance rate of 83.5%. The weighted average yield of accepted bids came in at 18.5% and the coupon rate was set at 18.5%, 0.6% points higher than that of the previously issued infrastructure bond IFB1/2023/6.5, whose coupon rate was set at 17.9%

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released its monthly statement on the maximum retail fuel prices in Kenya, effective from 15th February 2024 to 14th March 2024. Notably, the maximum allowed price for Super Petrol, Diesel and Kerosene decreased by Kshs. 1.0 each, and will retail at Kshs 206.4, Kshs. 195.5 and Kshs. 193.2 per litre respectively from the January 2024 prices of Kshs. 207.4.4, Kshs. 196.5 and Kshs. 194.2 respectively;

During the week, The Government, through the Ministry of National Treasury & Planning announced the successful pricing of a new USD 1.5 bn Eurobond. The new issuance (KENINT2031) has attracted a yield of 10.375% and a coupon rate of 9.75%, in line with our expectations which were informed by the prevailing market conditions, Kenya's credit ratings, and the unique nature of our buyback and issue plan. Interest payments for the bond are to be paid semi-annually on February 16th and August 16th starting August 2024;

During the week, The Government, on 15th February 2024, announced the results of the Tender offer of its USD 2.0 bn 10-year tenor Eurobond issued in 2014. The buyback offer received tenders worth 1.5 bn against the offered 1.4 bn, translating to an oversubscription rate of 106.1%, with Kenya accepting bids worth USD 1.4 bn, slightly below the offered USD 1.5 bn. This translated to an acceptance rate of 97.0%;

During the week, the global ratings agency, S&P Global affirmed Kenya's long-term sovereign credit rating at 'B' with a negative outlook and assigned a 'B' long-term issue rating to the proposed U.S. dollar-denominated Eurobonds. This came in following the buyback of the 10-year tenor USD 2.0 bn Eurobond tenders issued in 2014 and the new issuance of the KENINT2031 USD 1.5 bn Eurobond.

In addition, the global ratings agency, Moody's announced its revision of the Kenyan banks' outlook to negative from stable on the back of the high volume of non-performing loans (NPLs), which have thrown a pall over the sector's strong profitability and liquidity.

Also during the week, the National Treasury gazetted the revenue and net expenditures for the seventh month of FY'2023/2024, ending 31st January 2024 highlighting that total revenue collected as at the end of January 2024 amounted to Kshs 1,261.0 bn, equivalent to 48.9% of the revised estimates of Kshs 2,576.8 bn for FY'2023/2024 and is 83.9% of the prorated estimates of Kshs 1,503.1 bn;

Equities: During the week, the equities market recorded a mixed performance, with NSE 20 gaining by 0.3%, while NASI, NSE 10, and NSE 25 declined by 0.1%, 0.4%, and 0.5% respectively, taking the YTD performance to gains of 0.5%, 0.4% and 0.8% for NSE 25, NSE 10 and NSE 20 respectively while NASI declined by 1.0%. The equities market performance was driven by losses recorded by large cap stocks such as Diamond Trust Bank, NCBA Bank, and EABL of 6.7%, 3.5%, and 2.8% respectively. The losses were, however, mitigated by gains recorded by large-cap stocks such as Bamburi, Equity Group, and ABSA Bank of 2.3%, 1.3%, and 0.4% respectively;

During the week, British American Tobacco Kenya Plc released their FY'2023 financial results, recording a 19.2% decline in Profits after Tax (PAT) to Kshs 5.6 bn, from Kshs 6.9 bn recorded in FY'2022. The decline in PAT was majorly attributed to the 2.4% decrease in Gross Sales to Kshs 41.2 bn in FY'2023 from Kshs 42.2 bn recorded in FY'2022;

Real Estate: During the week, the Kenya National Bureau of Statistics (KNBS) released the Leading Economic Indicators (LEI) December 2023 Report which highlighted that in the month of November 2023, the number of visitor arrivals recorded stood at 123,604 persons, compared to 107,854 persons recorded during a similar period in 2022. Additionally, the value of building plans approved in the Nairobi Metropolitan Area increased by 54.1% to Kshs 22.1 bn in December 2023 from Kshs 14.3 bn recorded in November 2023. On a y/y basis, the value of approved building plans in the NMA increased by 30.1% to Kshs 195.7 bn as at December, from Kshs 150.3 bn recorded during a similar period in 2022;

Additionally, Knight Frank, an international Real Estate consultancy and management firm, released the Kenya Market Update H2'2023 highlighting that the average selling prices for prime housing units increased by 0.3% points and 2.5% points on q/q and y/y basis respectively;

In the residential sector, Kenya Mortgage Refinance Company (KMRC), a state-backed mortgage refinancing entity, increased the maximum loan size across the country to Kshs 10.5 mn from Kshs 8.0 mn and Kshs 6.0 mn for the Nairobi Metropolitan Area and the rest of the country respectively. In addition, President Ruto laid the foundation for the Makenji Affordable Housing Project located in Kandara Constituency, Murang'a County. The project will consist of 220 units, including 60 studio apartments, 100 two-bedroom apartments, and 60 three-bedroom apartments;

In the industrial sector, Airtel Africa announced plans to build a data centre in Nairobi, which will become its second facility in Africa after Nigeria in a move to diversify its revenue streams;

On the Unquoted Securities Platform Acorn D-REIT and I-REIT traded at Kshs 24.4 and Kshs 21.7 per unit, respectively, as of 16th February 2024. The performance represented a 22.0% and 8.3% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. In addition, Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 19.3%, representing a 0.1% points increase from the 19.2% recorded the previous week

Focus of the Week: Real Estate Investment Trusts (REITs) are collective investment vehicles that allow investors to contribute money as consideration for the acquisition of rights or interests in a trust that is divided into units with the intention of earning profits or income from Real Estate as beneficiaries of the trust. In 2013, Kenya joined the ranks of African countries establishing REIT frameworks, following Ghana and Nigeria in 1994 and 2007, respectively. More than ten years after REITs regulations were put in place, the performance of the Kenyan REIT market is dismal compared to other countries. This is attributable to several challenges and compounded by underdeveloped capital markets which have resulted in an overreliance on conventional sources of funding. The high cost of financing has proven to be a challenge to further advancement of the Real Estate sector. Despite the underperformance, we believe REITs are crucial to closing the funding gap in Real Estate. Because of their unique status as an investment avenue that grants access to capital markets, REITs have the potential to complement various projects in Kenya, including the burgeoning affordable housing initiative. Given the recent delisting of Fahari I-REIT, our topical this week looks at the role of REITs in the affordable housing agenda, progress of REITs in Kenya, key challenges facing the sector, and propose solutions to address them;

Investment Updates:

- Weekly Rates:
    - Cytonn Money Market Fund closed the week at a yield of 16.70% p.a. To invest, dial *809# or download the Cytonn App from Google Play store here or from the Appstore here;
    - Cytonn High Yield Fund closed the week at a yield of 19.30% p.a. To invest, email us at sales@cytonn.com and to withdraw the interest, dial *809# or download the Cytonn App from Google Play store here or from the Appstore here;
- We continue to offer Wealth Management Training every Monday, from 10:00 am to 12:00 pm. The training aims to grow financial literacy among the general public. To register for any of our Wealth Management Trainings, click here;
- If interested in our Private Wealth Management Training for your employees or investment group, please get in touch with us through wmt@cytonn.com;
- Cytonn Insurance Agency acts as an intermediary for those looking to secure their assets and loved ones' future through insurance namely; Motor, Medical, Life, Property, WIBA, Credit and Fire and Burglary insurance covers. For assistance, get in touch with us through insuranceagency@cytonn.com;
- Cytonn Asset Managers Limited (CAML) continues to offer pension products to meet the needs of both individual clients who want to save for their retirement during their working years and Institutional clients that want to contribute on behalf of their employees to help them build their retirement pot. To more about our pension schemes, kindly get in touch with us through pensions@cytonn.com;

Real Estate Updates:

- For more information on Cytonn's real estate developments, email us at sales@cytonn.com;
- Phase 3 of The Alma is now ready for occupation and the show house is open daily. To join the waiting list to rent, please email properties@cytonn.com;
- For Third Party Real Estate Consultancy Services, email us at rdo@cytonn.com;
- For recent news about the group, see our news section here;

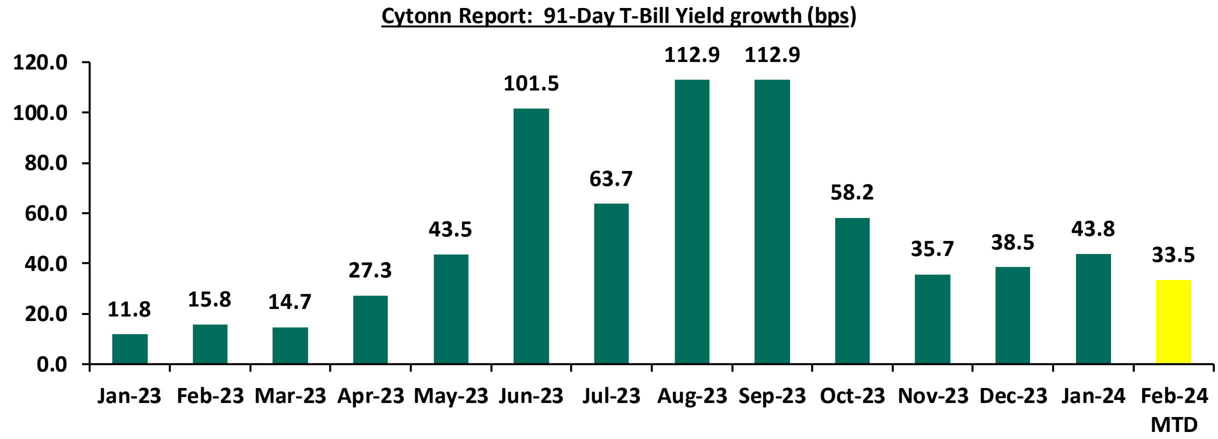
Hospitality Updates:

- We currently have promotions for Staycations. Visit cysuites.com/offers for details or email us at sales@cysuites.com;

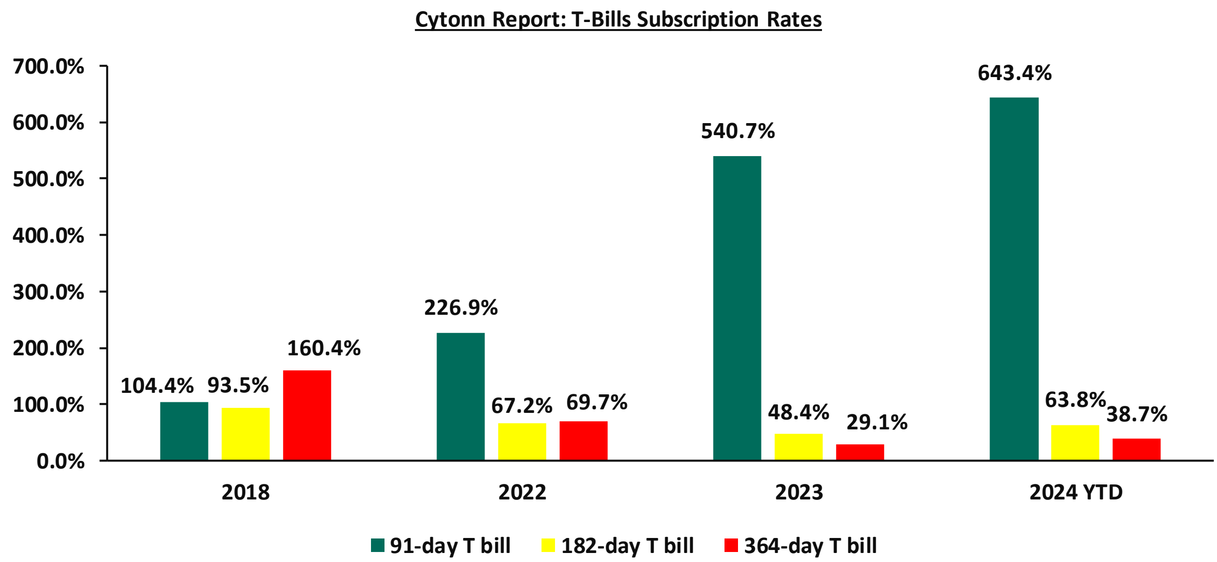
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed for the seventh consecutive week, with the overall oversubscription rate coming in at 177.8%, albeit lower than the oversubscription rate of 213.0% recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 26.2 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 654.1%, lower than the oversubscription rate of 867.6% recorded the previous week. The subscription rates for the 182-day paper increased to 112.3% from 94.5% recorded the previous week while the subscription rates for the 364-day paper decreased to 52.8% from the 69.7% recorded the previous week. The government accepted a total of Kshs 39.7 bn worth of bids out of Kshs 42.7 bn of bids received, translating to an acceptance rate of 92.9%. The yields on the government papers remained on an upward trajectory, with the yields on the 364-day, 182-day and 91-day papers increasing by 6.1 bps, 8.2 bps and 5.0 bps to 16.9%, 16.7% and 16.6%, respectively. The chart below shows the yield growth rate for the 91-day paper over the period:



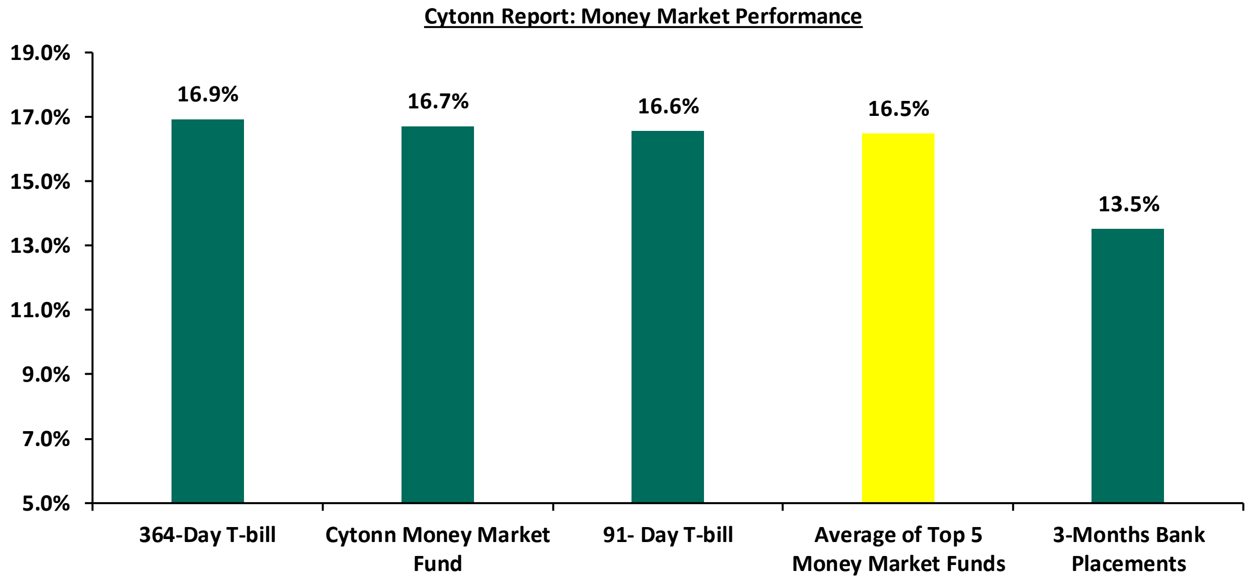
The chart below compares the overall average T-bill subscription rates obtained in 2018, 2022, 2023, and 2024 Year-to-date (YTD):



During the week, The Central Bank of Kenya released the auction results for the newly issued infrastructure bond IFB1/2024/8.5 with a tenor to maturity of 8.5 years. The bond was oversubscribed with the overall subscription rate coming in at 412.4%, with the government receiving bids worth Kshs 288.6 bn against the offered Kshs 70.0 bn. The government accepted bids worth Kshs 240.9 bn, translating to an acceptance rate of 83.5%. The weighted average yield of accepted bids came in at 18.5% and the coupon rate was set at 18.5%, 0.6% points higher than that of the previously issued infrastructure bond IFB1/2023/6.5, whose coupon rate was set at 17.9%.

Money Market Performance:

In the money markets, 3-month bank placements ended the week at 13.5% (based on what we have been offered by various banks), and the yields on the 364-day and 91-day papers increasing by 6.1 bps and 5.0 bps to 16.9% and 16.6%, respectively. The yields of the Cytonn Money Market Fund increased by 8.0 bps to 16.7% from 16.6% recorded the previous week, while the average yields on the Top 5 Money Market Funds decreased marginally by 0.4 bps to remain relatively unchanged from the 16.5% recorded the previous week.



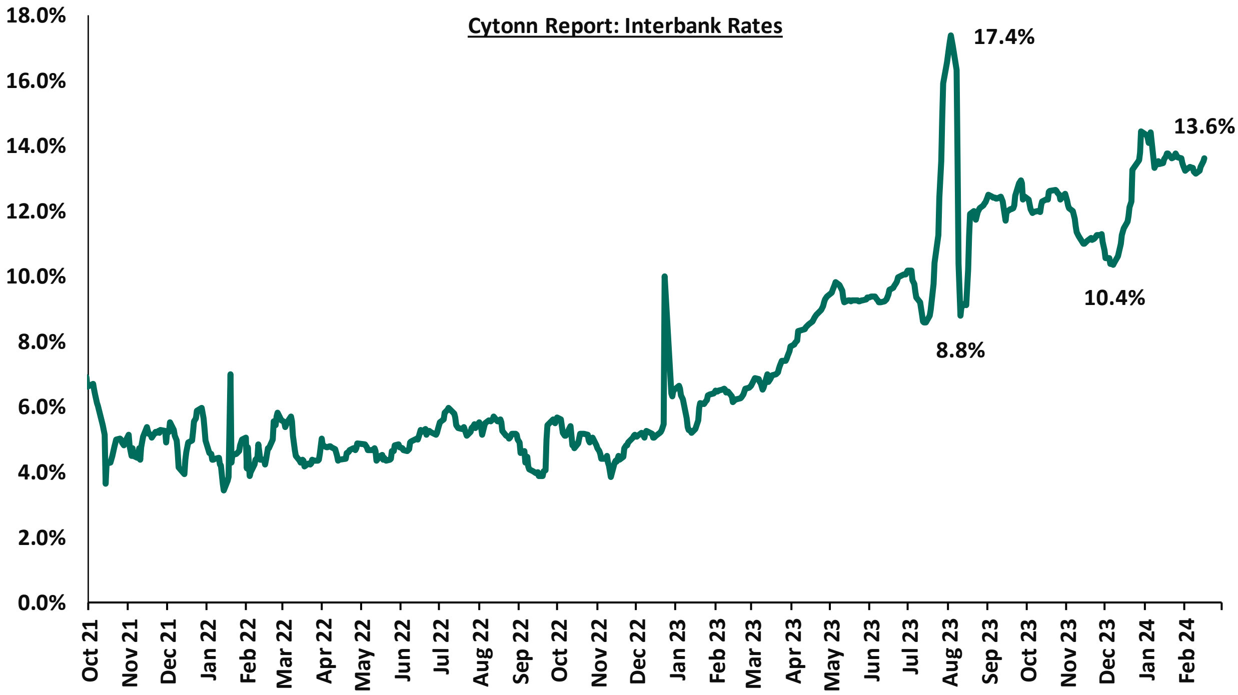
The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 16th February 2024:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 16th February 2024		
Rank	Fund Manager	Effective Annual Rate
1	Etica Money Market Fund	17.1%
2	Lofty-Corban Money Market Fund	17.0%
3	Cytonn Money Market Fund (*Dial *809# or download the Cytonn App)*	16.7%
4	GenAfrica Money Market Fund	16.0%
5	Apollo Money Market Fund	15.8%
6	Nabo Africa Money Market Fund	15.6%
7	Enwealth Money Market Fund	15.3%
8	Kuza Money Market fund	15.1%
9	Madison Money Market Fund	15.1%
10	GenCap Hela Imara Money Market Fund	15.0%
11	Co-op Money Market Fund	14.8%
12	Absa Shilling Money Market Fund	14.4%
13	Jubilee Money Market Fund	14.4%
14	AA Kenya Shillings Fund	14.2%
15	Mayfair Money Market Fund	14.0%
16	Mali Money Market Fund	13.9%
17	Sanlam Money Market Fund	13.8%
18	KCB Money Market Fund	13.6%
19	Old Mutual Money Market Fund	13.3%
20	Orient Kasha Money Market Fund	13.0%
21	Dry Associates Money Market Fund	12.7%
22	CIC Money Market Fund	12.2%
23	ICEA Lion Money Market Fund	11.9%
24	Equity Money Market Fund	11.5%
25	British-American Money Market Fund	10.2%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets marginally tightened, with the average interbank rate increasing by 0.2% points, to 13.4% from 13.3% recorded the previous week, partly attributable to the tax remittances that offset government payments. The average interbank volumes traded increased significantly by 62.9% to Kshs 40.5 bn from Kshs 24.9 bn recorded the previous week. The chart below shows the interbank rates in the market over the years:



Kenya Eurobonds:

During the week, the yields on Eurobonds were on a downward trajectory, with the yields on the 7-year Eurobond issued in 2019 and the 10-year Eurobond issued in 2018 decreasing the most by 1.5% and 1.2% points respectively, to 9.3% and 9.5% from 10.8% and 10.7% recorded the previous week, attributable to the announcement of the June maturity buyback, indicating improved investor perception on the country. The table below shows the summary of the performance of the Kenyan Eurobonds as of 15th February 2024;

Cytonn Report: Kenya Eurobonds Performance						
	2014	2018		2019		2021
Tenor	10-year issue	10-year issue	30-year issue	7-year issue	12-year issue	12-year issue
Amount Issued (USD)	2.0 bn	1.0 bn	1.0 bn	0.9 bn	1.2 bn	1.0 bn
Years to Maturity	0.4	4.1	24.1	3.3	8.3	10.4
Yields at Issue	6.6%	7.3%	8.3%	7.0%	7.9%	6.2%
01-Jan-24	13.6%	9.8%	10.2%	10.1%	9.9%	9.5%
01-Feb-24	14.6%	10.6%	10.6%	11.3%	10.5%	10.1%
8-Feb-24	10.3%	10.7%	10.8%	10.8%	10.8%	10.3%
9-Feb-24	10.3%	10.3%	10.5%	10.4%	10.5%	10.1%
12-Feb-24	10.4%	10.1%	10.5%	10.0%	10.4%	10.0%
13-Feb-24	10.4%	10.0%	10.6%	9.9%	10.5%	10.1%
14-Feb-24	10.1%	9.8%	10.5%	9.7%	10.3%	10.0%
15-Feb-24	9.4%	9.5%	10.4%	9.3%	10.1%	9.8%
Weekly Change	**(0.9%)**	**(1.2%)**	**(0.4%)**	**(1.5%)**	**(0.7%)**	**(0.5%)**

MTD Change	**(5.2%)**	**(1.1%)**	**(0.2%)**	**(2.0%)**	**(0.4%)**	**(0.3%)**
YTD Change	**(4.2%)**	**(0.4%)**	**0.2%**	**(0.8%)**	**0.2%**	**0.3%**

Source: Central Bank of Kenya (CBK) and National Treasury

Kenya Shilling:

During the week, the Kenya Shilling gained against the US Dollar by 10.7% for the third consecutive week, to close at Kshs 142.9, from Kshs 160.1 recorded the previous week. On a year-to-date basis, the shilling has appreciated by 9.0% against the dollar, a contrast to the 26.8% depreciation recorded in 2023.

We expect the shilling to be supported by:

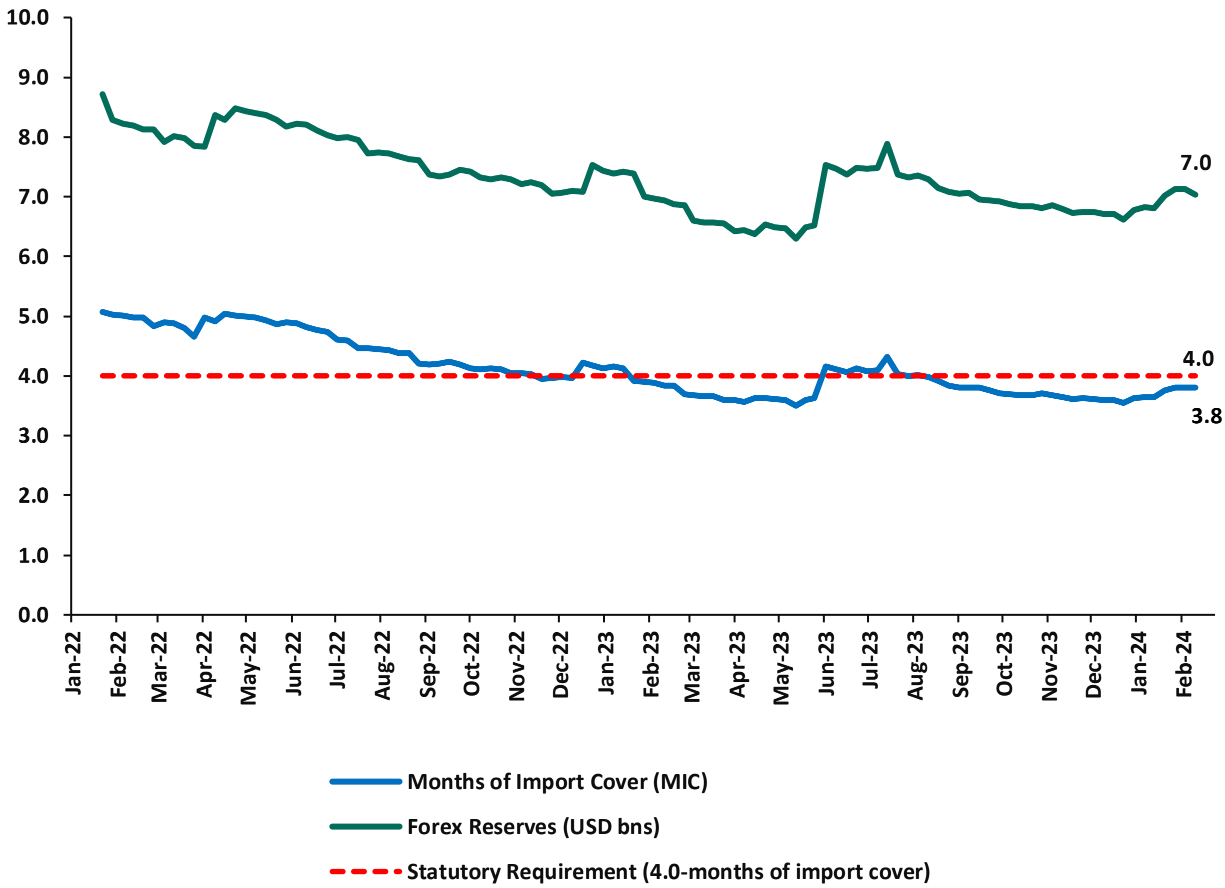
i. In the short-term the positive sentiment emanating from the successful Eurobond issuance given that market had priced in significant probability of default should support the shilling,
ii. Diaspora remittances standing at a cumulative USD 4,253.0 mn in the 12 months to January 2024, 5.3% higher than the USD 4,039.0 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the January 2024 diaspora remittances figures, America remained the largest source of remittances to Kenya accounting for 54.0% in the period, and,
iii. The tourism inflow receipts which came in at USD 333.9 mn in 2023, a 24.6% increase from USD 268.1 mn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 30.7% to 192,000 in the 12 months to December 2023, from 161,000 recorded during a similar period in 2022.

The shilling is however expected to remain under pressure in 2024 as a result of:

i. An ever-present current account deficit which came at 3.5% of GDP in Q3'2023 from 6.4% recorded in a similar period in 2022,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.5% of Kenya's external debt was US Dollar denominated as of September 2023, and,
iii. Dwindling forex reserves, currently at USD 7.0 mn (equivalent to 3.8 months of import cover), which is below the statutory requirement of maintaining at least 4.0 months of import cover.

Key to note, Kenya's forex reserves decreased by 1.4% during the week to USD 7.0 bn from the USD 7.1 bn recorded the previous week, equivalent to 3.8 months of import cover relatively unchanged from the months of import cover recorded the previous week, and remained below the statutory requirement of maintaining at least 4.0 months of import cover. The chart below summarizes the evolution of Kenya's months of import cover over the years:

Cytonn Report: Kenya Months of Import Cover and Forex Reserves



Weekly Highlights

I. Fuel Prices effective 15th February 2024 to 14th March 2024

During the week, the Energy and Petroleum Regulatory Authority (EPRA) released their monthly statement on the maximum retail fuel prices in Kenya, effective from 15th February 2024 to 14th March 2024. Notably, the maximum allowed price for Super Petrol, Diesel and Kerosene decreased by Kshs 1.0 each, and will retail at Kshs 206.4, Kshs 195.5 and Kshs 193.2 per litre respectively from the January 2024 prices of Kshs 207.4.4, Kshs 196.5 and Kshs 194.2 respectively.

Other key take-outs from the performance include;

i. The average landing costs per cubic meter for Diesel, Super Petrol, and Kerosene decreased by 3.1%, 1.7%, and 1.2% respectively to USD 728.0, USD 666.2, and USD 718.5 in January 2024, from USD 751.2, USD 677.8 and USD 727.0, respectively, in December 2023.
ii. The Kenyan shilling depreciated against the US Dollar by 3.5% to Kshs 164.4 in January 2024, compared to the mean monthly exchange rate of Kshs 158.8 recorded in December 2023.

We note that fuel prices in the country have decreased largely attributed to the government's efforts to stabilize pump prices through the petroleum pump price stabilization mechanism which has so far expended Kshs 9.9 bn in the FY2023/24 to cushion the increases applied to the petroleum pump prices. Nevertheless, fuel prices in the country remain under pressure from the high cost of fuel imports resulting from the sustained depreciation of the shilling against the US dollar, as well as the high taxation of petroleum products as provided in the Finance Act 2023. We expect that fuel prices will ease in the coming months as a result of the government's efforts to mitigate the cost of petroleum through the pump price stabilization mechanism coupled with the ongoing strengthening of the Kenyan Shilling against the United States Dollar.

II. Kenya USD 1.5 bn Eurobond Issuance

During the week, The Government, through the Ministry of National Treasury & Planning announced the successful pricing of a new USD 1.5 bn Eurobond. The new issuance (KENINT2031) has attracted a yield of 10.375% and a coupon rate of 9.75%, in line with our expectations which were informed by the prevailing market conditions, Kenya's credit ratings, and the unique nature of our buyback and issue plan. Interest payments for the bond are to be paid semi-annually on February 16th and August 16th starting August 2024.

The total proceeds for the bond came in at USD 1.46 bn, with the bond having been priced at a 97.27% discount. Maturity for the bond is set for 16th February 2031, with redemptions in three installments of USD 0.5 bn in 2029 and 2030 February, translating to an annualized average life of 6 years.

This issue follows issues by Ivory Coast and Benin earlier in the year. Continuing the trend for offers by other Sub-Saharan African countries, Kenya's issue was oversubscribed, with the overall subscription rate coming in at 393.3%. The issue received offers of USD 6.0 bn. The yield is, however, the highest for a bond issued in the SSA region this year, close to Ghana's 10.8% 2015 bond which they defaulted on.

Kenya is expected to use the proceeds from this issuance to finance the earlier announced buyback of the USD 2.0 bn 2014 10-year tenor Eurobond. The remaining amount of the initial bond will the repaid at maturity through a mix of syndicated financing, multilateral financing, and domestic financing. This issue ends the uncertainty that had hovered over Kenya's ability to repay the bond that is due for maturity, albeit at very high costs.

The table below shows the comparison between Kenya's issue and the other two issues in the Sub-Saharan Africa region;

Cytonn Report: Fitch Rating's Long-Term Foreign-Currency Issuer Default Rating (IDR)							
Fitch Rating's Long-Term Foreign-Currency Issuer Default Rating (IDR)				2024 Eurobond Issues			
Country	IDR Credit Rating	IDR Credit Outlook	Date	Value (USD mn)	Tenor (Years)	Yield at Issue	Coupon Rate
Ivory Coast	BB-	Stable	Feb-2024	1,100.0	8.5	7.650%	7.650%
				1,500.0	12.5	8.250%	8.250%
Benin	B+	Stable	Sep-2023	750.0	14.0	8.375%	8.375%
Kenya	B	Negative	Jul-2023	1,500.0	6.0	10.375%	9.750%

III. Kenya's USD 1.4 bn Eurobond Buyback Results

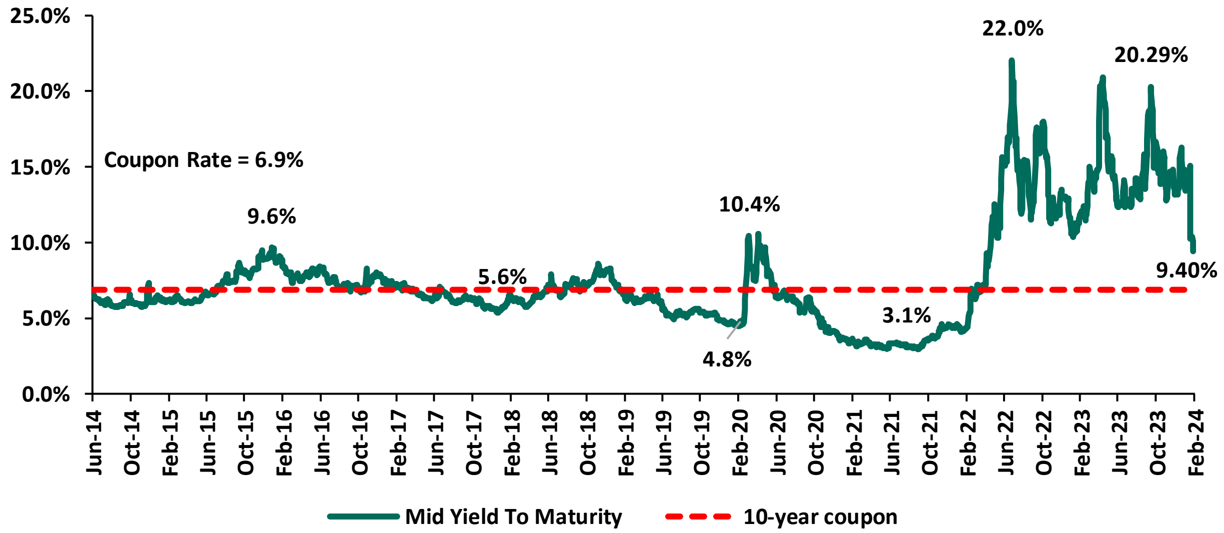
The Government, on 15th February 2024, announced the results of the Tender offer of its USD 2.0 bn 10-year tenor Eurobond issued in 2014. This follows the end of the tender period which opened from 7th of February 2024 to 14th February 2024 with the intent of purchasing Notes due in 2024 from their holders at par value, for cash. The results also came in two days after Kenya announced a successful pricing of the new USD 1.5 bn Eurobond. The buyback offer received tenders worth 1.5 bn against the offered 1.4 bn, translating to an oversubscription rate of 106.1%, with Kenya accepting bids worth USD1.4 bn, slightly below the offered USD 1.5 bn. This translated to an acceptance rate of 97.0%. The settlement date for the buyback was set on 21st February 2024.

As earlier announced, the buyback will be financed by the new issue of USD 1.5 bn which attracted a yield of 10.375% and a coupon rate of 9.75%. The Purchase Price for the Notes accepted for purchase is USD 1,000 per USD 1,000 in principal amount of such Notes plus the interests accrued. Consequently, all purchased Notes will be cancelled and will not be reissued or resold. The remaining notes worth USD 0.6 bn not offered or not accepted for purchase as per the Offer will continue to be in circulation and will repaid at maturity through a mix of syndicated financing, multilateral financing, and domestic financing. As announced by the CBK governor earlier, Kenya has in the last few weeks received disbursements of USD

684.0 mn from the IMF and USD 400.0 mn from the Trade Development Bank, and anticipates an additional USD 1.5 bn from the World Bank between March and April.

Kenya decided to proceed to the international markets for funding to meet its debt obligations which were a source of increased concern by all stakeholders. Through its leading dealer managers Citigroup Global Markets Limited and the Standard Bank of South Africa Limited, Kenya managed to have a buyback and new issue run concurrently in the market. As it stands, the cloud of debt default that hanged over the country for a long period seems to have passed, albeit at higher costs. Kenya's credit ratings, however, still remain negative as affirmed by Fitch in the wake of this buyback. The markets reacted positively to this announcement, with the yield on the 10-year 2014 Issue falling to 9.4%, from 10.3% at the end of the previous week. The graph below shows the yields for the bond since it was issued in 2014:

Cytonn Report: Kenya Eurobond Yields (10-year tenor, 2014 issue)



IV. Revenue and Net Expenditures for FY'2023/2024

The National Treasury gazetted the revenue and net expenditures for the seventh month of FY'2023/2024, ending 31st January 2024. Below is a summary of the performance:

Cytonn Report: FY'2023/2024 Budget Outturn - As at 31st January 2024						
Amounts in Kshs bn unless stated otherwise						
Item	12-months Original Estimates	Revised Estimates	Actual Receipts/Release	Percentage Achieved of the Revised Estimates	Prorated	% achieved of the Prorated
Opening Balance			2.6			
Tax Revenue	2,495.8	2,495.83	1,216.4	48.7%	1,455.9	83.6%
Non-Tax Revenue	75.3	80.9	41.9	51.8%	47.2	88.8%
Total Revenue	**2,571.2**	**2,576.8**	**1,261.0**	**48.9%**	**1,503.1**	**83.9%**
External Loans & Grants	870.2	849.8	241.6	28.4%	495.7	48.7%
Domestic Borrowings	688.2	851.9	305.2	35.8%	496.9	61.4%
Other Domestic Financing	3.2	3.2	3.5	111.1%	1.9	190.4%
Total Financing	**1,561.6**	**1,704.9**	**550.4**	**32.3%**	**994.5**	**55.3%**
Recurrent Exchequer issues	1,302.8	1,360.1	700.2	51.5%	793.4	88.2%
CFS Exchequer Issues	1,963.7	2,078.8	831.8	40.0%	1,212.7	68.6%
Development Expenditure & Net Lending	480.8	457.2	103.1	22.5%	266.7	38.6%
County Governments + Contingencies	385.4	385.4	174.3	45.2%	224.8	77.5%

Total Expenditure	**4,132.7**	**4,281.6**	**1,809.3**	**42.3%**	**2,497.6**	**72.4%**
Fiscal Deficit excluding Grants	**1,561.6**	**1,704.9**	**548.3**	**32.2%**	994.5	55.1%
Total Borrowing	**1,558.4**	**1,701.7**	**546.9**	**32.1%**	992.6	**55.1%**

Amounts in Kshs bn unless stated otherwise

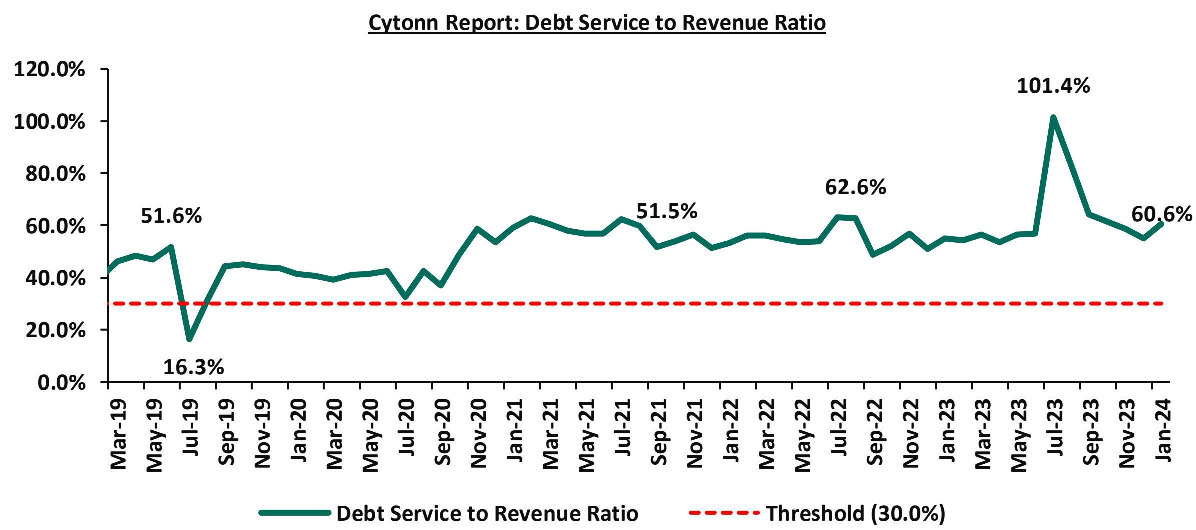
The Key take-outs from the release include;

a. Total revenue collected as at the end of January 2024 amounted to Kshs 1,261.0 bn, equivalent to 48.9% of the revised estimates of Kshs 2,576.8 bn for FY'2023/2024 and is 83.9% of the prorated estimates of Kshs 1,503.1 bn. Cumulatively, tax revenues amounted to Kshs 1,216.4 bn, equivalent to 48.7% of the revised estimates of Kshs 2,495.8 bn and 83.6% of the prorated estimates of Kshs 1,455.9 bn,

b. Total financing amounted to Kshs 550.4 bn, equivalent to 32.3% of the revised estimates of Kshs 1,704.9 bn and is equivalent to 55.3% of the prorated estimates of Kshs 994.5 bn. Additionally, domestic borrowing amounted to Kshs 305.2 bn, equivalent to 35.8% of the revised estimates of Kshs 851.9 bn and is 61.4% of the prorated estimates of Kshs 496.9 bn,

c. The total expenditure amounted to Kshs 1,809.3 bn, equivalent to 42.3% of the revised estimates of Kshs 4,281.6 bn, and is 72.4% of the prorated target expenditure estimates of Kshs 2,497.6 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 700.2 bn, equivalent to 51.5% of the revised estimates of Kshs 1,360.1 and 88.2% of the prorated estimates of Kshs 793.4 bn,

d. Consolidated Fund Services (CFS) Exchequer issues came in at Kshs 831.8 bn, equivalent to 40.0% of the revised estimates of Kshs 2,078.8 bn, and are 68.6% of the prorated amount of Kshs 1,212.7 bn. The cumulative public debt servicing cost amounted to Kshs 764.3 bn which is 41.0% of the revised estimates of Kshs 1,866.0 bn, and is 70.2% of the prorated estimates of Kshs 1,088.5 bn. Additionally, the Kshs 764.3 bn debt servicing cost is equivalent to 60.6% of the actual revenues collected as at the end of January 2024. The chart below shows the debt serving to revenue ratio;



e. Total Borrowings as at the end of January 2024 amounted to Kshs 546.9 bn, equivalent to 32.1% of the revised estimates of Kshs 1,701.7 bn for FY'2023/2024 and are 55.1% of the prorated estimates of Kshs 992.6 bn. The cumulative domestic borrowing of Kshs 851.9 bn comprises of Net Domestic Borrowing Kshs 471.4 bn and Internal Debt Redemptions (Rollovers) Kshs 380.5 bn.

January's 83.9% attainment of the revenue target is a 0.9%-points decline from the performance in December where government achieved 84.8% of the revenue targets. This decline can be attributed to the challenges posed by the tough economic conditions evidenced by the high inflation rate that increased by

0.3% points in January to 6.9% from the 6.6% recorded in December. The government's continued failure to achieve its prorated revenue targets for the seventh consecutive month in FY'2023/2024 reflects the challenges posed by the tough economic situation. The revenue collection continues to be impeded by the business environment which still remains in the contraction zone despite showing slight improvement, coming in at 49.8 in January. We believe that the performance of revenue collection in the coming months will be largely determined by how soon the country's business environment stabilizes, which is expected to be supported by the ongoing strengthening of the Shilling against the dollar. Notably, the government also continues to implement strategies to enhance revenue collection, such as expanding the revenue base and addressing tax leakages, as well as suspending tax relief payments.

V. Kenya's S&P Global Issuer Default Rating

Following Kenya's announcement, to go through with the earlier announced plan of buying back the 10-year tenor USD 2.0 bn Eurobond tenders issued in 2014, S&P Global Ratings affirmed Kenya's long-term sovereign credit rating at 'B' with a negative outlook and assigned a 'B' long-term issue rating to the proposed U.S. dollar-denominated Eurobonds. The government's decision to buy back some of its debt is not seen as a desperate move according to the S&P Global rating criteria. This is because bondholders who opt not to participate in the buyback will still receive their full investment back upon the bond's original maturity date, which is June 24th, 2024.

The negative outlook assigned to Kenya's sovereign credit rating underscores the potential risks and uncertainties that lie ahead. Due to the high inflation which currently stands at 6.9%, liquidity in the domestic capital markets has tightened. Additionally, external debt-servicing capacity remains a key concern amidst high external refinancing requirements. The government revised its budget deficit target to 5.5% of GDP for FY'2023/2024 from the 4.4% approved under the Finance Act, reflecting underperformance in revenue collection as well as rising costs of paying back old debts due to currency pressures.

Acknowledging Kenya's strong GDP growth, dynamic private sector, and diversified economy, the ratings agency also raised concerns over the high fiscal deficits, debt levels, and sizable external financing requirements. These challenges underscore the importance of prudent fiscal management and effective debt sustainability measures to safeguard Kenya's economic stability.

While securing loans can seem like a quick fix, Kenya's access to external financing is a double-edged sword. The disbursements from development partners' multilateral and regional institutions such as the IMF of a total USD 4.4 bn as of December 2023, an additional USD 400.0 mn from Trade and Development Bank in January 2024 and expected inflows of upto USD 1.5 bn and USD 100.0 mn from the World Bank and African Development Bank respectively; are expected to support the foreign exchange reserves of USD 7.1 bn as of 9th February 2024, with 3.8 months of import cover. Even though these loans help in the short term, they add to Kenya's already high debt burden. Getting loans helps Kenya avoid immediate financial trouble, but long-term solutions like managing debt and boosting exports are crucial for lasting stability.

According to S&P Global, Kenya's ratings could go lower over the next 6 to 12 months on the back of increased external financing attributable to a decline in the foreign exchange reserves. Additionally, any future debt-repurchase operations related to a distressed currency performance and limited progress on fiscal consolidation could lead to a further decline in the ratings.

Kenya's economic stability hinges on its ability to manage its debt and external financing while achieving fiscal consolidation. Continued efforts in these areas are crucial to avoid a credit rating downgrade and secure a more stable outlook.

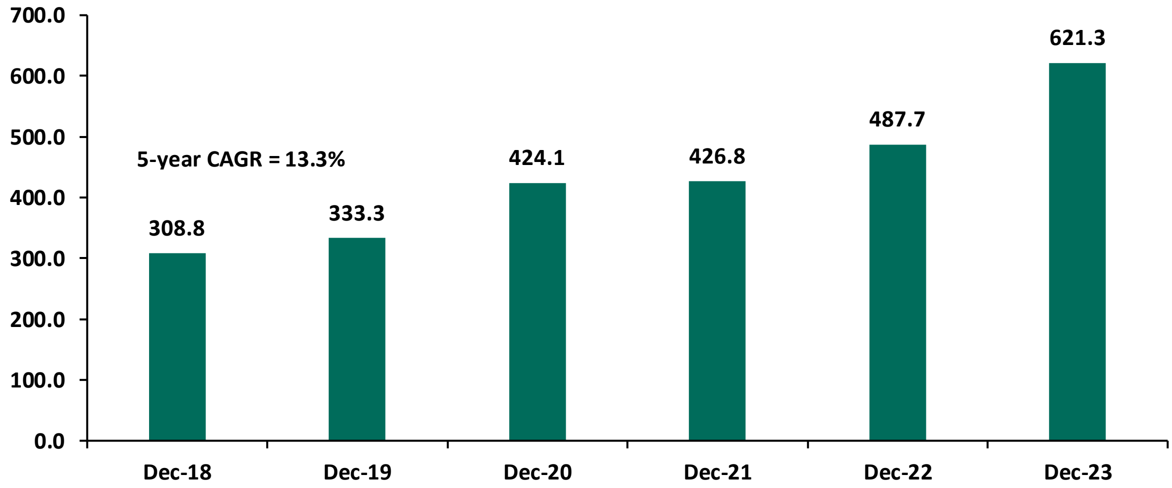
VI. Moody's Downgrades Kenyan Banks' Outlook to Negative

On February 15th 2024, the global ratings agency, Moody's announced its revision of the Kenyan banks' outlook to negative from stable on the back of the high volume of non-performing loans (NPLs), which have thrown a pall over the sector's strong profitability and liquidity.

The loan defaults increased to Kshs 621.3 bn in December 2023 from the Kshs 487.7 bn recorded in December 2022. These number of non-performing loans accounted for 14.8% of the sector's loan book in December 2023, up significantly from 13.3% in 2022, attributable to the high inflation and interest rates and the reduced demand for goods and services that have combined to weaken borrowers' ability to service loans.

Notably, the Monetary Policy Committee (MPC) raised the Central Bank Rate (CBR) by a cumulative 375 basis points to close the year at 12.5%. In its latest sitting in February 2024, the MPC raised the CBR to 13.0%, the highest in twelve years. The decision by the committee to raise the rate displays efforts to cushion the high inflation rates and to support the local currency, that has since appreciated against the US dollar significantly by 9.0% to Kshs 145.9 as of 16th February 2024 from the Kshs 160.4 recorded on 6th February 2024 when the central bank rate was raised to 13.0%. This increase in the rate however translates to high loan prices that cause borrowers to struggle during repayments. Below is a graph of NPLs over the last five years;

Cytonn Report: Banking Sector Non-performing Loans (Kshs bn)



Source: CBK, Treasury

The Moody's outlook is not a credit rating action, but rather an assessment of credit fundamentals in the banking industry for the next 12 to 18 months. The agency's concern about the high amount of non-performing loans stems mostly from the impact on bank profitability, since banks are required to increase their provisioning whenever the number of default loans rises.

The global ratings agency further noted that the positive impact of higher interest income is expected to be offset by the negative impacts of higher loan loss provisioning and higher cost of deposits, resulting in declined profits for banks this year.

As the banking sector's asset quality deteriorates, commercial banks may reduce the issuing of new loans in order to manage the mounting non-performing loans. Banks may use steps similar to those prompted by the Covid-19 crisis to stabilise their loan books, such as extending repayment times to consumers.

Rates in the Fixed Income market have been on an upward trend given the continued high demand for cash by the government and the occasional liquidity tightness in the money market. The government is 10.3% ahead of its prorated net domestic borrowing target of Kshs 301.7 bn, having a net borrowing position of Kshs 332.9 bn out of the domestic net borrowing target of Kshs 471.4 bn for the FY'2023/2024. Therefore, we expect a continued upward readjustment of the yield curve in the short and medium term, with the government looking to maintain the fiscal surplus through the domestic market. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk

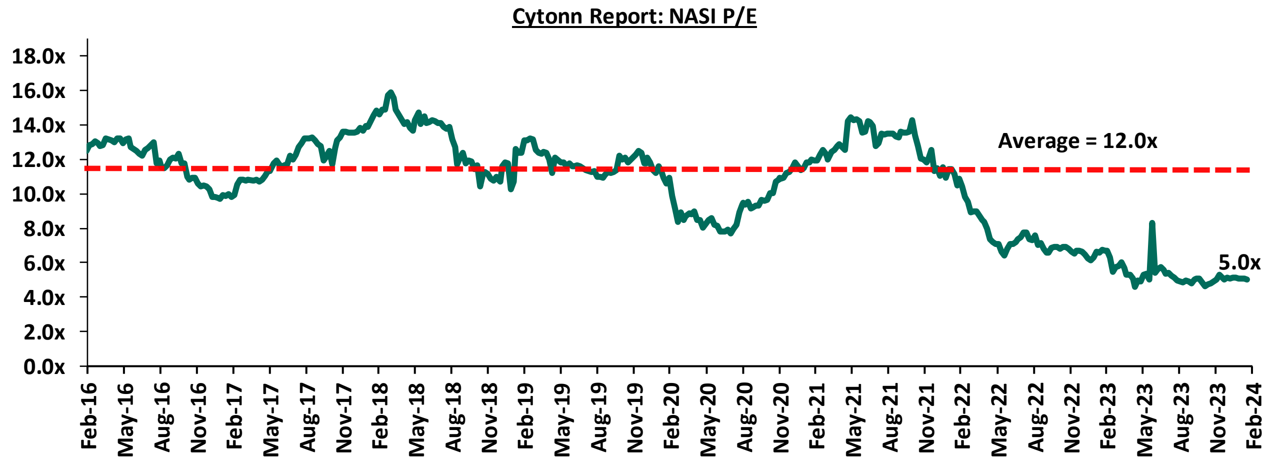
<u>Equities</u>

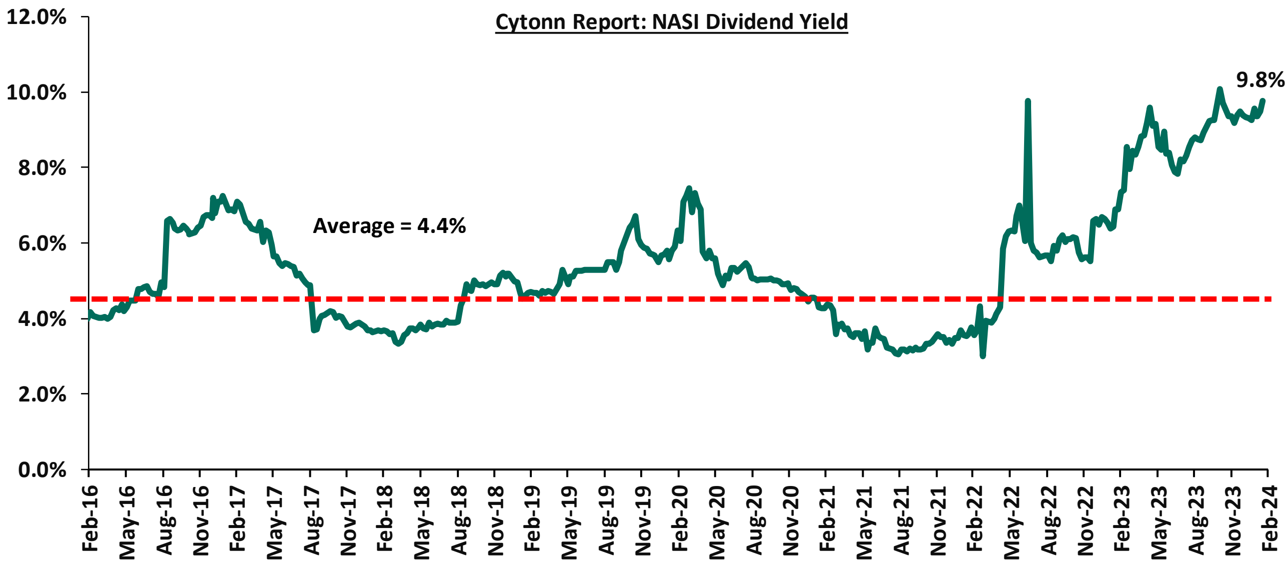
Market Performance:

During the week, the equities market recorded a mixed performance, with NSE 20 gaining by 0.3%, while NASI, NSE 10, and NSE 25 declined by 0.1%, 0.4%, and 0.5% respectively, taking the YTD performance to gains of 0.5%, 0.4% and 0.8% for NSE 25, NSE 10 and NSE 20 respectively while NASI declined by 1.0%. The equities market performance was driven by losses recorded by large cap stocks such as Diamond Trust Bank, NCBA Bank, and EABL of 6.7%, 3.5%, and 2.8% respectively. The losses were, however, mitigated by gains recorded by large-cap stocks such as Bamburi, Equity Group, and ABSA Bank of 2.3%, 1.3%, and 0.4% respectively.

During the week, equities turnover increased by 3.2% to USD 6.4 mn from USD 6.2 mn recorded the previous week, taking the YTD total turnover to USD 31.0 mn. Foreign investors remained net sellers for the sixth consecutive week with a net selling position of USD 0.4 mn, similar to the net selling position of USD 0.4 mn recorded the previous week, taking the YTD foreign net selling position to USD 1.9 mn.

The market is currently trading at a price-to-earnings ratio (P/E) of 5.0x, 58.4% below the historical average of 12.0x. The dividend yield stands at 9.8%, 5.4% points above the historical average of 4.4%. Key to note, NASI's PEG ratio currently stands at 0.6x, an indication that the market is undervalued relative to its future growth. A PEG ratio greater than 1.0x indicates the market is overvalued while a PEG ratio less than 1.0x indicates that the market is undervalued. The charts below indicate the historical P/E and dividend yields of the market;





Universe of Coverage:

Cytonn Report: Universe of Coverage										
Company	Price as at 09/02/2024	Price as at 16/02/2024	w/w change	YTD Change	Year Open 2024	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
KCB Group***	20.0	19.9	(0.5%)	(9.6%)	45.6	31.2	10.0%	67.2%	0.3x	Buy
Sanlam	6.6	6.8	2.7%	13.0%	11.6	10.3	0.0%	51.8%	1.9x	Buy
Jubilee Holdings	190.0	180.0	(5.3%)	(2.7%)	316.8	260.7	6.3%	51.1%	0.3x	Buy
Kenya Reinsurance	1.9	1.9	0.0%	0.0%	2.3	2.5	10.8%	46.5%	0.1x	Buy
NCBA***	37.6	36.3	(3.5%)	(6.6%)	25.5	48.3	11.3%	44.4%	0.7x	Buy
I&M Group***	17.4	17.4	(0.3%)	(0.6%)	21.4	22.1	12.9%	40.3%	0.4x	Buy
Diamond Trust Bank***	48.8	45.6	(6.7%)	1.8%	59.5	58.5	10.2%	38.7%	0.2x	Buy
ABSA Bank***	12.1	12.1	0.4%	4.8%	11.8	14.6	11.2%	31.9%	1.0x	Buy
CIC Group	2.1	2.0	(6.5%)	(12.7%)	2.2	2.5	6.1%	31.1%	0.6x	Buy
Stanbic Holdings	115.0	114.0	(0.9%)	7.5%	87.0	132.8	11.0%	27.4%	0.8x	Buy
Standard Chartered***	165.0	163.5	(0.9%)	2.0%	130.0	185.5	13.3%	26.8%	1.1x	Buy
Co-op Bank***	12.2	12.1	(0.8%)	6.6%	13.0	13.8	12.3%	26.3%	0.6x	Buy
Equity Group***	37.5	38.0	1.3%	11.0%	52.8	42.8	10.7%	23.5%	0.8x	Buy
Britam	4.7	5.0	6.2%	(2.9%)	7.6	6.0	0.0%	19.6%	0.7x	Accumulate
Liberty Holdings	5.5	5.5	0.4%	42.5%	7.1	5.9	0.0%	7.6%	0.4x	Hold
HF Group	3.8	3.9	2.1%	12.2%	3.8	3.9	0.0%	0.8%	0.2x	Lighten

Weekly Highlights:

I. British American Tobacco (BAT) Kenya Plc FY'2023 Financial Performance

During the week, British American Tobacco Kenya Plc released their FY'2023 financial results, recording a 19.2% decline in Profits after Tax (PAT) to Kshs 5.6 bn, from Kshs 6.9 bn recorded in FY'2022. The decline in PAT was majorly attributed to the 2.4% decrease in Gross Sales to Kshs 41.2 bn in FY'2023 from Kshs 42.2 bn recorded in FY'2022. The performance was further weighed down by the 5.5% increase in indirect taxes to Kshs 15.7 bn in FY'2023, from Kshs 14.9 bn recorded in FY'2022 mainly driven by the upward revision of excise duty by 10.0% in July 2022 and a further 6.0% increment in October 2022. The tables below show the breakdown of BAT's financial performance;

Cytonn Report: British American Tobacco (BAT) Kenya Plc Summarized Income Statement			
Income Statement	FY'2022	FY'2023	Y/Y Change
	Kshs (bn)	Kshs (bn)	
Gross Sales including Indirect Taxes	42.2	41.2	(2.4%)
Exercise Duty and Value-Added Taxes	(14.9)	(15.7)	5.5%
Net Revenue	**27.4**	**25.6**	**(6.7%)**
Cost of operations	(17.5)	(17.6)	0.8%
Profit from operations	**9.9**	**7.9**	**(19.8%)**
Net Finance Costs/Income	0.0	0.1	193.9%
Profit Before Income Tax	**9.9**	**8.0**	**(19.1%)**
Income Tax Expenses	(3.0)	(2.5)	(18.8%)
Profit After Tax	**6.9**	**5.6**	**(19.2%)**
Dividend Paid	5.7	5.0	(12.3%)
Earnings Per Share (Kshs)	**68.9**	**55.7**	**(19.2%)**

Source: British American Tobacco (BAT) Kenya Plc FY'2023 Financial Report

Cytonn Report: British American Tobacco (BAT) Kenya Plc Summarized Balance Sheet			
Balance Sheet	FY'2022	FY'2023	Y/Y Change
	Kshs (bn)	Kshs (bn)	
Current Assets	11.9	12.2	3.3%
Non-Current Assets	12.1	11.8	(2.4%)
Total Assets	**23.9**	**24.1**	**0.4%**
Current Liabilities	5.5	5.8	5.8%
Non-Current Liabilities	2.1	2.0	(4.0%)
Total Liabilities	**7.6**	**7.8**	**3.1%**
Total Equity	**16.4**	**16.3**	**(0.8%)**

Source: British American Tobacco (BAT) Kenya Plc FY'2023 Financial Report

Key take outs from the financial performance include;

i. Net revenue decreased by 6.7% to Kshs 25.6 bn in FY'2023, from Kshs 27.4 bn recorded in FY'2022, mainly driven by the 2.4% decline in gross sales to Kshs 41.2 bn in 2023, from Kshs 42.2 bn in 2022 coupled with the 5.5% increase in indirect taxes that came in at Kshs 15.7 bn in FY'2023, from Kshs 14.9 bn in FY'2022. Notably, the decrease in gross sales is attributed to the high inflationary pressures resulting in increased prices of factor inputs, and the continued erosion of the market share by illegal cigarettes,
ii. Indirect Taxes increased by 5.5% to Kshs 15.7 bn, from Kshs 14.9 bn attributable to a cumulative 16.0% increase in exercise duty tax rates between the FY'2022 and FY'2023,
iii. Cost of sales increased marginally by 0.8% to Kshs 17.6 bn in FY'2023, from Kshs 17.5 bn in FY'2022, largely driven by increased cost of inputs occasioned by the elevated inflationary pressures with annual inflation averaging 7.7% in 2023 coupled with the local currency depreciation which made the importation of inputs more costly,
iv. The Group's current liabilities increased by 5.8% to Kshs 5.8 bn in FY'2023, from Kshs 5.5 bn recorded in FY'2022, mainly attributable to an increase in short-term loans despite the significant

improvement of the net financial income to Kshs 0.1 bn in FY'2023, from a financial income of Kshs 0.03 bn recorded in FY'2022,

v. Earnings per share decreased significantly by 19.2% to Kshs 55.7 in FY'2023, from Kshs 68.9 in FY'2022, mainly due to the 6.7% decline in net revenue to Kshs 25.6 bn in FY'2023, from Kshs 27.4 bn recorded in FY'2022, and,

vi. The board of directors proposed a final dividend of Kshs 45.0 per share pending approval by shareholders at the Annual General Meeting to be held on 26th June 2024 with an expected book closure on 24th May 2024. The total dividend to be paid for the FY'2023 amounts to Kshs 50.0 per share, translating to a dividend yield of 11.9%, as at 16th February 2024.

In the face of a tough macroeconomic climate, BAT's PAT declined by 19.2% to Kshs 5.6 bn in FY 2023, down from Kshs 6.9 bn recorded in FY'2022. The challenging operating environment was characterized by local currency depreciation and high inflationary pressures eroding consumers' purchasing power, coupled with the fiscal policies that have increased excise taxes over the last 12 months. As a result, the increased taxes continue to weigh down on the Group's overall performance and profitability. In addition, regulatory uncertainty relating to BAT's modern oral product hindered the company from commercializing its nicotine pouch factory in Nairobi and resulted in supply chain disruptions for tobacco-free oral nicotine pouches. Going forward, we expect the Group's earnings to be supported by market expansion following the addition of Malawi, Mozambique, Angola, Zimbabwe, and Zambia to BAT Kenya's scope of operation resulting in increased export volumes. However, the regulatory uncertainty following the expiry of the temporary license to sell the nicotine pouches without standard-sized health warnings in July 2023, continues to hinder the supply and sale of the product, as well as the operationalization of its planned nicotine pouch production plant in Nairobi. Key to note, the Group's announcement of a final dividend of Kshs 45.0 per share for the period ending 31st December 2023, adding to the interim dividend of Kshs 5.0 per share brings the total dividend for FY'2023 to Kshs 50.0, translating to a 12.3% decline from Kshs 57.0 total dividend per share paid in FY'2022.

We are "Neutral" on the Equities markets in the short term due to the current tough operating environment and huge foreign investor outflows, and, "Bullish" in the long term due to current cheap valuations and expected global and local economic recovery. With the market currently being undervalued to its future growth (PEG Ratio at 0.6x), we believe that investors should reposition towards value stocks with strong earnings growth and that are trading at discounts to their intrinsic value. We expect the current high foreign investor sell-offs to continue weighing down the equities outlook in the short term.

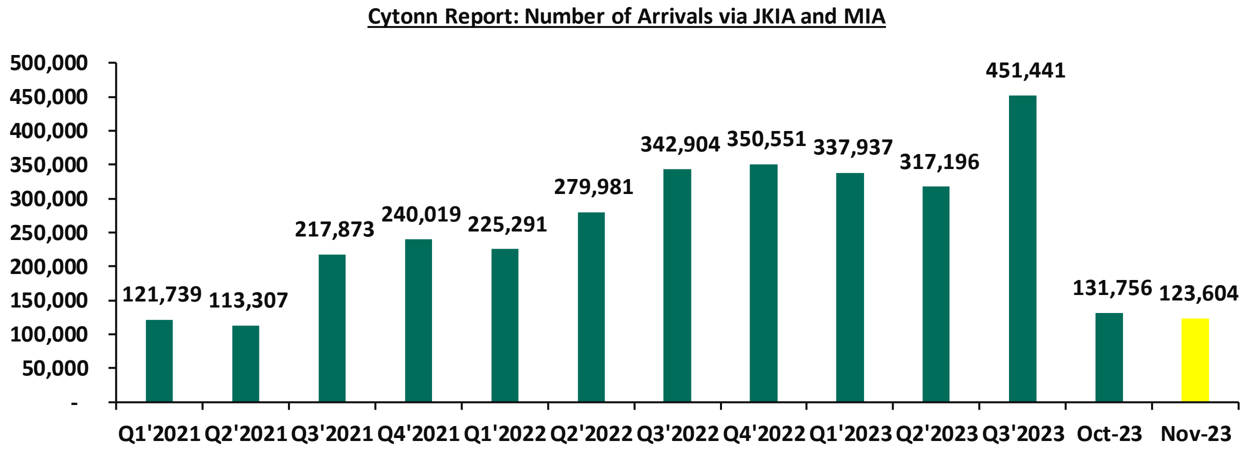
<u>Real Estate</u>

I. Industry Report

a. Leading Economic Indicators Report (LEI) December 2023 Report

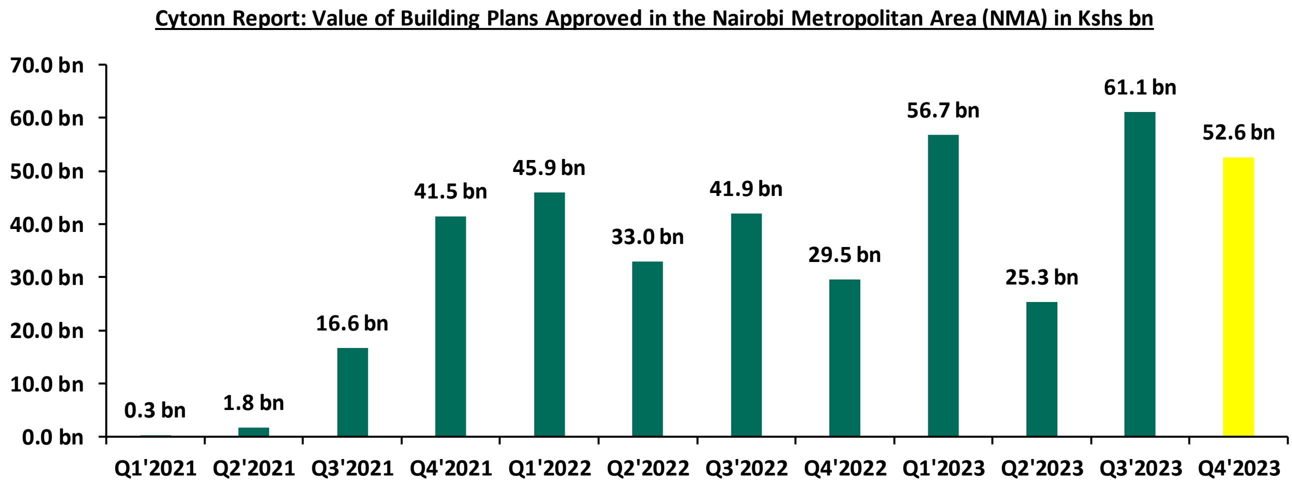
During the week, the Kenya National Bureau of Statistics (KNBS) released the Leading Economic Indicators (LEI) December 2023 Report which highlighted the performance of major economic indicators. Key highlights related to the Real Estate sector include;

i. In the month of November 2023, the number of visitor arrivals recorded stood at 123,604 persons, compared to 107,854 persons recorded during a similar period in 2022. On a year-on-year (y/y) basis, the performance represented a 27.3% increase to 1,361,934 persons, compared to 1,070,011 persons recorded during a similar period in 2022. The improved performance is attributable to; i) increased efforts to promote local and regional tourism, ii) the tourism board alignment of its marketing initiatives towards targeting emerging and established source markets, iii) increased international marketing of Kenya's tourism market by the Ministry of Tourism in collaboration with the Kenya Tourism Board, through platforms such as the Magical Kenya, iv) development of niche products such as cruise tourism, adventure tourism, culture and sports tourism, and, v) an increase in corporate and business Meetings, Events, and Conferences (MICE) from both the public and private sectors. The chart below shows the number of international arrivals in Kenya between Q1’2021 and November 2023;



Source: Kenya National Bureau of Statistics (KNBS)

In the month of December 2023, the value of building plans approved in the Nairobi Metropolitan Area increased by 54.1% to Kshs 22.1 bn from Kshs 14.3 bn recorded in November 2023. On a q/q basis, the value of approved building plans in Q4’2023 decreased by 13.9% to Kshs 52.6 bn from Kshs 61.1 bn recorded in Q3’2023. On a y/y basis, the value of approved building plans in the NMA increased by 30.1% to Kshs 195.7 bn as at December, from Kshs 150.3 bn recorded during a similar period in 2022. This was attributable to the clearing of a large number of pending approvals by the Nairobi County Government, and sustained demand for Real Estate development facilitated by positive demographics which are above global averages. The chart below shows the trend in the value of approved building plans in Kenya between Q1’2021 and December 2023;



Source: Kenya National Bureau of Statistics (KNBS)

Going forward, we expect Kenya’s Real Estate sector to register positive growth and improved performance supported mainly by; i) increased demand for housing driven by relatively higher urbanization and population growth rates, ii) improved access to financing evidenced by a 6.2% y/y increase in gross loans advanced to the Real Estate sector to Kshs 495.0 bn in Q2’2023, from Kshs 466.0 bn recorded in Q2’2022, and, iii) the rise in visitor arrivals to the country which is poised to support the performance of the hospitality sector, bolstering both room and bed occupancies. However, we expect the sector’s growth to be dampened by; i) elevated credit risk linked to a 20.9% increase in gross Non-Performing Loans (NPLs) in the Real Estate sector to Kshs 96.0 bn in Q2’2023, from Kshs 79.4 bn in Q2’2022, ii) increased cost of construction costs as a result of the prevailing macro-economic conditions in the country, and, iii) oversupply in select Real Estate sectors,

b. Kenya Market Update H2'2023 Report by Knight Frank

During the week, Knight Frank, an international Real Estate consultancy and management firm, released the Kenya Market Update H2'2023 Report highlighting the performance of key Real Estate sectors in the country. The following were the key take outs from the report:

i. In the residential sector, the average selling prices for prime housing units increased by 0.3% points in H2'2023. On y/y basis, the sector registered a 2.5% increase, lower than an annual appreciation of 4.1% registered in 2022. The declined appreciation was largely attributable to depreciation of the Kenyan shilling, and a calm business environment as the country recovered from the uncertainty of the election period, and post-election jitters that occurred in H1'2023. The prime residential market in Kenya is driven by expatriates and high net worth individuals. In the prime residential rental market, prime properties continued on an upward trend and registered an annual appreciation of 5.9% in FY'2023. This was attributable to the sustained appreciation of the dollar against the Kenya Shilling which consequently led to a net increase in disposable income for expatriates hence increased demand,
ii. The average asking rents for prime commercial office spaces stagnated at USD 1.2 per SQFT in H2'2023 from H1'2023. Commercial office space occupancy increased by 5.0% to 76.5% in H2'2023 from 71.5% recorded in H1'2023. The performance was attributable to a limited supply of grade A offices, and, increased uptake of existing A-grade properties. Additionally, the growth of grade A office continued driven by growing demand from international investors, governments, diplomatic missions, and multinational corporations attracted by Kenya's appeal as a top investment destination in Africa,
iii. In the retail sector, prime rents ranged between Kshs 250 per SQF on the uppermost floors to Kshs 800 per SQF on the ground floor in Nairobi suburbs. Retailers responded to the evolving consumer needs which compelled them to establish their presence in residential areas. This shift, coupled with reduced disposable incomes and the surge in e-commerce, is prompting retailers to recalibrate their customer outreach strategies, and,
iv. The industrial sector in Africa has consistently posted the highest returns on investment compared to the other real estate sectors. Governments in Africa continue to encourage investments in the industrial sector via various initiatives such as establishments of special economic zones (SEZ), and export processing zones (EPZ). The limited adoption of high-end industrialization in Africa poses a challenge for potential investors, as they often need to import the majority of machinery parts in addition to the limited locally available ones.

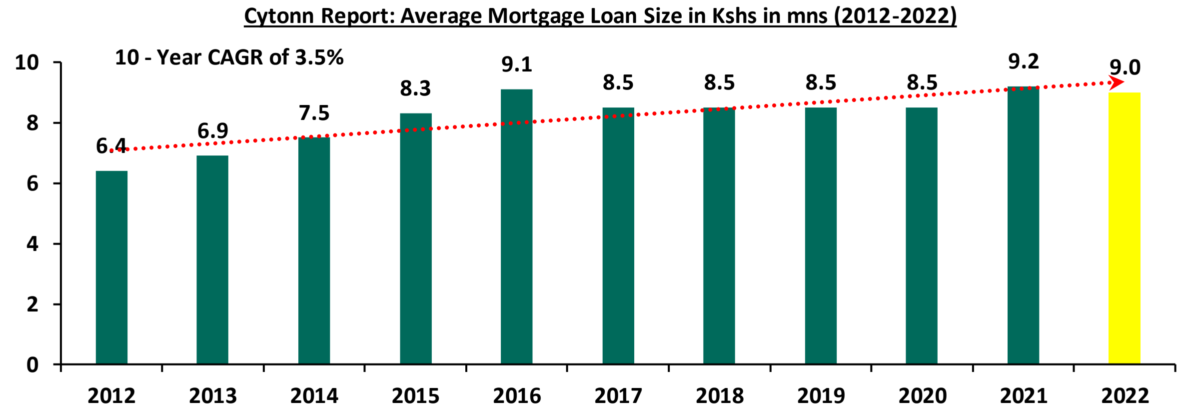
The findings of this report are in line with our Annual Markets Review 2023 Report which highlighted an occupancy increase in the commercial office segment and an increase in demand for industrial space in the region. We continue to uphold our perspective that the Real Estate sector's performance will primarily be sustained by; i) increased investment by foreigners in the retail segment, ii) demand for housing evidenced by positive demographics, iii) increased investment by the government to improve infrastructure capital, iv) increased activities by the government through the Affordable Housing Program (AHP), v) increased number of international arrivals supporting the hospitality sector, vi) aggressive expansion by both local and international retailers, and, vii) growing trend in demand for coworking office space arrangement. Nevertheless, the sector's growth will be limited by; i) oversupply of space in select Real Estate classes, ii) increased cost of construction, iii) extended durations of building approvals, and, iv) increased stringent measures by lenders to developers amid rising credit risk.

II. Residential Sector

a. Kenya Mortgage Refinance increased the maximum loan size

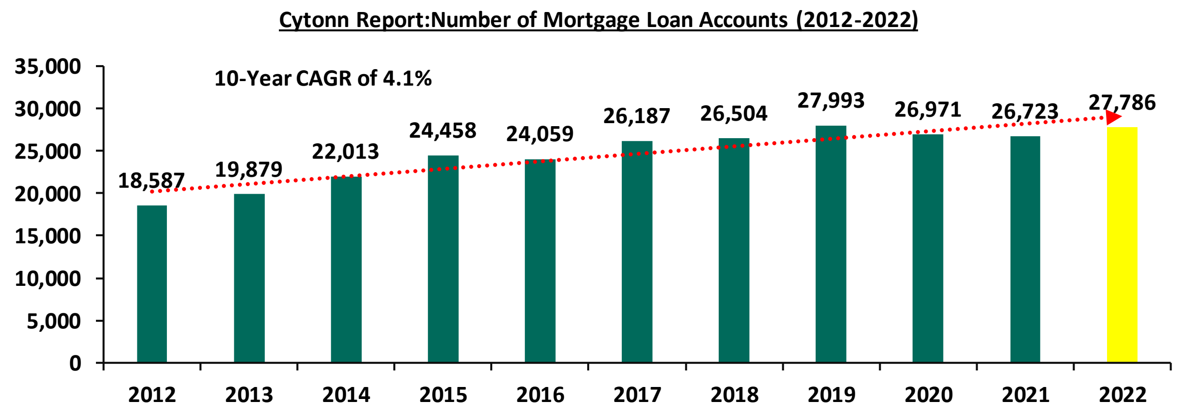
During the week, Kenya Mortgage Refinance Company (KMRC), a state-backed mortgage refinancing entity, increased the maximum loan size across the country to Kshs 10.5 mn from Kshs 8.0 mn and Kshs 6.0 mn for the Nairobi Metropolitan Area and the rest of the country, respectively. KMRC cited the heightened macroeconomic pressures as the rationale behind this decision, which have adversely affected construction costs, property prices, and consequently reduced the purchasing power of homebuyers as a result of decreased disposable income. Additionally, KMRC attributed this adjustment to the rise in household income to Kshs 200,000 from Kshs 150,000.

KMRC disburses loans to Primary Mortgage Lenders (PMLs), who subsequently lend to homebuyers at single-digit rates of 9.5%, notably lower than the average market lending rate of 12.3% as of 2022, according to the Bank Supervisory Annual Report 2022. Moreover, this increase will position KMRC's mortgage offerings above the average maximum home loan size of Kshs 9.0 mn as of 2022. The trend of average mortgage loan size has been upward in the recent past, realizing a 10-year Compounded Annual Growth Rate (CAGR) of 3.5% to Kshs 9.0 mn from Kshs 6.4 mn as shown in the graph below;



Source: Central Bank of Kenya

Notably, the increase in loan size has also been accompanied by a rise in the number of loan accounts, posting a Compound Annual Growth Rate (CAGR) of 4.1% over a 10-year period. This can be attributed to increased demand for housing, as both government and private entities have intensified their efforts to provide long-term and affordable loan options. The graph below shows the average mortgage loan accounts from 2012 to 2022;



Source: Central Bank of Kenya

We expect that the move by KMRC will enhance its competitiveness in the loan market and support government efforts to achieve the target of delivering 1,000,000 mortgages under the Bottom-Up Economic Transformation Agenda (BETA). The increase in loan size will provide significant support to aspiring homeowners who have been affected by the challenging macroeconomic conditions, which have eroded their purchasing power. Additionally, we anticipate that this move will contribute to an increase in homeownership across the country. However, the growth of the mortgage market continues to be constrained by several factors, including: i) low levels of income, ii) high costs of property purchases, and iii) limited access to affordable long-term financing.

b. President Ruto laid foundation stone for Makenji Affordable Housing Project

During the week, President Ruto laid the foundation for the Makenji Affordable Housing Project located in Kandara Constituency, Murang'a County. The project will consist of 220 units, including 60 studio apartments, 100 two-bedroom apartments, and 60 three-bedroom apartments. Additionally, the project will occupy a four-acre piece of land provided by the County Government under a Public-Private Partnership (PPP). It will also feature an expansive pool, green play spaces, and areas designated for small-scale traders. The ongoing project has provided job opportunities to over 600 youths, it has engaged 50 steel fabricators and carpenters from the Jua Kali industry. Furthermore, the project will involve the upgrading of Makenji Dispensary to a level 3 facility and the improvement of Makindi Primary School. Below is a table summarizing the unit types, sizes, and prices for the project

Cytonn Report: Makenji Affordable Housing Project-Affordable Housing				
Typology	**Size (SQM)**	**Price (Kshs in mns)**	**Price per SQM**	**Monthly Payment**
Studio	20	0.9	48,000	5,200
2-bedroom	40	1.9	48,000	10,400
3-bedroom	60	2.9	48,000	15,600
Average	**40**	**1.9**	**48,000**	**10,400**

Source: Boma Yangu

We expect the project will; i) help addressing the prevailing problem of housing deficit in the country, ii) improve the livelihood of the local community by providing decent housing, iii) spur economic activities in the region, and, iv) create employment opportunities for the local residents. In line with the government's continued focus on providing affordable housing to its citizens, we expect to witness more project initiatives and completions under the Affordable Housing Program (AHP) going forward.

III. Industrial Sector

During the week, Airtel Africa announced plans to build a data centre in Nairobi, which will become its second facility in Africa after Nigeria in a move to diversify its revenue streams. The data centre in Nairobi will be mainly usable in the telecommunication sector as well as in other sectors. Additionally, the centre will have a capacity of 7.0 megawatts to trail the 36-megawatt centre that it plans to build in Lagos, Nigeria.

The construction is expected to take approximately 2 years, and completion is scheduled by mid-2026. In December last year, Airtel Africa launched Nxtra, its data hub business aimed at meeting the continent's growing need for trusted, and sustainable data center capacity and to serve the fast-growing African digital economy. Nxtra aims to build one of the largest networks of data centres in Africa with high-capacity data centres in major cities located strategically across Airtel Africa's footprint. The move will support Kenya's industrial sector which currently witnessing increasing demand driven by data centers, growth in e-commerce, and demand for cold rooms. Airtel African joins other players in the sector such as Africa Data Centre who aim at delivering quality high-grade industrial space in Kenya.

Going forward, we expect to witness growth in the sector supported by; i) Kenya's continued recognition as a regional hub hence attracting investments, ii) continued improvement in infrastructure through projects such as the Standard Gauge Railway (SGR), the Eastern and Northern Bypasses connecting Jomo Kenyatta International Airport (JKIA) and other regions in the Nairobi Metropolitan Area, among other key infrastructural improvements which we expect will increase the output of Special Economic Zones (SEZs) and Inland Container Depots (ICDs), iii) government's accelerated focus on exporting agricultural and horticultural products to the international market, with an aim to improve the quantity, quality, efficiency, and reliability of Kenya-farmed produce thereby increasing the country's competitiveness, and, vi) rising demand for e-commerce warehouses in the retail sector

IV. Regulated Real Estate Funds

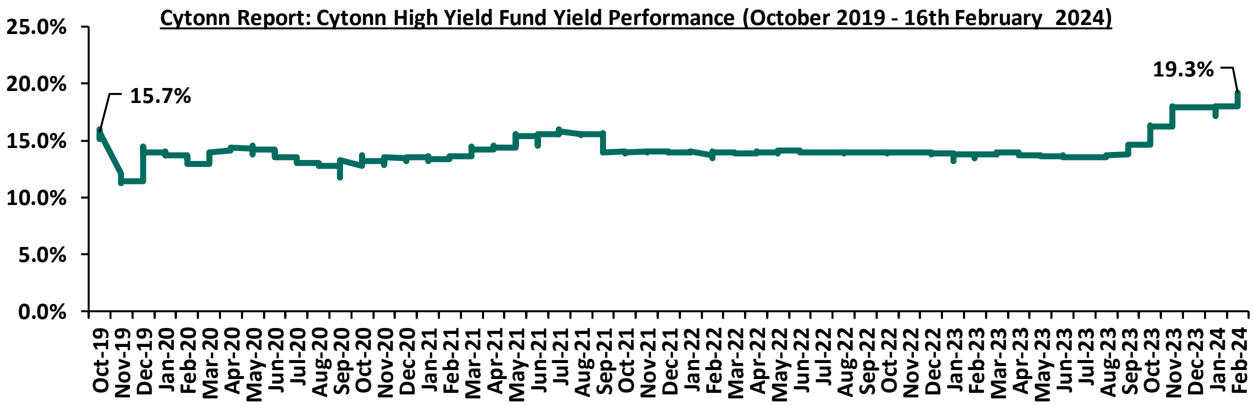
a. Real Estate Investments Trusts (REITs)

In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 24.4 and Kshs 21.7 per unit, respectively, as of 16th February 2024. The performance represented a 22.0% and 8.3% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 12.3 mn and 30.7 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 633.8 mn, respectively, since inception in February 2021.

REITs provide various benefits like tax exemptions, diversified portfolios, and stable long-term profits. However, the continuous deterioration in performance of the Kenyan REITs and restructuring of their business portfolio is hampering major investments that had previously been made. The other general challenges include; i) inadequate comprehension of the investment instrument among investors, ii) prolonged approval processes for REITs creation, and, iii) high minimum capital requirements of Kshs 100.0 mn for trustees

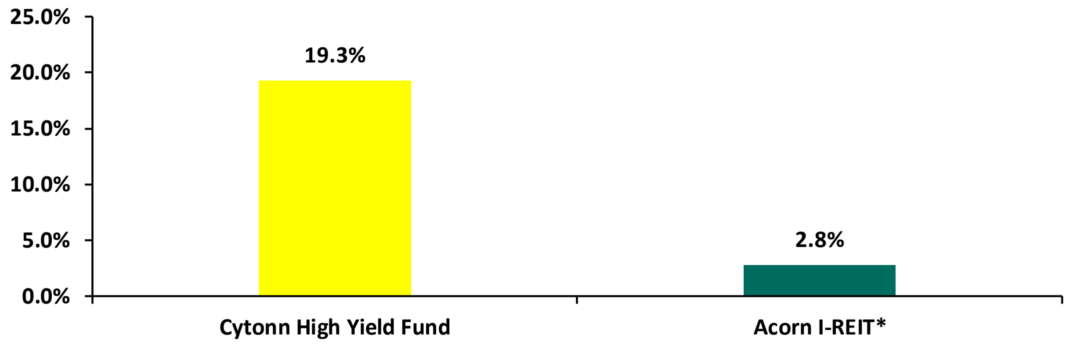
b. Cytonn High Yield Fund (CHYF)

Cytonn High Yield Fund (CHYF) closed the week with an annualized yield of 19.3%, representing 0.1% points increase from the 19.2% recorded the previous week. On a Year-to-Date (YTD) basis, the performance represents a 1.3% increase from the 18.0% yield recorded on 1st January 2024 and a 3.6% Inception-to-Date (ITD) increase from the 15.7% yield. The graph below shows Cytonn High Yield Fund's performance from November 2019 to 16th February 2024;



Notably, the CHYF has outperformed Acorn I-REIT a regulated Real Estate fund with an annual yield of 2.8%. As such, the higher yields offered by CHYF makes the fund one of the best alternative investment resource in the Real Estate sector. The graph below shows the yield performance of two Regulated Real Estate Funds;

Cytonn Report: Real Estate Regulated Funds Yield Performance February 2024



*H1'2023

Source: Cytonn Research

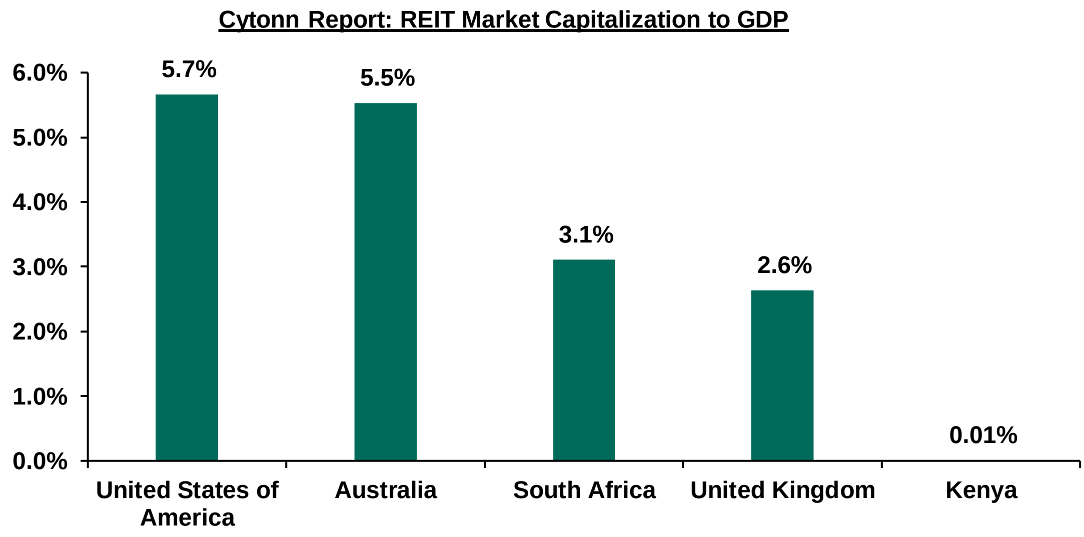
We expect the performance of Kenya's Real Estate sector will be supported by; i)increased activities and private institutions geared towards affordable housing, ii) increased demand for housing supported by positive demographics, iii) increased investments by local and international investors, especially in the retail segment, and, iv) continued improvement and expansion of infrastructural development by the government. On the other hand, we expect the sector's growth to be limited by; i)rising cost of construction, ii)oversupply of select Real Estate segments, and, limited investor knowledge in REITs.

Focus of the Week: Real Estate Investment Trusts (REITs) Progress Update in Kenya

Kenya's Real Estate sector has been a significant contributor to the country's GDP, growing at a Compounded Annual Growth Rate (CAGR) of 5.5% for the past 5 years. In Q3'2023, the sector expanded by 5.4%, reaching Kshs 785.9 bn compared to Kshs 743.4 bn recorded in the same period in 2022. This surge in growth highlights the sector's increasing importance, with its contribution to the national GDP reaching 10.5%, up from 10.0% in the previous quarter. Several factors have contributed to the Real Estate sector's growth, including; i) the government's continued emphasis on the affordable housing agenda, ii) aggressive expansion strategies pursued by both local and international retailers, iii) rapid population and urbanization growth rates, iv) the reopening and expansion of the hospitality sector amidst economic recovery, v) enhanced investor confidence, vi) the Kenya Mortgage Refinance Company's (KMRC) persistent efforts to increase access to homeownership through long-term, low-interest home loans for potential buyers, vii) a heightened appetite for Mixed-Use Developments (MUDs) due to their convenience, and viii) ongoing infrastructure improvements across the country creating new investment opportunities.

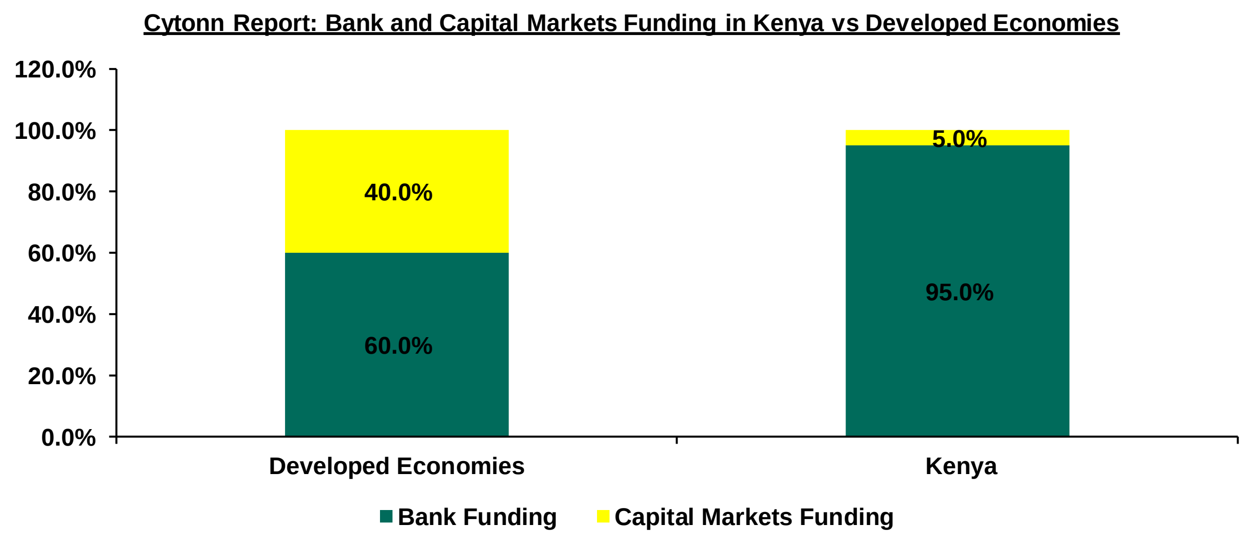
Despite the above cushioning factors, various challenges continue to impede the optimum performance of the Real Estate sector such as increased construction costs, existing oversupply of physical space in select sectors, and difficulties in accessing financing in light of elevated credit risk and rising interest rates. In support of this, gross Non-Performing Loans (NPLs) advanced to the Real Estate sector increased by 29.5% to Kshs 97.9 mn in 2023 from Kshs 75.6 mn recorded in 2022. To address this shortfall in funding, stakeholders in the Real Estate sector have been actively exploring alternative financing avenues, including Real Estate Investment Trusts (REITs), which are regulated by the Capital Markets Authority (CMA). The CMA established a comprehensive framework and regulations for REITs in 2013, enabling developers to raise capital through this avenue.

However, since 2013, the Kenyan REIT market continues to be subdued owing to various challenges such as the large capital requirements of Kshs 100.0 mn for trustees which limits the role solely to banks, prolonged approval process for REIT creation, high minimum investment amounts set at Kshs 5.0 mn which discourage investments, and lack of adequate knowledge of the financial asset class by investors. Notably, REIT market capitalization in Kenya remains significantly lower compared to other jurisdictions as shown below;



Source: European Public Real Estate Association (EPRA), World Bank

The REITs challenge is further compounded by Kenya's underdeveloped capital markets as compared to other African countries such as South Africa. Currently, there exists only one listed REIT in the country, albeit one that is not actively trading. The above indicates a sector that has remained moribund since REIT regulations were put in place in 2013. Due to this, most property developers rely on conventional sources of funding such as banks, compared to other developed countries. According to the Capital Markets Authority (CMA)'s Q4'2020 Capital Markets Soundness Report, financing for construction in Kenya was majorly sourced from the banking sector at 95.0% while capital markets contributed only 5.0%. The table below shows the comparison of development funding in Kenya against developed economies;



Source: World Bank, Capital Markets Authority (CMA)

Subsequent to the putting in place of REIT regulations in 2013, four REITs were authorized in the Kenyan market, all structured as closed-ended funds with fixed numbers of shares. However, currently none of them are actively trading on the Main Investments Market Segment Nairobi Securities Exchange (NSE). With the recent delisting of ILAM Fahari I-REIT, LAPTrust Imara I-REIT remains the only listed REIT in the country, having been quoted on the restricted market sub-segment of the Main Investment Market of the NSE. However, we note that Imara did not raise money upon listing. Acorn I-REIT and D-REIT are not listed but trade on the Unquoted Securities Platform (USP), an over-the-counter market segment of the NSE. The table below highlights all the REITs authorized by the Capital Markets Authority (CMA) in Kenya;

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	Delisted on 12th February 2024
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	March 2023	Main Investment Market: Restricted Sub-segment	Restricted

Source: Nairobi Securities Exchange, CMA

We believe REITs are crucial to closing the funding gap in Real Estate. Because of their unique status as an investment avenue that grants access to capital markets, REITs have the potential to complement various projects in Kenya, including the burgeoning affordable housing initiative. We have previously done four topicals namely; i) Real Estate Investment Trusts (REITs) as an Investment Alternative in 2019, ii) Real Estate Investment Trusts in Kenya in 2021, iii) Real Estate Investment Trusts Performance in Kenya in 2022, and, iv) Real Estate Investments Trusts (REITs) Progress in Kenya in 2022. This week on our topical, we shed light on the progress of REITs in Kenya and explore strategies to enhance their performance. Our discussion encompasses the following key areas:

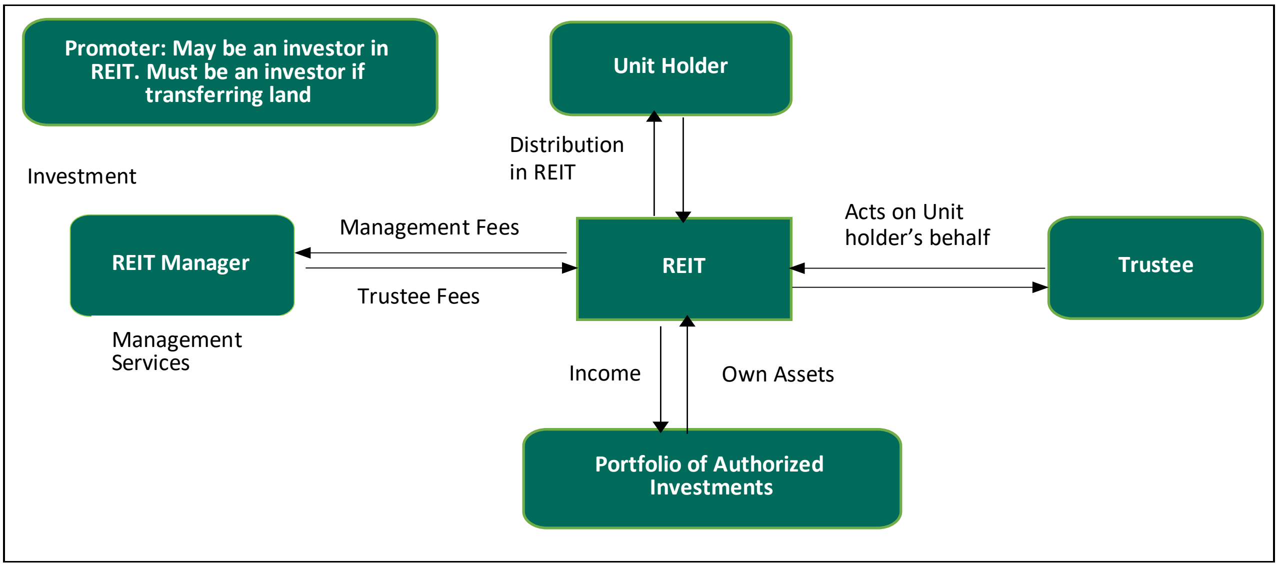
i. Overview of REITs,
ii. Types of REITs,
iii. Role of REITs in Affordable Housing Agenda,
iv. Advantages and challenges associated with investing in REITs,
v. Progress and performance of REITs in Kenya,
vi. Case studies of REITs in other countries,
vii. Recommendations, and,
viii. Conclusion.

Section I: Overview of REITs

REITs are essentially regulated collective investment vehicles that allow investors to contribute money's worth as consideration for the acquisition of rights or interests in a trust that is divided into units with the intention of earning profits or income from Real Estate as beneficiaries of the trust. Investors can purchase and sell shares of REITs on the stock market. REITs source funds to build or acquire Real Estate assets, which they sell or rent to generate income. At the end of a fiscal year, the generated income is then dispersed as returns (dividends) on investment to the shareholders. There are four important parties who collaborate to guarantee the protection of REITs interests and to help promote accountability and transparency inside the REIT structure. These parties include:

i. **The Promoter**: This party is involved in setting up a REIT scheme. The promoter is regarded as the initial issuer of REIT securities and is involved in making submissions to the regulatory authorities to seek relevant approvals of a draft trust deed, draft prospectus or an offering memorandum. Some of the REIT promoters in Kenya include Acorn Holdings Limited and LAP Trust,
ii. **The REIT Manager**: This is a company that has been incorporated in Kenya and has been issued a license by the authority (CMA) to provide Real Estate and fund management services for a REIT scheme on behalf of investors. Currently, there are 10 REIT Managers in Kenya namely; Cytonn Asset Managers Limited (CAML), Acorn Investment Management, Stanlib Kenya Limited, Nabo Capital, ICEA Lion Asset Managers Limited, Fusion Investment Management Limited, H.F Development and Investment Limited, Sterling REIT Asset Management, Britam Asset Managers Limited, and CIC Asset Management Limited,
iii. **The Trustee**: This is a corporation or a company that has been appointed under a trust deed and is licensed by the authority (CMA) to hold the Real Estate assets on behalf of investors. The Trustee's main role is to act on behalf of the investors in the REIT, by assessing the feasibility of the investment proposal put forward by the REIT Manager and ensuring that the assets of the scheme are invested in accordance with the Trust Deed. REIT trustees in Kenya include; Kenya Commercial Bank (KCB), Co-operative Bank (Coop), Housing Finance Bank and NCBA Bank Kenya, and,
iv. **Project/Property Manager**: The role of the project manager is to oversee the planning and delivery of the construction projects in the REITs. The property manager on the other hand plays the role of managing the completed Real Estate development that has been acquired by a REIT with his main goal being profit generation.

The relationship between key parties in a typical REIT structure is depicted in the figure below;



Source: Capital Markets Authority (CMA)

Section II: Types of REITs

In Kenya, there are three main types of REITs:

- **Income Real Estate Investment Trust (I-REITs):** This' a type of REIT in which investors pool their capital for purposes of acquiring long term income generating Real Estate including residential, commercial, and other Real Estate asset types. In I-REITs, investors gain through capital appreciation and rental income,

- **Development Real Estate Investment Trusts (D-REITs):** A D-REIT is a type of REIT in which investors pool together their capital together for purposes of acquiring Real Estate with a view of undertaking development and construction projects. A D-REIT can be converted into an I-REIT once development is complete where the investors can choose to sell, reinvest, or lease their shares. D-REIT investors gain from sale profits once an asset is sold in a commercial arm's length transaction, and,
- **Islamic Real Estate Investment Trusts:** An Islamic REIT is a unique type of REIT that invests primarily in income-producing Shari'ah-compliant Real Estate developments. A fund manager is required to conduct a compliance test before investing to ensure it is Shari'ah compliant and that non-permissible activities are not conducted in the estate and if so, then on a minimal basis.

Section III: Role of REITs in Affordable Housing Agenda

Real Estate Investment Trusts (REITs) possess the potential to revolutionize Kenya's affordable housing landscape, by offering promising opportunities to address both demand and supply challenges. In recent years, Kenya has witnessed a surge in urbanization and population growth rates, amplifying the need for affordable housing solutions. However, traditional financing mechanisms and development processes have struggled to keep pace with this demand, creating a significant gap in the housing market. Against this backdrop, REITs emerge as a strategic tool to mobilize capital, streamline development processes, and catalyze both the demand and supply sides of the affordable housing agenda. By pooling funds from investors and leveraging expertise in project management, REITs hold the potential to transform the affordable housing sector, bridging the gap between housing supply and demand while ensuring the timely delivery of quality housing units. We now explore the multifaceted role of REITs in advancing the affordable housing agenda in Kenya, analyzing their impact on both demand and supply dynamics.

A. Demand Side

- **Mobilizing Capital:** This investment vehicle allows individuals and institutions to pool their resources, channelling significant funds into projects aimed at addressing the housing deficit. By democratizing access to Real Estate investment opportunities, REITs attract diverse investors, facilitating the aggregation of substantial capital for affordable housing developments. While the government has been making efforts to mobilize capital for affordable housing through initiatives like the Kenya Mortgage Refinancing Company (KMRC) and the National Housing Development Fund (NHDF), REITs offer a complementary approach. Unlike government-led programs, REITs provide a private-sector-driven mechanism for mobilizing capital. They attract a wide range of investors, including both institutional and retail investors, thereby diversifying funding sources for housing projects. Additionally, REITs have the flexibility to invest in various types of Real Estate assets, including residential properties targeted at low and middle-income earners. This diversity allows REITs to adapt to evolving market demands and allocate capital efficiently to where it's most needed, thus augmenting the government's efforts in addressing the affordable housing agenda,
- **Addressing Financing Gap:** REITs offer developers an alternative financing avenue characterized by more favorable terms and lower borrowing costs compared to conventional sources like bank loans. By providing access to capital at competitive rates, REITs enable developers to overcome financial hurdles that may hinder the implementation of affordable housing projects. This ensures a steady flow of funds into the sector, supporting the development of housing units for low and middle-income earners. Moreover, REITs' ability to tailor financing solutions to suit developers' needs enhances flexibility and promotes innovation. Ultimately, by addressing the financing gap, REITs contribute significantly to advancing the affordable housing agenda and fostering sustainable urban development, and,

- **Off-take Arrangements:** Through agreements to purchase or lease a predetermined quantity of housing units, I-REITs offer developers a dependable revenue stream, enhancing the appeal of projects to investors. This reliability reduces uncertainties associated with sales and occupancy rates, fostering investor confidence and project sustainability. Additionally, by assuming the role of off-takers, REITs could contribute to the financial feasibility of affordable housing initiatives, facilitating their execution and eventual success. Thus, by providing this essential function, REITs play a pivotal role in catalyzing the demand for affordable housing units, aligning with broader efforts to address housing needs and promote inclusive urban development.

B. Supply Side

- **Expertise in Project Management:** REITs, through the Trustees, possess extensive expertise in project management, property development, and asset management all of which are crucial in the implementation of affordable housing initiatives. Their dedicated teams ensure timely and budget-friendly project execution, minimizing delays and cost overruns. With experience in site selection and design optimization, REIT Trustees identify suitable locations and maximize affordability without compromising quality and in adherence to the Offering Memorandum and the Trust Deed. Efficient development processes enable swift delivery of housing units to meet demand. Post-construction, REITs offer ongoing asset management, ensuring long-term viability through maintenance and tenant management. Overall, their proficiency accelerates affordable housing supply, attracting investors and advancing the affordable housing agenda,
- **Streamlining Development Process:** REITs streamline the development process by leveraging partnerships with seasoned developers and property managers. These collaborations enhance efficiency by tapping into the expertise of industry professionals. By optimizing construction costs and improving operational efficiency, REITs ensure that affordable housing projects are executed seamlessly and within budget, and,
- **Timely Delivery of Housing Units:** With dedicated teams focused on project management and property development, D-REITs can effectively oversee the entire development process from inception to completion. Their experience in navigating regulatory frameworks, coordinating with contractors, and managing construction timelines allows them to expedite project delivery without compromising on quality. This timely delivery will not only benefit the community by providing much-needed housing but also will contribute to the overall economic development of the region.

In conclusion, REITs offer a promising solution to the challenges facing the affordable housing sector in Kenya and thus can play a pivotal role in increasing the supply of affordable housing units, while simultaneously meeting the growing demand for quality housing. Their ability to catalyze investment and facilitate project development makes them a valuable tool in achieving the affordable housing agenda and promoting sustainable urban development.

Section IV: Benefits and challenges associated with investing in REITs

a. Benefits of Investing in Real Estate Investment Trusts (REITs)

i. **Diversification:** Investing in REITs alongside fixed income securities and equities helps spread risk across diverse asset classes, industries, and sectors when combined into a single portfolio. REITs typically hold physical assets like land and buildings and frequently enter into lengthy leases with their tenants. This provides stability and reliability to investments,

ii. **Stable and Consistent Income:** Investors in I-REITs enjoy regular rental income, with regulations mandating the distribution of at least 80.0% of earnings as dividends to unit holders,

iii. **Flexibility:** REITs offer adaptability, allowing investors to tailor their portfolio to match fund characteristics, Real Estate market segments, and geographic preferences,

iv. **Competitive Long-Term Returns:** REITs deliver robust, long-term yields, enhancing portfolio efficiency,

v. **Liquidity:** Unlike physical property, REIT investments offer greater liquidity, with units or shares easily tradable, particularly in publicly listed REITs,

vi. **Tax Benefits:** REITs often benefit from various tax exemptions, providing advantages for both investors and investee companies. For instance, a listed REIT grants corporate tax exemption to the underlying owners of Real Estate assets, currently set at 30.0% annually. Taxation is primarily on profit distribution to unit-holders, subject to withholding tax rates of 5.0% for residents and 10.0% for non-residents. The amendment to Section 20 of the Income Tax Act through the Finance Bill 2019 further exempts REITs' investee companies from income tax, encouraging increased investment in Real Estate development companies without the need for property transfers to the REIT. Additionally, transferring properties to a REIT attracts stamp duty exemptions under Section 96A (1) (b) of the Stamp Duty Act,

vii. **Transparency:** REITs' listing ensures transparency, with stringent financial reporting and corporate governance guidelines,

viii. **Access to Capital:** REITs enable pooling of funds for long-term Real Estate projects, supplementing existing capital sources like debt and equity markets, and,

ix. **No Shareholder Liability:** As is the case with equity investments in other publicly traded companies, shareholders have no personal liability for the debts of the REITs in which they invest.

b. Challenges Associated with investing in REITs

i. **Inadequate Investor Knowledge -** REIT instruments suffer from insufficient investor awareness and education, resulting in limited investment activity. This lack of understanding among investors was a key factor contributing to the low subscription rate of 29.0% and subsequent underperformance of Stanlib Fahari I-REIT. Additionally, it played a role in the failed issuance of Fusion D-REIT in 2016,

ii. **High Minimum Capital Requirement for Trustees –** Presently, Kenya has just four entities authorized as REIT trustees. In contrast, South Africa allows a broader range of entities, including public companies, approved institutions, or banks, to serve as trustees, resulting in a more extensive pool of trustees available. To enhance the REIT market's accessibility, it's essential to encourage more corporate entities to seek REIT trustee licenses. This necessitates a review of the minimum share capital requirement, expanding it to encompass other suitable players. Such adjustments would streamline the process of introducing REITs to the market, fostering their growth and participation,

iii. **High Minimum Asset Size for Investment Companies -** As per the regulations set by the Capital Markets Authority (CMA), the minimum threshold for initial assets stands at Kshs 300.0 mn for Income REITs (I-REITs) and Kshs 100.0 mn for Development and Construction REITs (D-REITs). These requirements pose significant challenges for many companies in the country to attain and manage the assets, making it particularly difficult for medium and small start-ups to enter the REIT market. Consequently, the high entry barriers discourage investment uptake, as achieving the initial asset thresholds typically necessitates substantial investments in Real Estate, limiting opportunities for smaller players to participate in the market,

iv. **Subdued Performance of Select Real Estate Sectors -** Despite the resurgence of Kenya's Real Estate sector, the oversupply of physical space issue still persists as of 2023, there was an oversupply of 5.8 mn SQFT in the Nairobi Metropolitan Area (NMA) commercial office market, 3.0 mn SQFT in the NMA retail market, and 1.7 mn SQFT in the overall Kenyan retail market. This surplus has led to subdued occupancy rates and yields, presenting a significant challenge for the sector,

v. **Lengthy Licensing and Approval Processes -** The licensing and approval procedures for REITs are arduous and time-consuming, demanding extensive documentation and adherence to diverse legal and regulatory stipulations. This cumbersome process might dissuade potential promoters from investing in REITs, prompting them to explore alternative, more streamlined avenues for capital raising,

vi. **Opacity of Exact Returns for Underlying Assets -** Despite the best efforts of the regulator to promote transparency in the operation and administration of REITs in Kenya, there exists a gap in the determination of returns from individual assets held by these trusts. This means that investors are not able to tell the exact yields of underlying assets owned by a REIT and this is mainly caused by the lack of a clear framework for the determination of returns as well as valuation standards especially with regards to investment grade commercial assets,

vii. **Shallow Investment-Grade Asset Pipeline -** The pool of available investment grade Real Estate assets in Kenya that have the ability to generate attractive and sustainable returns is shallow. For instance, Stanlib Fahari I-REIT had to apply for a regulatory exemption to extend the deadline for acquiring Real Estate assets after failing to meet the 75.0% of Real Estate income-generating assets threshold within 2 years of the REIT's authorization to operate. The low supply of investment-grade properties for sale in the market was also a key factor that contributed to the acquisition of Stanlib Fahari I–REIT's properties in Nairobi's Industrial Area, a generally low-performing zone in the property market, amidst pressure to beat CMA's deadline to invest at least 75.0% of the REIT's total net asset value in Real Estate within 2 years of its authorization, and,

viii. **Inconsistent Income -** Rental income may be inconsistent over the investment period, attributable to various factors such as termination of lease agreements and failure to renew the same or secure tenants in good time for income continuity. Efficient management of REITs becomes a key factor in the realization of good returns.

Section V: REITs progress and performance in Kenya

In 2013, Kenya and South Africa joined the ranks of African nations adopting REITs as an investment vehicle, following the lead of Ghana and Nigeria, who established their REIT frameworks in 1994 and 2007, respectively. Presently, in Kenya, there are only four authorized REITs: i) ILAM Fahari I-REIT, ii) Acorn Student Accommodation I-REIT, iii) Acorn Student Accommodation D-REIT, and, iv) LAPTrust Imara I-REIT. However, ILAM Fahari I-REIT, the only one that was actively trading on the NSE, was delisted on 12th February 2024. As a result, LAPTrust Imara I-REIT has remained the sole REIT listed on the Nairobi Securities Exchange (NSE), although it is currently not actively trading. The REIT which was set to remain restricted for the next three years, has traded only once since its listing in March 2023. LAPTrust Imara I-REIT had sought permission to withhold trading for three years in a bid to provide the I-REIT sufficient time to build a performance track record, allowing investors to gain confidence in the asset class. The two Acorn REITs launched in February 2021 trade on an over the counter platform of the NSE referred to as Unquoted Securities Platform (USP). Despite Kenya's adoption of REIT regulations in 2013, in the same year as South Africa, the country lags behind South Africa, which boasts 33 listed REITs. This section evaluates the performance of Kenya's REIT industry, including market activities and progress in implementing policy proposals by the Capital Market Authority to enhance the REIT sector's attractiveness to investors.

Notable Activities

Some of the recent notable activities in the Kenyan REIT's sector include;

1. **Licensing of NCBA Bank Kenya PLC as REIT Trustee:** On 5th February, the Capital Markets Authority (CMA) licensed NCBA Bank Kenya PLC to become a Real Estate Investment Trust (REIT) trustee in Kenya. The recent licensing of NCBA Bank Kenya PLC as a REIT trustee by the Capital Markets Authority (CMA) marks a significant development in Kenya's Real Estate investment landscape.

This accreditation, issued in alignment with regulatory frameworks, reflects the CMA's commitment to bolstering the country's Real Estate capital markets, particularly in support of the government's Affordable Housing agenda. Following NCBA Bank's recent entry, the number of licensed REIT trustees in Kenya stands at 4. These include Housing Finance Company (Kenya) Limited, Kenya Commercial Bank (KCB), Co-operative Bank of Kenya Limited, and NCBA Bank. It is expected that NCBA Bank Kenya will support investments in the Real Estate sector, contributing to the overall growth of the economy and the Affordable Housing Initiative. With NCBA Bank now authorized to act as a REIT trustee, it can play a crucial role in facilitating financing for Real Estate projects, including those aimed at providing affordable housing. For more information, please see our Cytonn Weekly #06/2024,

2. **ILAM Fahari I-REIT Delisting:** ILAM Fahari Income Real Estate Investment Trust (ILAM Fahari I-REIT or IFIR) through a public notice dated 6th February 2023 announced it received approval from the Capital Markets Authority (CMA) to delist from the Main Investment Market Segment (MIMS) of the Nairobi Securities Exchange (NSE). The delisting, effective from Monday, February 12th 2024, followed the resolution by Unitholders of ILAM Fahari to delist in November 2023. As a result, the last day of trading for the REIT on the Main Investment Market segment of the NSE was 9th February 2024. Subsequently, ILAM Fahari initiated the process of applying to have its securities admitted for trading over the counter on the Unquoted Securities Platform (USP) of the NSE.

   The delisting of ILAM Fahari I-REIT reflects both the challenges faced by the REIT and its proactive response to them. Leading to its delisting, ILAM Fahari I-REIT encountered operational hurdles that necessitated a re-evaluation of its structure and operations. The decision to delist stems from a culmination of factors, including the REIT's history of undersubscription during its Initial Public Offering (IPO) and performance limitations attributed to its relatively small portfolio size. Following the undersubscription, the REIT failed to raise substantial capital for property investment. As a result, ILAM Fahari I-REIT faced constraints in expanding its portfolio, leading to concentration risks and subdued investor confidence. The delisting process was initiated following resolutions made during an Extraordinary General Meeting (EGM) held in December 2023. Key among these resolutions was;

   a. The proposed conversion of ILAM Fahari I-REIT from an unrestricted I-REIT to a restricted I-REIT which was voted for by 93.1% of unitholders,
   b. The delisting of the REIT from the Main Investment Market of the NSE which was passed by 93.0% of unitholders,
   c. The subsequent quotation of the REIT on the Unquoted Securities Platform (USP), and,
   d. The authorization of ICEA Lion Asset Management (ILAM) and the Co-operative Bank of Kenya as the Fund Manager and Trustee of ILAM Fahari I-REIT to take all requisite actions for the conversion and delisting.

   The REIT's delisting forms part of the REITs strategic restructuring aimed at enhancing operational efficiency and investor returns being implemented by the REIT manager ICEA Lion Asset Management (ILAM). We note that the REIT's de-listing will have several implications to various stakeholders as outlined below;

   i. **Non-Professional Unitholders:** In Kenya, retail or non-professional investors in REITs are individuals have invested minimum amounts below Kshs 5.0 mn or who hold units valued at Kshs 5.0 mn and below. Non-Professional investors who accepted the redemption the offer will cease to be Unitholders upon transferring their units and receiving payment. However, non-professional investors who choose not to accept the offer will be subject to restrictions on trading units post-delisting. It is worth noting that post conversion, investments to the REIT is only for Professional investors. As such, Non-professional investors who retain their units will be collectively placed in a nominee account, ensuring compliance with REIT regulations. This structure allows them to retain ownership rights and participate in voting via the nominee account, providing a streamlined approach to manage their investments,

ii. **Professional Unitholders:** Professional unitholders of ILAM Fahari I-REIT will continue holding their units unaffected by the delisting. Post-delisting, the intention is to list units on the Unquoted Securities Platform (USP) for liquidity, although availability cannot be guaranteed. However, if the value of their units falls below the regulatory threshold, professional investors will need to top up to comply. Transactions on the USP may be subject to taxes. In the context of the Kenyan REITs, a professional investor includes any person licensed under the Capital Markets Act or an authorized collective investment scheme or a bank or subsidiary of a bank, insurance company, cooperative, statutory fund, pension or retirement fund or a person including a company, partnership, association or a trustee on behalf of a trust which, either alone, or with any associates on a joint account subscribes for REIT securities with an issue price equal to at least Kshs 5.0 mn,

iii. **Tenants:** Delisting will not impact tenants of the REIT's properties,

iv. **Regulators:** The REIT will remain regulated by the CMA as a Restricted I-REIT, while the NSE will manage the Unquoted Securities Platform (USP), and,

v. **Other Contractual Obligations:** Existing obligations will not be affected by the delisting.

For more information, please see our Cytonn Weekly #06/2024, Cytonn Monthly – November 2023, Cytonn Weekly #43/2023, Cytonn Weekly #42/2023, Cytonn Weekly #41/2023 and ILAM Fahari Conversion Offering Memorandum.

3. **Acorn Student Accommodation D- REIT Strategic Sale:** In December 2023, Acorn Student Accommodation Development REIT (ASA D-REIT) announced it had sold its latest stabilized asset, Qwetu Aberdare Heights II, to the Acorn Student Accommodation Income REIT (ASA I-REIT) in a Kshs 1.5 bn deal. The acquisition of the 630-bed capacity hostel located adjacent to Qwetu Aberdare Heights I and United States International University (USIU) brings the total number of assets acquired by the I-REIT to four over the last three years. Other projects acquired by the ASA I-REIT include; Qwetu Wilsonview in February 2021, Qwetu Aberdare Heights I in October 2022 and recently Qwetu Hurlingham in June 2023.

   Through the sale, ASA D-REIT will repay Kshs 600.0 mn of the Acorn Green Bond, pushing the repayment of the Kshs 5.7 bn bond to Kshs 3.0 bn ahead of its maturity in November 2024. The bond which was first floated in 2019, was issued in partnership with Private Equity Fund Helios and had attracted an 85.0% subscription rate, raising Kshs 4.3 bn of the targeted amount of Kshs 5.0 bn. The bond was priced at a rate of 12.3%, and was intended to be used to finance sustainable and climate-resilient student accommodation with a combined capacity of 40,000 beds. For more information, please see our Cytonn Q3'2019 Markets Review report. Acorn D-REIT also announced its debut dividend payout of Kshs 240.0 mn, after a three-year grace period in line with its offering memorandum, through which unitholders will achieve a dividend yield of 3.4%,

4. **Lowering of Minimum Amounts for D-REIT to Kshs 100,000:** In November 2023, the government proposed the revision of the threshold for Development REITs (D-REITs) from Ksh 5.0 mn to Ksh 100,000. The new threshold was fronted during the annual general meeting of the REITs Association of Kenya (RAK) at Enashipai Resort and Spa in Naivasha, where Investment Principal Secretary Mr. Abubakar Hassan acknowledged that the sector's lacklustre performance and stunted growth was attributable to the high minimum share capital requirements discouraging entry to the Kenyan REIT market. This adjustment sought to attract more investors and foster a conducive environment for sustainable growth in Real Estate investment. The move reflects the government's commitment to supporting the sector amidst challenges such as high investment costs and complex processes. Investment Principal Secretary Abubakar Hassan emphasized the

importance of REITs in meeting the growing demand for quality Real Estate assets, especially amid urbanization and affordable housing initiatives. By making D-REITs more accessible to a wider range of investors, including retail and smaller-scale participants, this policy change is poised to stimulate investment growth, broaden the investor base, and spur economic development in the Real Estate sector,

5. **LAPTrust Imara I-REIT's Trading debut:** In October 2023, LAPTrust Imara I-REIT traded for the first time since its listing. With a total of 30.0 mn shares traded in two deals valued at Kshs 600.0 mn, its share price remaining unchanged from its listing price of Kshs 20.00. The I-REIT which is structured as a close-ended fund consisting of 346.2 mn units worth Kshs 6.9 bn was initially intended to remain non-public, with no securities offered to the general market for the next three years. For more information, please see our Cytonn Weekly #43/2023. Currently, LAPTrust Imara I-REIT is listed on the Main Investment Market-Restricted Sub-Segment of the Nairobi Securities Exchange and remains inactive,

6. **Conversion of ILAM Fahari I-REIT from an Unrestricted I-REIT to a Restricted I-REIT:** In August 2023, the Capital Markets Authority (CMA) gave its approval for the conversion of ILAM Fahari Income Real Estate Investment Trust (REIT) from an Unrestricted I-REIT to a the Restricted REIT through a Conversion Offering Memorandum. Conversion was to be carried out through a redemption offer, where 36,585,134 units held by retail investors, worth below Kshs 5.0 mn were to be redeemed at Kshs 11.0 per unit to ICEA Lion Asset Management Limited. The REIT also received applications from non-professional investors seeking to top up their portfolio with an additional 421,945 units.

   Following the conclusion and subsequent lapsing of the conversion offer period by ICEA Lion Asset Managers (ILAM) on Friday 6th October, ILAM Fahari announced it would redeem a total of 36.2 mn units, against the total 36.6 mn units which were set to be redeemed, representing a redemption rate of 88.4%, whereas 421,945 units were allocated to Non-Professional investors for purposes of topping up their holdings to the Professional investor threshold. The overall oversubscription rate for the offer stood at 13.1%. In November 2023, at an Extraordinary General Meeting (EGM), 93.1% unitholders voted for the conversion of ILAM Fahari I-REIT from an unrestricted I-REIT to a restricted I-REIT and subsequent delisting. Notably, once executed, the transaction will result in ICEA LION Asset Management increasing its unitholding to 22.7% post redemption, purchasing an additional 19.9% of units valued at Kshs 397.8 mn. This will significantly increase ILAM's holding from its initial of 2.8%.

   By transitioning to a Restricted I-REIT, ILAM Fahari I-REIT aims to reset its structure, focusing on a more targeted investor base comprising Professional Investors. The conversion to a restricted REIT will allow Fahari I-REIT to offer specialized investment opportunities to their stakeholders, providing increased flexibility and potential for growth. In addition, the new structure aligns with ILAM Fahari's strategic vision to optimize its investments and provide investors with innovative avenues to diversify their portfolio. We however note that, while this move allows the REIT flexibility for operational restructuring, potential disposal of non-core assets, and capital raising initiatives to optimize its performance, its conversion restricts investments in the instrument to only high net worth individuals thus locking out potential retail investors. For more information, please see our Cytonn Monthly – August 2023, and Cytonn Weekly #36/2023, and,

7. **Progress towards the creation of the Kenya National REIT (KNR):** In February 2023, the Capital Markets Authority (CMA) in collaboration with the Sanduku Investment Initiative, the Association of Pension Trustees and Administrators of Kenya (APTAK) and the Nairobi Securities Exchange (NSE) announced ongoing plans to create a Kenya National REIT (KNR) as an accreditation body for REITs and their stakeholders within the Kenyan REITs market. REITs that will be registered under

KNR will be structured for immediate investor uptake in the capital markets as scalable asset classes with the potential to contribute to national economic growth. The Retirements Benefits Authority (RBA) and the APTAK will also work with Trustees to review the REIT investment mandates, thereby allowing participation of pension funds in the KNR REITs as an alternative asset class.

The Sanduku Investment Initiative is a Public-Private Partnership (PPP) financing model launched by President Ruto to bring together the participation of financial sector players such as; pension funds, insurance companies, SACCOs, Islamic finance institutions, and global investors. The objective of the model is to raise Kshs 1.0 tn over the next five years, as part of Kenya's Economic Transformation Agenda. It was envisioned Sanduku will financially support the government's priority projects such as; the Railway City Development, Nairobi International Financial Centre, Kenani Leather Park, and Makongeni Modern Suburb, among others, in line with the government's plan for significant infrastructure initiatives and the Affordable Housing Program (AHP). After the REIT market and industry stakeholders validate the proposed KNR model, additional engagements will be conducted to ensure there is investment appetite and support. This will be followed by structuring and launching a pilot REIT under KNR. For more information, please see our Cytonn Weekly #06/2023. We note however, that since the proposal was first floated in February 2023, no further discussions with regards to the matter have been floated and KNR is yet to materialize. Further, it's not clear what specific advantages the Sanduku initiative will be offering that is not present in the current REIT regime.

Section VI: Case studies of REITs in other countries

In our previous topicals covering the REIT market in Kenya, we highlighted the REIT markets of several countries such as Singapore, Australia, South Africa, China and United Kingdom. This week, we now take a look at the lessons on the operational and policy framework in the REIT market that we can learn from these aforementioned countries, in addition to those from Belgium and the United States of America (USA);

Cytonn Report: Summary of Case studies of REITs in Various Countries	
Country	**Key Take-outs**
Belgium	• Belgian REITs (BE-REITs) were established in 1995 under the Belgian law of December 4, 1990. As of 15th February 2024, there are 17 listed BE-REITs on the Brussels Stock Exchange (BSE), 10 of which are included in the European Public Real Estate Association (EPRA) Index; investing in a variety of Real Estate assets, including immovable property, public-private partnerships, and infrastructure projects. According to EPRA's Global REIT survey 2023, BE-REITS collectively represent a market capitalization of approximately EUR 19.5 bn, constituting around 1.1% of the global REIT index. BE-REITs are regulated by the Financial Services and Markets Authority (FSMA) and must comply with strict rules regarding asset composition, risk diversification, leverage limits, profit distribution obligations, and corporate governance • All shares of a Belgian BE-REIT must be listed on a stock exchange, with a minimum of 30.0% free float. Listing can only occur after registration on the BE-REIT list and after publishing a prospectus • Belgian law mandates that the BE-REIT annually distribute the positive balance between 80.0% of its net operational income, as specified by Royal Decree, and the reduction in its debt. If the ratio of indebtedness, whether statutory or consolidated, surpasses 65.0% or is projected to do so as a result of the distribution, no distribution is permitted • Belgian regulations impose a risk diversification requirement on BE-REITs, limiting their investment in a single 'Real Estate project' to no more than 20.0% of their total assets. A 'Real Estate project' encompasses one or more properties where investment risk is considered a single risk for the REIT. This requirement aims to prevent overexposure to specific properties and enhance risk management • Under specific conditions, BE-REITs can obtain derogations from the risk diversification rule from the FSMA, provided their leverage limit does not exceed 33.0% of their consolidated

	assets. This flexibility allows BE-REITs to pursue investment opportunities that may deviate from standard diversification requirements while maintaining prudent leverage levels • BE-REITs in Belgium are subject to corporate income tax at a rate of 25.0%. However, their taxable basis is effectively reduced, resulting in a low or near-zero taxable basis. BE-REITs are taxed on non-arm's length benefits received, expenses not deductible for tax purposes, undisclosed salaries, and commissions. Rental income and most business income are generally not included in the taxable basis, enhancing tax efficiency • Capital gains realized by BE-REITs are generally excluded from the taxable basis, provided they are obtained at arm's length terms. This exemption encourages investment in Real Estate assets without imposing additional tax burdens on capital gains • BE-REITs may benefit from exemptions or reduced withholding tax rates on dividends and interest income received from both Belgian and non-Belgian sources. However, withholding tax of 30.0% is typically applicable on dividends distributed by BE-REITs to shareholders, with potential exemptions for certain corporate domestic shareholders based on specific conditions and tax treaties. Individual shareholders are subject to a 30.0% final levy on dividend withholding tax. However, capital gains realized on BE-REIT shares are generally not taxable unless considered speculative or not within the scope of normal wealth management
United States of America (USA)	• The United States Real Estate Investment Trusts (US-REITs) were established by the US Congress in 1960 with the aim of democratizing access to large-scale income-producing Real Estate investments for smaller investors. The regulatory framework governing US-REITs encompasses tax laws and has undergone multiple revisions over the years, including updates in the Inflation Reduction Act of 2022. The fundamental rules for US-REITs are outlined in sections 856 and 857 of the Internal Revenue Code • To elect REIT status in the US, a company must file a special tax return (Form 1120-REIT) for the relevant year, without the need for prior approval or notification. Annually, the REIT must also send letters to its shareholders requesting details of beneficial share ownership, with modest penalties for non-compliance. US-REITs can take the legal form of any domestic entity, such as a corporation, partnership, business trust, or limited liability company, by making a 'check the box' election with the IRS. However, financial institutions like banks or insurance companies are ineligible for this option • There is no minimum share capital requirement for a US-REIT. Shareholder requirements mandate that REIT shares must be transferable and, starting from the second taxable year, the REIT must have a minimum of 100 shareholders, with restrictions on the concentration of share ownership by fewer individuals or private foundations. Various stock classifications, including common and preferred stock, are permitted, with equal treatment required for shareholders within the same class • While listing is not mandatory for obtaining REIT status, US-REITs have the option to go public or remain private. Listing requirements vary for publicly offered REITs (those registered with the SEC) and private REITs. Additionally, there are no restrictions on foreign shareholders, though certain tax implications under FIRPTA (Foreign Investment in Real Property Tax Act) may apply unless exemptions are met • As of March 2021, the collective market capitalization of publicly traded US REITs amounted to USD 1.3 tn, with a total of 221 publicly held REITs in the United States. REITs must adhere to the 75.0% asset test, which mandates that a majority of their assets be comprised of Real Estate, government securities, or cash items. Additionally, at least 75.0% of gross income must be derived from Real Estate property rental or mortgage interest, with no more than 5.0% from non-qualifying sources. Leverage is another key aspect of US-REIT operations, with no statutory or regulatory limits imposed. However, tax reforms introduced in 2017 limit the deductibility of business interest to 30.0% of a taxpayer's tax version of EBIT, affecting the financing strategies of REITs and their capital structures • US law mandates REITs to distribute at least 90.0% of their ordinary taxable income annually as dividends. Failure to meet this requirement may result in a 4.0% excise tax unless at least 85.0% of the income is distributed within the year it is generated. While REITs are not obligated to distribute capital gains, undistributed gains are subject to corporate income tax, with provisions for shareholders to receive tax credits • REITs are required to adhere to comprehensive disclosure standards, ensuring transparency and accountability to investors. This includes providing timely and accurate financial reports, operational updates, and material event disclosures, enabling investors to make informed decisions • Distributed dividends are deducted when calculating a REIT's taxable income. Retained income is subject to ordinary corporate income tax. Dividends from ordinary income are generally taxed as ordinary dividends, with a 20.0% deduction under section 199A through

	2025. A REIT acting as a dealer is subject to a 100.0% excise tax on dealer sales profits, unless it meets certain safe harbour conditions. Non-arm's length transactions with a taxable REIT subsidiary are taxed at a 100.0% rate • Retained capital gains are subject to corporate income tax. Shareholders receive an increased tax basis and a tax credit for taxes paid by the REIT. Capital gains distributions attributable to the sale of US real property are subject to the Foreign Investment in Real Property Tax Act (FIRPTA) • No withholding tax is levied on distributions to US shareholders. Foreign shareholders may be subject to a 30.0% withholding tax on ordinary income dividends, with possible reductions under double tax treaties. Return of capital distributions are subject to a 10.0% withholding tax, which can be reduced with a withholding certificate • Corporate shareholders pay a 21.0% rate on REIT capital gains and ordinary income distributions. • Individual shareholders are subject to income tax rates of up to 37.0%, plus a 3.8% surtax on investment income for high earners. Qualified REIT dividends qualify for a lower 20.0% rate, while capital gain distributions are taxed at rates of up to 23.8%. Shareholders are taxed on return of capital distributions only to the extent they exceed their tax basis in REIT shares • Foreign REITs may be subject to a 30% withholding tax on gross rental income unless they elect to be taxed on a net basis or are actively operating rental property in the US. US shareholders of foreign REITs may face taxation at corporate or individual rates, depending on various factors such as treaty benefits and PFIC status

In summary, stakeholders in the REIT markets of Singapore, Australia, South Africa, China, the UK, Belgium, and the US have established favourable conditions for REITs, offering incentives to participants that enhance their appeal compared to other investment options. Our examination of these countries' REIT markets reveals valuable insights that could enhance Kenya's REIT market. Key factors contributing to the success of REITs in these nations include supportive regulatory frameworks and well-designed REIT structures. Moreover, the increasing popularity of REITs in these jurisdictions reflects growing investor confidence in REITs as a viable investment avenue.

Section VII: Recommendations

The Kenyan REIT market has the potential to grow and this is possible if there is a supportive framework set up similarly to the above highlighted case studies. In view of this, the following measures can be implemented to rejuvenate the Kenyan REIT market;

i. **Encourage Different Legal Entities to pursue REIT Formation:** In both Belgium and the United States, REIT formation allows for flexibility in the choice of legal entities, contributing to the diversity and dynamism of the REIT market. Belgium permits various legal structures, including public limited companies, limited liability companies and cooperative companies, offering options tailored to different investor preferences and business models. Similarly, in the US, REITs can be structured as corporations, trusts, or associations, providing versatility in organizational structures. Kenya should follow suit by encouraging different legal entities for REIT formation. By expanding the range of permissible structures beyond traditional trust-based models, such as permitting corporations or limited liability companies, Kenya can accommodate diverse investor needs and facilitate easier entry into the REIT market,

ii. **Streamlined approval process:** To enhance the efficiency of Real Estate Investment Trusts (REITs) approval, consolidating the approval structure into a single agency, rather than the existing two (CMA and KRA), is recommended. Consolidating the approval process under one agency would eliminate the necessity of navigating through two distinct agencies for REITs approval. This consolidation would streamline the process, improving efficiency, reducing costs, and enhancing transparency and accountability,

iii. **Abolish Minimum Investment Requirements:** Kenya should consider abolishing minimum capital requirements for Real Estate Investment Trusts (REITs), similar to the approach adopted in the United States. Removing this barrier would encourage greater participation in the REIT market by lowering entry barriers for investors and facilitating the establishment of REITs, thus fostering market growth and innovation,

iv. **Reduce the minimum Capital for Trustees:** The minimum capital required of trustees of Kshs 100.0 mn is too high, effectively limiting the trustees to banks only. Currently there are 4 banks registered as REIT Trustees, being Kenya Commercial Bank (KCB), Co-operative Bank (Coop), Housing Finance Bank and NCBA Bank Kenya. We recommend the minimum should be brought down to Kshs 10.0 mn, to match the minimum needed for a Pension Fund Trustee. This would increase the number of Trustees that REIT Managers can pick from,

v. **Fostering Institutional Grade Real Estate Development:** Presently, insufficient urban planning has led to a discernible void in the Real Estate sector for properties that offer more than mere residential accommodations and can generate attractive returns for investors. Addressing this gap involves promoting the development of institutional grade Real Estate assets, which would furnish robust underlying properties for REITs, thereby bolstering investor returns,

vi. **Flexibility in Listing:** Belgium's requirement of ensuring 30.0% of shares held by the public offers a balance between public ownership and flexibility for REIT promoters. Kenya could adopt a similar approach to encourage broader investor participation while ensuring adequate liquidity in the market. Additionally, Kenya could emulate the United States in providing flexibility in listing options for REITs. Allowing REITs, the choice to go public or remain private offers greater flexibility to meet diverse investor preferences and business models. By accommodating both publicly listed and privately held REITs, Kenya can promote market inclusivity and cater to the needs of a wide range of investors, thereby enhancing the vibrancy and liquidity of the REIT market,

vii. **Education and Awareness:** Conduct investor education and awareness campaigns to educate potential investors about the benefits and risks of investing in REITs. By enhancing investor knowledge and understanding, more investors may be encouraged to participate in the REIT market, contributing to its growth and development, and,

viii. **Simplify the REIT formation process:** Currently, the bureaucratic procedures involved in forming a REIT can extend the timeline to between one to two years. The CMA should streamline this process to enhance efficiency and minimize the time required for formation.

Section VII: Conclusion

In conclusion, the progress of Real Estate Investment Trusts (REITs) in Kenya showcases both achievements and opportunities for further development. While the regulatory framework laid out under the Capital Markets (Real Estate Investment Trusts) Regulations, 2013 provides a foundation for REITs, there remains challenges to address and lessons to learn from global counterparts. Embracing these recommendations can propel Kenya's REIT market, fostering economic expansion and delivering appealing prospects for Real Estate investors.