Whispers from Kenya

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Property bubble, probably not, but don't overlook the risks

Macro Strategy Report

Market demand is there, but are the buyers?

When you scratch the surface and look past Kenya's housing deficit of c2mn homes, growing 200k units annually, you see a market where affordability is stretched to the point where only 12.3% of urban households can afford to buy the cheapest new build house (USD26k / KES2.7mn) built by a developer /contractor. Furthermore, when we add this to avg. gross income of just USD7.34k and the small number of formally employed people (2.7mn in 2020), which is declining (-6% Y-o-Y), it is hard to see where the growth will come from. High land prices (per acre) of +USD500k and +USD100k in the suburbs and satellite towns of Nairobi, respectively, means there is a disconnect between buyers and affordability. These unfavourable structural challenges are nothing new, but we believe this has finally started to show as the masses have been crowded out. We think structural changes are needed to improve the outlook, which looks stagnant at best. If not, the bursting of this bubble could have a significant impact on listed financial services companies and in particular, the banks.

Nairobi prices showing signs of softening

Current land prices in the high-end residential segment have fallen significantly from their peak levels over the past four years. Most notably, land prices in Runa in 1Q21 were 27% below their recent peak in 4Q17. On the commercial side, we note that land prices in Upperhill (Nairobi's most expensive suburb – USD4.6mn an acre) are 13% below the peak in 4Q17. Since 4Q17, land prices in the suburbs of Nairobi have all underperformed the CPI basket (see Fig.15).

Tough Nairobi office market is now very visible

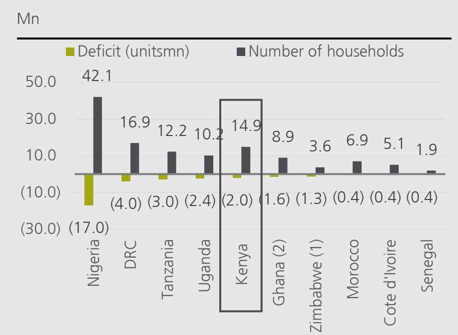
Post Nairobi's office stock growing at a 2012-20 CAGR of 21.3% (to 36.4mn sq. ft), available supply in Nairobi's metropolitan area now exceeds demand (7.7mn sq. ft vs 0.2mn sq. ft). Worryingly, office vacancy rates in Nairobi rose to 22.3% in 2020 from 9% in 2011. Average rental yields in Nairobi are also down to 7% vs 8.5% in 2016.

Financial services companies most exposed to property weakness

Of the 20 financial services companies we review in this note, we estimate their total property exposure is USD42.9bn (43% of GDP). Indirect exposure i.e., real estate collateral held by banks, accounts for 86% (USD37.1bn) of total exposure. When ranked by total property exposure as a percentage of total assets (2020), **the most exposed were KCB Group (209%), HF (206%) and Family Bank (106%)** and the **least exposed were Sanlam (9%), Liberty (5%) and Jubilee (5%).**

SSA – Housing deficits vs number of households, 2020

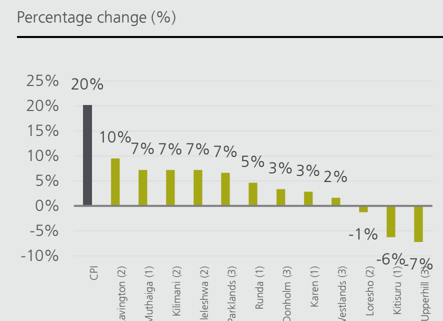
Mn



Source: Company data

Nairobi suburbs – changes in land price since 4Q17

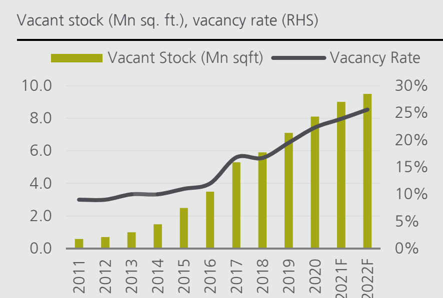
Percentage change (%)



Source: Hass Consult. (1) High-end; (2) Upper-middle income; and (3) Other

Nairobi office market – Trends in vacancies

Vacant stock (Mn sq. ft.), vacancy rate (RHS)



Source: Cytonn

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1. Housing deficits do not tell the whole story

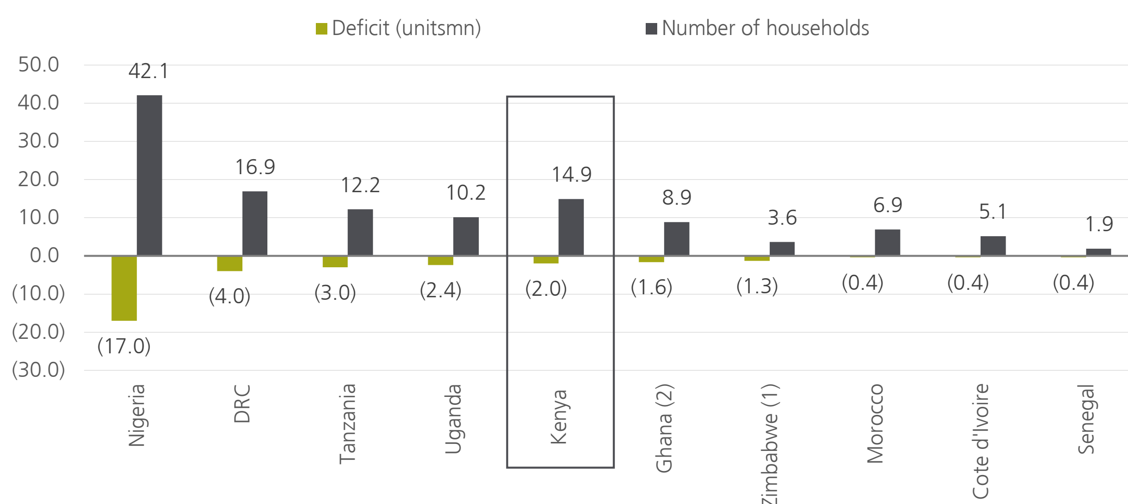
In this section, we explain why we believe the housing deficit does not tell us the whole story. While there is excess demand for housing, we believe the low levels of affordability make bridging the current gap very challenging. This in turn is exacerbated by high land and property prices, particularly in Nairobi. So, while there may be genuine household demand for housing, accessibility, even with financing, is very limited. In our opinion, the limited accessibility of the *wanainchi* (or masses), is starting to filter through with stagnate to receding retail property prices at the high end.

Kenya - housing deficit outlined

As shown below, Kenya is not unique in Sub-Sahara Africa (SSA) with regard to its housing deficit. As per Shelter Afrique, Kenya's 2020 housing deficit was around 2mn units, which is equivalent to around 13% of its households (15mn). With a housing deficit-to-household ratio of 13%, Kenya is actually in a better position than most of its peers in East Africa (Tanzania, 25% and Uganda, 24%) and West Africa (Nigeria, 40% and Ghana, 18%).

Figure 1: SSA – Housing deficits vs number of households, 2020

Mn



Source: Shelter Afrique, World Population Data Sheet, 2020, UN Department of Economic and Social Affairs and EFG Hermes estimates. (1) Urban areas only. (2) Shelter Afrique data provided is for rooms - 5.7mn. Therefore, we divided this figure by the number of people per household to get an estimate for the current housing deficit.

Although Kenya's housing deficit relative to the number of households is not as wide as its peers, its housing deficit is estimated to be growing at around 200k units annually. The growth in Kenya's housing deficit has traditionally been explained by: i) the country's high population growth rate (2.25% per annum); ii) rapid urbanisation rate (4.3% per annum); and iii) low supply of new housing units (only 50,000 per annum). While we strongly believe that the aforementioned factors have contributed and will continue to contribute to the growth in Kenya's housing deficit, we believe that worsening affordability is also a key driver of the growing housing deficit in Kenya.

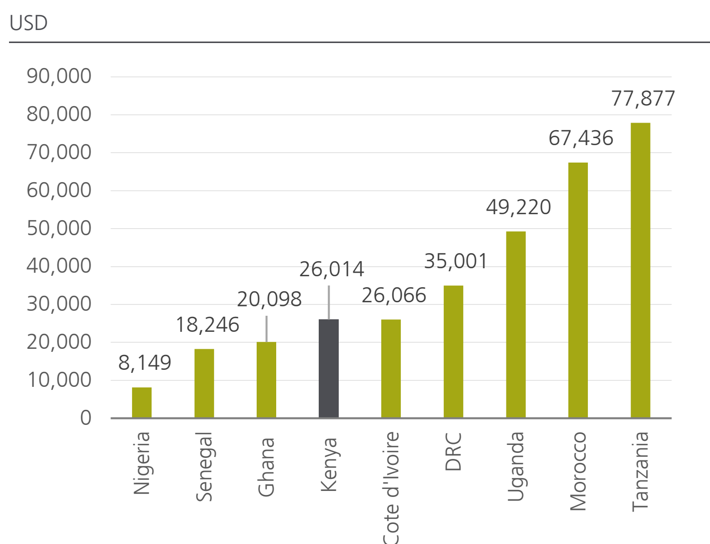
In the following section, we explain why affordability is an ongoing challenge that needs to be resolved in order to close the housing deficit.

The 'affordability' of demand

Whilst there is no doubting the excess demand for housing, the challenges around affordability mean that resolving its housing deficit is becoming increasingly illusive, in our opinion. To illustrate the challenges around affordability, we have taken data published by the Centre for Affordable Housing Finance in Africa (CAHF) on the cost of the cheapest newly built house in Kenya and a number of its SSA peers. As shown in the charts below, the CAHF calculates that the cheapest cost of a newly built house by a formal developer or contractor in Kenya's urban areas is USD26,014 (KES2.7mn) and the average size of this unit is 88m^2.

Figure 2: Cost of cheapest newly built urban house in 2020

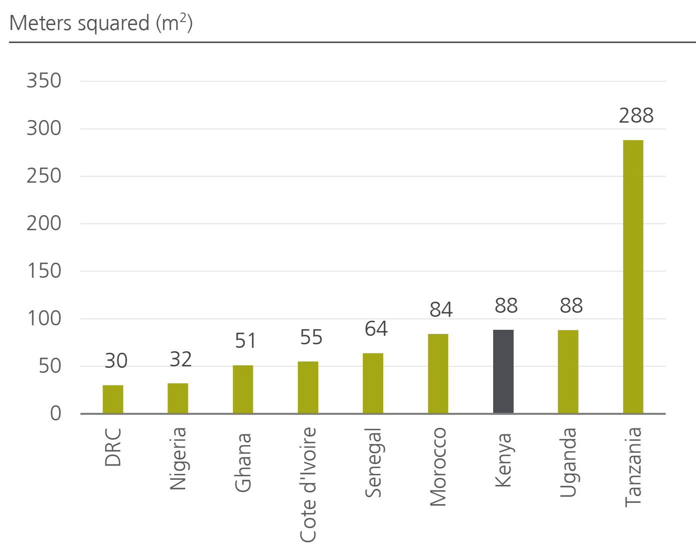
USD



Source: CAHF and Bloomberg.

Figure 3: Size of cheapest newly built urban house in 2020

Meters squared (m^2)

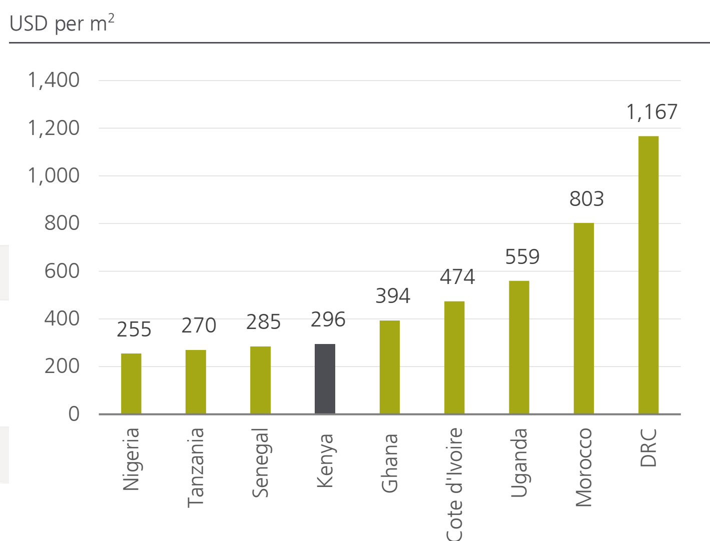


Source: CAHF

Although the cost of building a low-cost home in Kenya's urban areas is 47% and 67% cheaper than Uganda and Tanzania, respectively, it is more than double the cost of Nigeria (USD8,149 or NGN3.1mn). Notably, the low-cost houses built by the Millard Fuller Foundation on the outskirts of Abuja are the cheapest in Africa according to the CAHF. At an average size of 32m^2, these houses in Nigeria also rank amongst the smallest in Africa.

Figure 4: Cost of cheapest newly built urban house, 2020

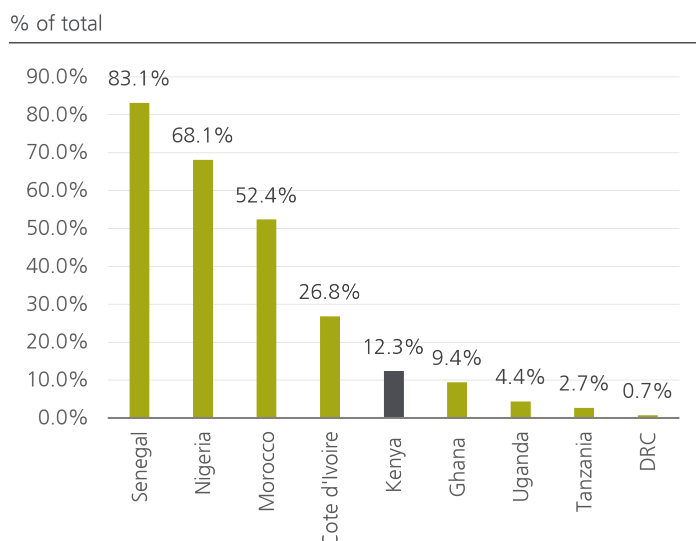
USD per m^2



Source: CAHF and Bloomberg

Figure 5: Urban household affordability (1) with finance, 2020

% of total



Source: CAHF. (1) Percentage of urban households that can afford the cheapest newly built urban home by a formal builder or contractor.

Given that the average price per m2 in Nigeria is only USD255 and the size of these low-cost homes are small, the CAHF estimates that 68.1% of urban households in Nigeria could afford these homes with finance. In the particular case of Nigeria, we would note that the Millard Fuller Foundation offers its mid-low-income earners a range of convenient payment options. However, in Kenya, Tanzania and Uganda, the CAHF estimates that only 12.3%, 4.4% and 2.7% of urban households could afford the lowest-cost new built home with financing, respectively.

To conclude on the challenges of affordability in Kenya, we provide an update on the latest employment statistics provided by the Kenya National Bureau of Statistics (KNBS). As shown below, Kenya had only 2.7mn formally employed people in 2020. To put this figure into context, Kenya has a working population (15-65 years) of around 33mn (61% of its total population). Therefore, only 8% of Kenya's working population is formally employed.

Figure 6: Kenya – Formal employment by sector, 2016-20 (thousands)

	2016	2017	% Chng	2018	% Chng	2019	% Chng	2020	% Chng	2016-20 CAGR
Agriculture	294.5	289.8	-2%	294.3	2%	296.7	1%	280.6	-5%	-1%
Manufacturing	315.1	317.5	1%	321.3	1%	329.0	2%	293.8	-11%	-2%
Construction	199.1	204.9	3%	209.8	2%	212.7	1%	212.4	0%	2%
Wholesale/retail	238.5	249.3	5%	258.9	4%	267.7	3%	249.7	-7%	1%
Info. & comm.	115.2	122.4	6%	129.3	6%	130.4	1%	117.2	-10%	0%
Financial services.	65.0	63.5	-2%	64.0	1%	65.9	3%	65.0	-1%	0%
Education	196.9	212.1	8%	223.9	6%	228.7	2%	181.1	-21%	-2%
Health & social serv.	95.7	102.2	7%	108.0	6%	114.6	6%	103.6	-10%	2%
Other	388.5	397.8	2%	407.5	2%	417.5	2%	353.1	-15%	-2%
Total private sector	**1,908.5**	**1,959.5**	**3%**	**2,017.0**	**3%**	**2,063.2**	**2%**	**1,856.5**	**-10%**	**-1%**
Agriculture	42.2	42.3	0%	42.3	0%	41.9	-1%	41.7	0%	0%
Public services	247.6	294.1	19%	296.5	1%	304.6	3%	310.1	2%	6%
Education	349.4	349.6	0%	354.9	2%	369.1	4%	381.9	3%	2%
Other	135.5	147.1	9%	149.1	1%	149.6	0%	150.9	1%	3%
Total public sector	**774.7**	**833.1**	**8%**	**842.8**	**1%**	**865.2**	**3%**	**884.6**	**2%**	**3%**
Total employment	**2,683.2**	**2,792.6**	**4%**	**2,859.8**	**2%**	**2,928.4**	**2%**	**2,741.1**	**-6%**	**1%**

Source: KNBS

Not only is Kenya's formally employed population very small, but it is also shrinking. As shown above, the number of formally employed people in Kenya fell 6% Y-o-Y in 2020, with those in the private sector falling 10% Y-o-Y. Worryingly, formal employment in the private sector of Kenya has fallen at a 2016-20 CAGR of 1%. While the contraction in 2020 formal employment can primarily be explained by the COVID-19 pandemic, we would note that the annual growth in formal employment prior to this was rather anemic (see above).

Figure 7: Kenya – Average gross annual salaries by sector, 2016-20 (KES)

	2016	2017	% Chng	2018	% Chng	2019	% Chng	2020	% Chng	2016-20 CAGR
Agriculture	274,057	303,365	11%	333,743	10%	369,441	11%	376,389	2%	8%
Manufacturing	394,969	438,132	11%	480,072	10%	529,978	10%	558,332	5%	9%
Construction	607,531	630,168	4%	671,655	7%	717,869	7%	758,375	6%	6%
Wholesale/retail	617,847	678,291	10%	742,506	9%	821,343	11%	874,714	6%	9%
Info. & comm.	852,965	910,565	7%	978,335	7%	1,051,426	7%	1,130,829	8%	7%
Financial services	1,678,369	1,758,398	5%	1,843,578	5%	1,948,663	6%	2,046,309	5%	5%
Education	896,537	931,242	4%	961,249	3%	996,488	4%	980,909	-2%	2%
Health & social serv.	764,583	828,615	8%	897,134	8%	970,654	8%	1,052,483	8%	8%
Other	650,790	710,767	9%	766,919	8%	834,224	9%	855,886	3%	7%
Total private sector	**620,051**	**670,221**	**8%**	**721,238**	**8%**	**780,092**	**8%**	**809,903**	**4%**	**7%**
Agriculture	416,410	421,598	1%	433,421	3%	478,809	10%	510,856	7%	5%
Public services	518,066	531,633	3%	575,484	8%	606,352	5%	566,399	-7%	2%
Education	584,104	604,281	3%	663,696	10%	711,970	7%	729,573	2%	6%
Other	1,133,354	1,152,886	2%	1,206,029	5%	1,350,316	12%	1,447,839	7%	6%
Total public sector	**649,930**	**666,226**	**3%**	**717,049**	**8%**	**773,870**	**8%**	**784,587**	**1%**	**5%**
Total employment	**628,678**	**669,029**	**6%**	**720,004**	**8%**	**778,253**	**8%**	**801,733**	**3%**	**6%**

Source: KNBS

In addition to having a small formally employed population, the average employed Kenyan only made KES801,733 (USD7,344) per year. To put this into context, the cheapest urban home in Kenya costs 3.54x (USD26,014) the average 2020 salary of a formally employed person. Worryingly, a person working in financial services, which boasts the highest average annual salary (KES2.1mn or USD18,744) in Kenya, could not afford the cheapest urban home with one year's gross salary.

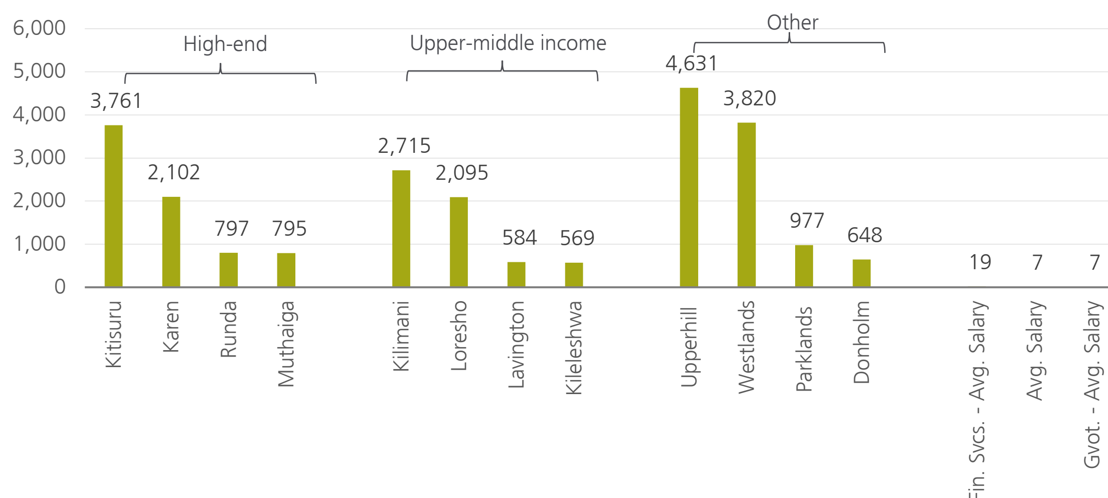
To put Kenya's formal salaries into context, we track the recent trends in Nairobi land prices in the following section. Note that, we focus on Nairobi because historical data is available. There is very limited sequential data for other cities in Kenya.

Nairobi property prices exacerbate 'affordability' challenges

Based on the information provided by Hass Consult, we have provided (in the chart below) the 1Q21 average cost per acre of land in the **high-end** (Karen, Kitisuru, Muthaiga and Runda), **upper-middle income** (Kilimani, Kileleshwa, Lavington and Loresho) and **other** (Donholm, Parklands, Upperhill and Westlands) segments of the Nairobi property market. On the other segments, they tend to have a high commercial bias and therefore represent some of the most expensive suburbs in Nairobi.

Figure 8: Nairobi suburbs – Average value per acre (1Q21) vs annual salaries in the formal sector (2020)

USD thousands

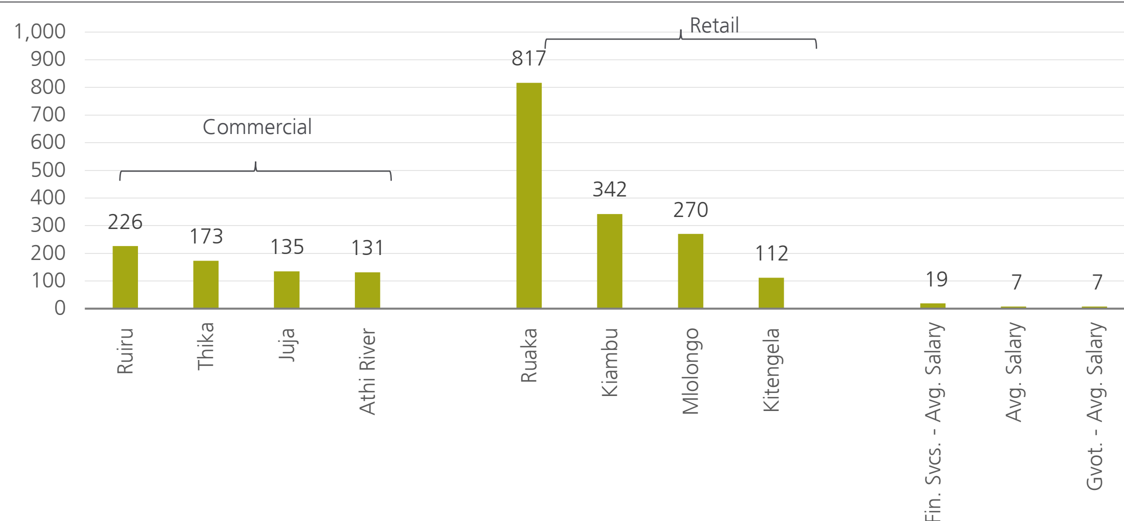


Source: Hass Consult, Bloomberg and KNBS

As shown above, buying an acre of land in the two most expensive suburbs of Nairobi (Upperhill and Westlands) is not even remotely possible for the average employee in the financial services sector. Based on the average costs per acre shown above, we estimate that if an average employee in the financial services sector was provided an interest free loan, it would take them 247 years and 204 years to buy an acre in Upperhill and Westlands, respectively. This is assuming that they would be able to retain 100% of their gross income, which is also not possible. Interestingly, it would take the same employee 30 years (assuming 100% retention of gross income) to buy one acre in Kileleshwa, which ranks amongst the least expensive upper-middle income suburbs in Nairobi.

Figure 9: Nairobi satellite towns – average value per acre (1Q21) vs annual salaries in the formal sector (2020)

USD thousands



Source: Has Consult, Bloomberg and KNBS

Given the high cost of land in Nairobi's suburbs, the formally employed have been increasingly moving to the satellite towns around Nairobi. At a cost of USD112k per acre, we calculate that it would take an average employee in the financial services sector six years to buy an acre in Kitengela, which is around 30km from downtown Nairobi. Again, we are clearly assuming that the employee's loan is interest free and full retention of gross salary. Notably, the cost of an acre of land in Ruaka is very high (USD817k) because it is only 12km from downtown Nairobi and near high-end suburbs of Runda, Kitisuru and Gigiri.

To conclude on the affordability of land prices in Nairobi, we compare (in the charts below) the change in suburb and satellite town land prices over the past 10 years against the change in formal annual salaries over the same period.

Figure 10: Change in avg. value per acre (by suburb) vs annual salaries over the past 10 years (2010-20)

Multiples (x)

Source: Hass Consult and KNBS

Figure 11: Change in avg. value per acre (by satellite town) vs annual salaries over the past 10 years (2010-20)

Multiples (x)

Source: Hass Consult and KNBS

Based on the charts above, formal annual salaries have broadly moved in line with suburb land prices, but have significantly lagged land prices in Nairobi's satellite towns. Given that satellite towns are where the average formal worker has been increasingly forced to live, this has significantly reduced the affordability of these areas. The question one has to ask is, how much further away from Nairobi will the formal workforce have to live before it is affordable for them and will a sufficient number of low-cost homes be built for them?

In the meantime, the next section shows how the high property prices have led to a soft property market in high-end retail and commercial properties in Nairobi.

2. Nairobi, showing signs of softening

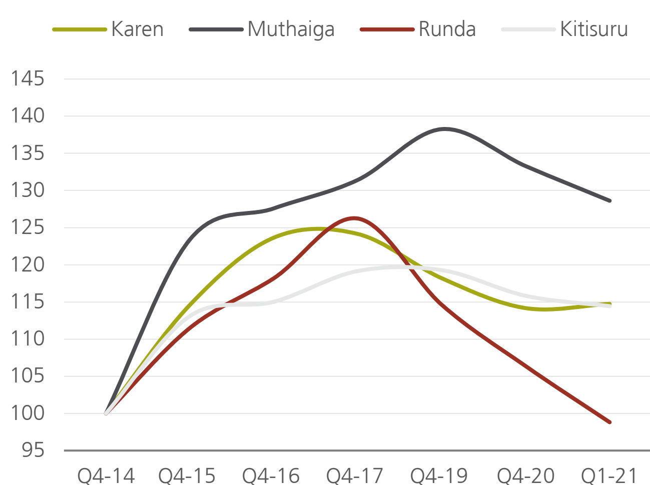
In this section we use industry data to illustrate softening in high-end retail and commercial property prices in the suburbs of Nairobi over the past four years (4Q17-1Q21). In the satellite towns of Nairobi, the quarterly growth (Y-o-Y) in residential and commercial property prices has clearly slowed since 4Q19. Could this represent the early signs of a deeper correction in high-end property prices?

Land prices are a good leading indicator of softening prices

As shown below, current land prices in the high-end segment are significantly lower than their peak levels over the past four years. Most notably, 1Q21 land prices in Runa were 27% below their recent peaks in 4Q17. In the middle-income segment, current land prices are also lower than their peak levels over the past four years, but not by as much as the high-end segment.

Figure 12: Nairobi high-end segment – Land price Index

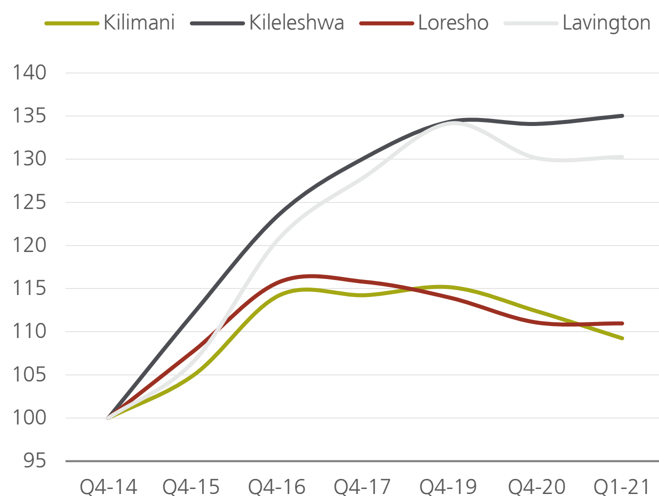
Index with 4Q14 = 100%



Source: Hass Consult

Figure 13: Nairobi upper-middle income segment – Land price Index

Index with 4Q14 = 100%



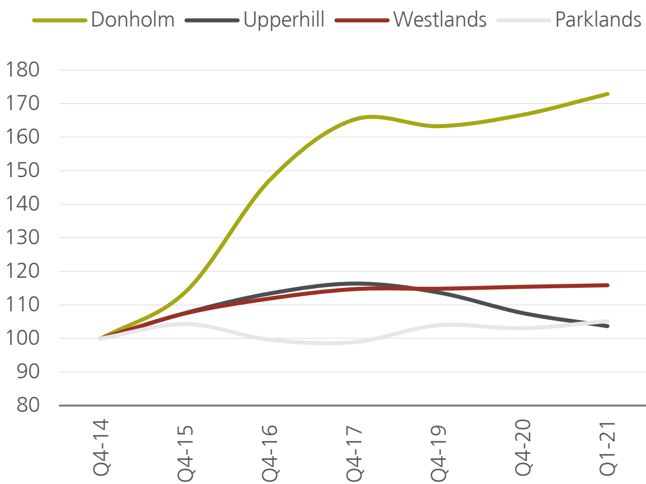
Source: Hass Consult

In the other segment (shown above), we would note that while current land prices in Parkland and Westlands have changed little from their peak levels over the past four years, current land prices in Upperhill (Nairobi's most expensive suburb) are 13% below their peaks in 4Q17. Donholm stands out within the other segment for being the only suburb that has continued to see its land prices materially appreciate since 4Q17.

On the performance of suburb land prices in Nairobi, we note that between 4Q17 and 1Q21, they have all materially underperformed the CPI. In our opinion, this has to be concerning for the outlook of the property market in Nairobi's suburbs.

Figure 14: Nairobi other segment – land price Index

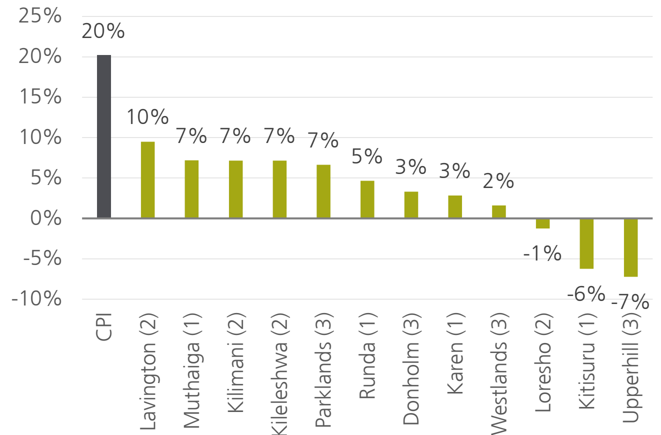
Index with 4Q14 = 100%



Source: Hass Consult

Figure 15: Nairobi suburbs – changes in land price from 4Q17

Percentage change (%)

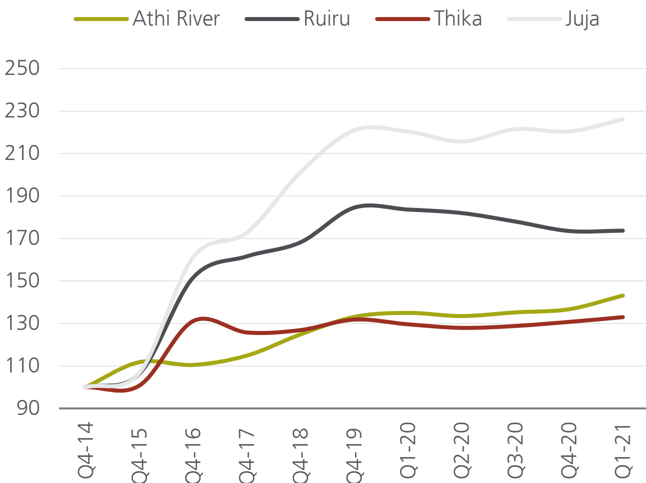


Source: Hass Consult. (1) High-end; (2) Upper-middle income; and (3) Other

Turning our attention to the satellite towns of Nairobi, we note that commercial, residential and other land prices have all increased over the past four years (see below).

Figure 16: Nairobi's satellite towns – Commercial land price Index

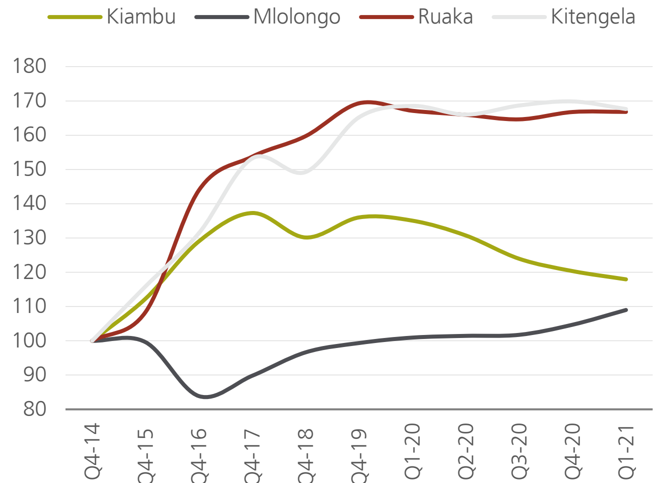
Index with 4Q14 = 100%



Source: Hass Consult

Figure 17: Nairobi's satellite towns – Residential land price Index

Index with 4Q14 = 100%

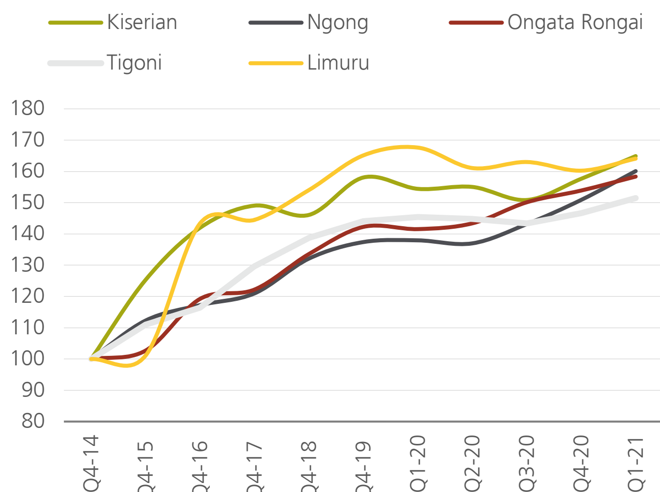


Source: Hass Consult

As shown below, the satellite towns of Ngong, Juja, Athi River and Mlolongo have all outperformed the CPI between 4Q17 and 1Q21. Only Kiambu town, which is the second most expensive retail satellite town, has seen its land prices decline between 4Q17 and 1Q21.

Figure 18: Nairobi's satellite towns – other land price Index

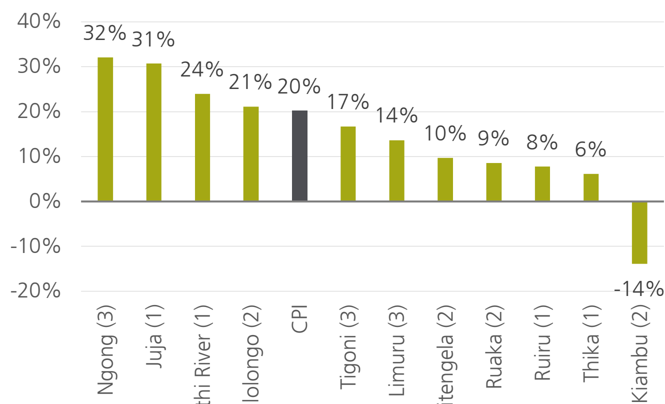
Index with 4Q14 = 100%



Source: Hass Consult

Figure 19: Nairobi's satellite towns – changes in land price from 4Q17

Percentage change (%)



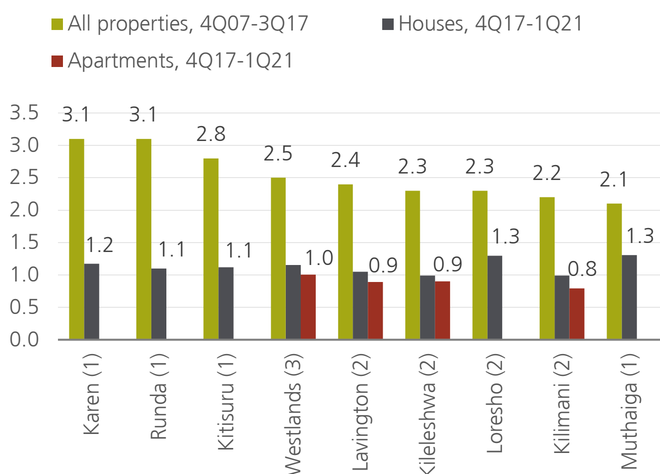
Source: Hass Consult. (1) Commercial; (2) Residential; and (3) Other

Trend in property sale and rental prices also slowing

As shown below, the increase in property prices (both sales and rentals) slowed significantly between 4Q17 and 1Q21 when compared to periods of strong growth (4Q07-3Q17).

Figure 20: Property sale price trends, 4Q07-1Q21

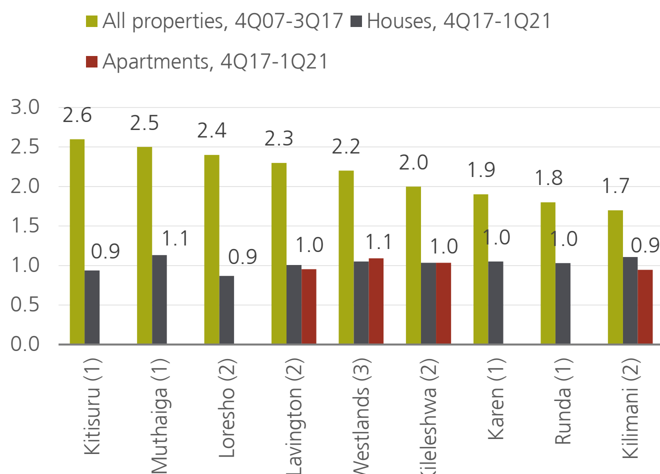
Absolute change in period (x)



Source: Hass Consult. (1) High-end; (2) Upper-middle income; and (3) Other

Figure 21: Property rental price trends, 4Q07-1Q21

Absolute change in period (x)



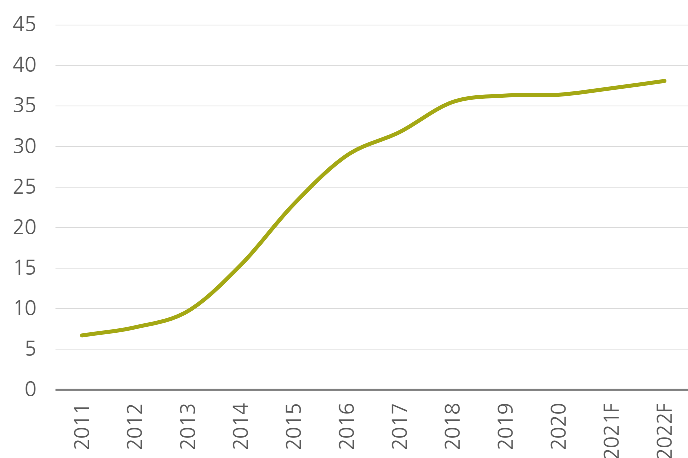
Source: Hass Consult. (1) High-end; (2) Upper-middle income; and (3) Other

Pains in the Nairobi office market, now very visible

Office stock growth in Nairobi's metropolitan area has seen an eight-year CAGR of 21.3% to 36.4mn sq. ft. in 2020 from 7.7mn sq. ft. in 2012. In 2020, the available supply stood at 7.1mn sq ft largely exceeding demand, which fell to 0.2mn sq. ft. in the same year. Data available from 2011 onwards also shows that vacancy rates have continued to rise over a similar period, from a vacancy rate of 9% in 2011 to 22.3% in 2020. The oversupply of office space and low demand due to various reasons, including deteriorating economic conditions since the onset of the COVID-19 pandemic, has resulted in a 0.5ppt decline in average rental yields to 7.0% in 2020 from 7.5% in 2019. Meanwhile, occupancy rates declined by 2.6ppts to 77.7% in 2020, from 80.3% in 2019. Asking rents and prices also declined by 3.0% Y-o-Y and 2.8% Y-o-Y, respectively, to an average of KES93 and KES12,280 per sq. ft. in 2020, down from KES96 and KES12,638 per sq. ft. in 2019, respectively.

Figure 22: Office supply in 2020 stood at 36.4mn sq. ft.

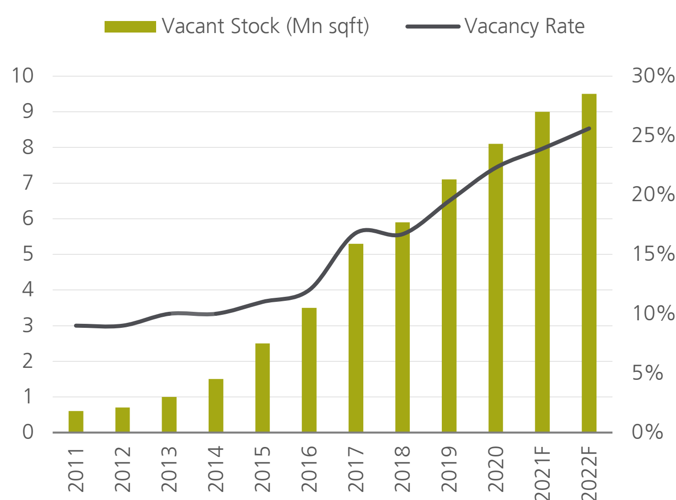
Total office stock (Mn sq. ft.)



Source: Cytonn

Figure 23: Office vacancies have risen significantly since 2011

Vacant stock (Mn sq. ft.), vacancy rate (RHS)

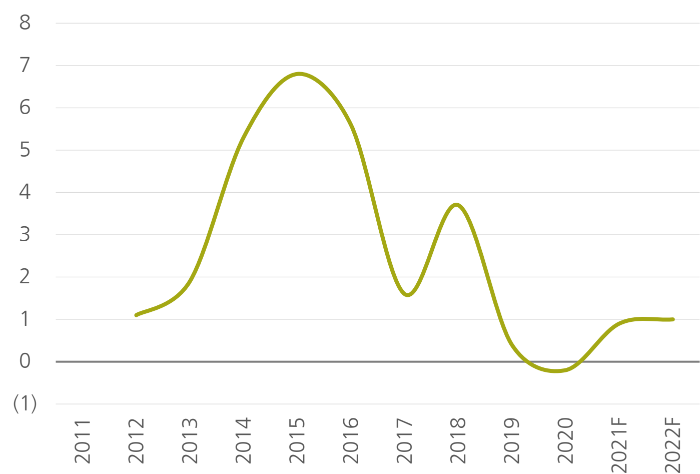


Source: Cytonn

In 2020, Gigiri, Karen and Westlands were the best performers recording an average rental yield of 8.5%, 7.8%, and 7.8%, respectively, due to their prime locations and large availability of Grade-A quality offices. Thika Road and Mombasa Road were the worst performing nodes recording rental yields of 5.8% and 4.8%, respectively, attributable to their poor locations (both roads suffer from high levels of traffic congestions) and lower quality office spaces.

Figure 24: Demand for office space has softened since 2015

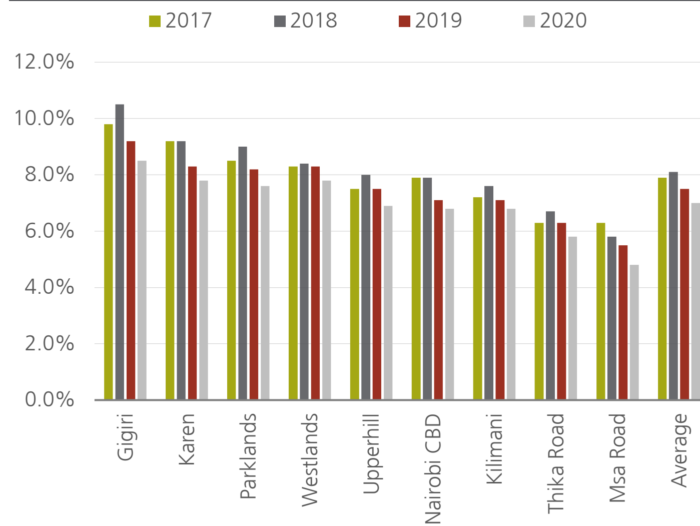
Demand for office space (Mn sq. ft.)



Source: Cytonn

Figure 25: Rental yields across all nodes in Nairobi have declined

Rental yields (%), 2017-20



Source: Cytonn

Figure 26: Average rental prices came off slightly in 2020, and rental yields have also softened

	2013	2015	2016	2017	2018	2019	2020
Occupancy	90%	89%	88%	82.60%	83.80%	80.30%	77.70%
Asking rents (KES per sq. ft.)	95	97	97	101	101	96	93
Average prices (KES per sq. ft.)	12,433	12,776	12.031	12,649	12,407	12,638	12,280
Average rental yields (%)	8.30%	8.10%	8.50%	7.90%	8.30%	7.50%	7.00%

Source: Cytonn

3. Property exposure – implications for financial services companies

In our opinion, the quoted sector most at risk of a potential property bubble is the financial services sector and in particular: investment companies, insurers and banks. In this section, we outline the property exposures (investments and land/ building assets) and implied rental yields of the leading financial services companies in Kenya. Focusing on the banks, we detail their exposures to real estate collateral, as this is much larger than their direct property exposures and could have a significant impact on their provision outlook if there is a sharp correction in property values.

Property exposures outlined

As shown below, we estimate that the total 2020 property exposure of the one investment company (Centum), seven insurers (Britam, CiC, Jubilee, Kenre, Liberty, Sanlam and UAP) and 12 banks (Absa Kenya, Bank of Baroda, Co-op, DTB Group, Equity Group, Family Bank, HF, I&M Group, KCB Group, NCBA, Stanbic Holdings and StanChart Kenya) is KES4,687bn (USD42.9bn). To put this property exposure into context, this represents 81% of the combined assets of these companies (KES5,808bn or USD53.2bn) and 43% of Kenya's 2020 GDP (USD99.3bn).

Figure 27: Financial services companies – mix of property exposures, 2020

In KESmn, unless otherwise stated

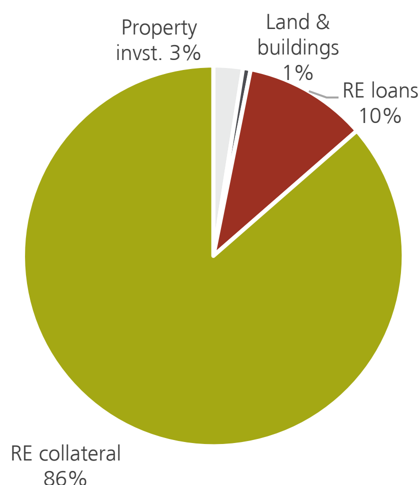
	Property invst.	Land & buildings	RE loans	RE collateral	Total exposure	Total assets
KCB Group (3)	6,035	4,510	163,683	1,886,832	2,061,060	987,810
Equity Group	5,576	6,213	100,642	525,022	637,453	1,015,093
NCBA (3)	-	-	27,333	340,844	368,177	527,868
DTB Group	-	3,442	51,549	293,561	348,551	425,054
I&M Group (3)	-	4,715	53,302	249,843	307,860	358,100
Co-op	-	3,139	30,254	246,034	279,427	537,076
HF (2)	1,331	967	40,182	71,985	114,465	55,445
Stanbic Holdings (4)	-	234	N/A	106,123	106,357	328,593
Family Bank (3)	23	1,039	3,632	91,392	96,087	90,661
StanChart Kenya (3)	-	1,670	1,415	86,731	89,816	325,605
Absa Kenya	-	51	N/A	88,001	88,052	379,441
Bank of Baroda (3)	-	533	15,852	63,786	80,171	166,313
Centum	41,181	358	-	-	41,539	101,864
Britam (1)	16,443	258	1,217	-	17,918	136,962
UAP	16,459	1,455	-	-	17,914	63,459
Kenre	12,175	-	-	-	12,175	53,237
CiC (1)	7,465	745	100	-	8,310	38,786
Jubilee (1)	6,714	-	47	-	6,761	145,864
Sanlam	2,384	424	-	-	2,808	31,521
Liberty	833	1,019	-	-	1,852	39,301
Total exposure	116,620	30,770	489,208	4,050,154	**4,686,752**	5,808,052
Total exposure (USDmn)	**1,068**	**282**	**4,481**	**37,100**	42,931	**53,202**
- % of GDP	*1%*	*0%*	*5%*	*37%*	*43%*	*54%*

Source: Company data, EFG Hermes estimates.
(i)RE loans for insurers are mortgage loans;
ii) RE loans for Housing Finance (HF) are estimated to be all loans except the unsecured loans;
iii) RE collateral for the banks that do not provide this figure is assumed at 75% of total collateral, which is the average figure of the banks that did provide this disclosure (Absa Kenya, Co-op and Equity Group); and
iv) We assume RE collateral for Stanbic Holdings is all corporate and retail mortgage collateral.

With regard to the mix in property exposures, the vast bulk of the exposure is what we would describe as indirect exposure (i.e., real estate collateral held by the banks). As shown below, we estimate that the 2020 total real estate collateral held by the 12 banks listed below was KES4,050bn (USD37.1bn) or 86% of the total property exposure.

Figure 28: Property exposures mix (by type), 2020

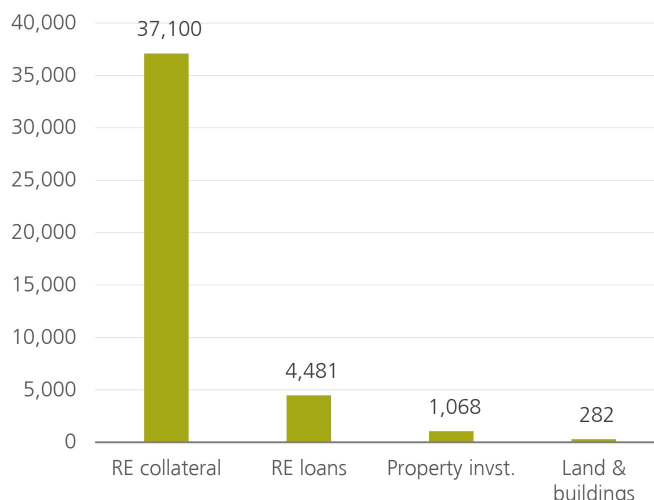
% of total



Source: Company data, EFG Hermes estimates

Figure 29: Property exposures mix (by type), 2020

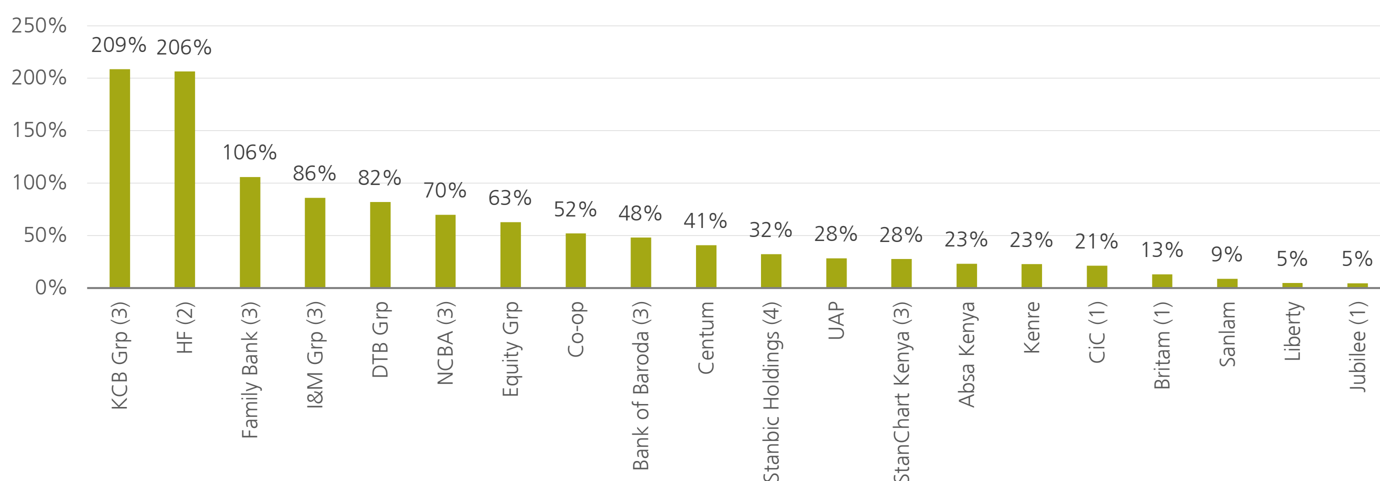
In USDmn



Source: Company data, EFG Hermes estimates

With real estate collateral forming the bulk of Kenya's leading financial services companies' property exposure, the banks rank amongst the most exposed to a correction in property prices. As shown below, the companies with the highest estimated property exposures as a percentage of total assets (2020) were KCB Group, HF and Family Bank and the least exposed were Sanlam, Liberty and Jubilee.

Figure 30: Financial services companies – Total property exposures/ total assets, 2020 (%)



Source: Company data, EFG Hermes estimates

After outlining the absolute size and mix in the property exposures of Kenya's leading financial services companies, we now detail these exposures by type (property investments, land & buildings, real estate loans and real estate collateral) in the following sections.

Property investments

On the KES116.6bn (USD1.1bn) of 2020 property investments held by the 20 financial services companies listed above, the seven insurers collectively accounted for 54% (KES62.5bn or USD572mn) of total property investments. While Centum had 2020 property investments of KES41.2bn (USD377mn or 35% of the total), the banks only contributed 11% of total 2020 property investments. The bulk of the property investments held by the banks were in KCB Group (KES6.0bn or USD55mn) and Equity Group (KES5.6bn or USD51mn). On these bank's property investments, we note that they were both made recently (KCB Group in 2019 and Equity Group in 2020).

On the timing of the property investments made by KCB Group and Equity Group, they happened at the same time the insurers were finally starting to book fair value losses against their property investments. As shown in the collective movements in property investments by our seven insurers in the table below, they collectively booked fair value losses of KES2.4bn (USD24mn) and KES1.8bn (USD19mn) in 2019 and 2020, respectively.

Figure 31: Kenyan insurers (1) – Collective movements in property investments, 2017-20

In KESmn, unless otherwise stated

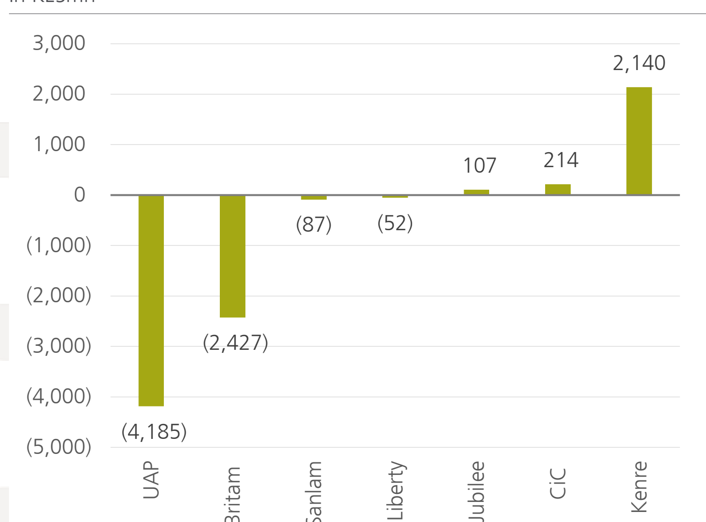
	2017	2018	2019	2020
Start period	59,929	62,444	64,290	61,880
Additions	3,850	2,039	1,346	2,514
Disposals	(19)	(528)	(939)	(597)
FV G&L	900	951	(2,405)	(1,884)
Other	(2,216)	(415)	(412)	560
End period	62,444	64,491	61,880	62,473
End period (USDmn)	*605*	*633*	*612*	*572*

Source: Company data. i) The insurers are: Britam, CiC, Jubilee, Kenre, Liberty, Sanlam and UAP.

On how the insurers ranked with regard to the fair value gains/(losses) that they have booked over the past two years (2019-20), two insurers have booked the largest write-downs: UAP (KES4.2bn or a 21% cut to its 2018 property investments) and Britam (KES2.4bn or a 15% cut to its 2018 property investments). At UAP and Britam, we note that their flagship properties in Upperhill are finally starting to deliver significant improvement in their occupancy rates (UAP is now at 98% and Britam is at 57%, but we expect this to improve to 80% by year-end). Amongst the insurers (see below), Kenre stands out positively as it was able to book fair value gains of KES2.1bn or a 21% increase of its 2018 property investments over the same period. On these gains at Kenre, we note that it benefited from placing previously disputed lands on-balance sheet post their resolution; the one-off gain that was booked in 2019 was KES1.7bn.

Figure 32: Collective fair value gains/ (losses), 2019-20

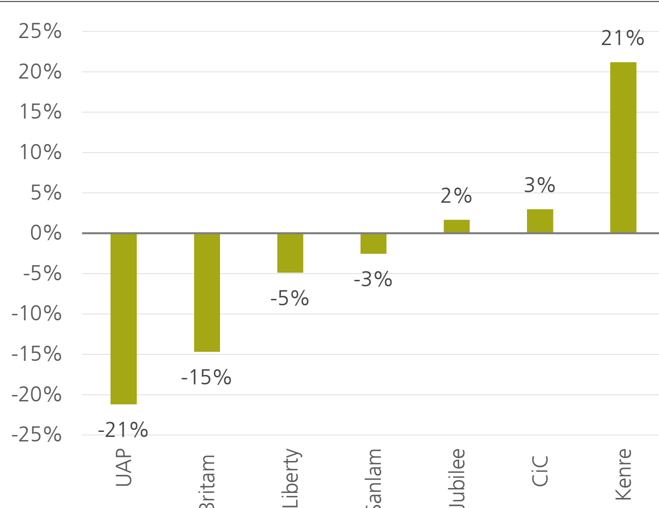
In KESmn



Source: Company data.

Figure 33: Collective fair value gains/ (losses)/ property investments

2019-20 collective fair value gains/(losses)/ 2018 property investment (%)



Source: Company data.

In addition to the recent write-downs of property investments, the average net rental income yields of the insurers that disclosed this information, has consistently been below the industry target of 8% over the past four years (2017-20). Notably, 2020 was the only year in which the average net rental income yield of our insurers was higher than inflation and this was due to the high yield booked by Liberty (13.5% vs 8.3% in 2019). Like Jubilee, Liberty benefits from: i) a strong strategic affiliation to its anchor shareholder (Standard Group vs AKFED for Jubilee); and ii) having no meaningful undeveloped land banks.

Figure 34: Net rental income yields (by company), 2017-20

Calculated as net rental income/ average property investments

	2017	2018	2019	2020
Britam	0.4%	0.6%	0.4%	0.9%
CiC	-	3.3%	2.4%	2.6%
Jubilee	5.6%	6.2%	8.9%	8.0%
Kenre	9.0%	8.9%	7.9%	7.9%
Liberty	-	-	8.3%	13.5%
Sanlam	-	-	3.2%	2.3%
UAP	4.7%	5.4%	5.2%	7.9%
Insurers (average)	**2.8%**	**3.5%**	**5.2%**	**6.2%**
Equity Group	-	-	-	5.6%
Inflation	**8.0%**	**4.7%**	**5.2%**	**5.3%**

Source: Company data and EFG Hermes calculations.

Focusing on the individual insurers, we are particularly concerned by the very low net rental income yields being booked by Britam, Sanlam and CiC. Although the net rental income yield booked by Equity Group in 2020 (5.6%) was above inflation, it was well below the 8.0% threshold. With low rental income yields, we believe these insurers are particularly at risk to any further corrections in property prices.

Land & buildings assets

On the KES30.8bn (USD282mn) of 2020 land & building assets held by the 20 financial services companies reviewed in this chapter, the 12 banks collectively accounted for 86% (KES26.5bn or USD243mn) of total land & building assets held. Notably, Centum and all 11 of our insurers had 2020 land & building assets of only KES358mn (1% of total) and KES3.9bn (13% of total), respectively.

In our opinion, the higher bank exposure to land & building assets is a reflection of their priorities, which are focused on owning their offices and branches and not in making property investments like insurers. As the banks occupy the bulk of these assets, we have not seen aggressive fair value losses reported against them. As shown below, the cumulative fair value losses booked by all 20 financial services companies against land & buildings over the past three years (2018-20) was KES-553mn or a 3% decline of the total land & buildings held in 2017.

Figure 35: Kenyan financial service companies (1) – Collective movements in land & buildings, 2017-20

In KESmn, unless otherwise stated

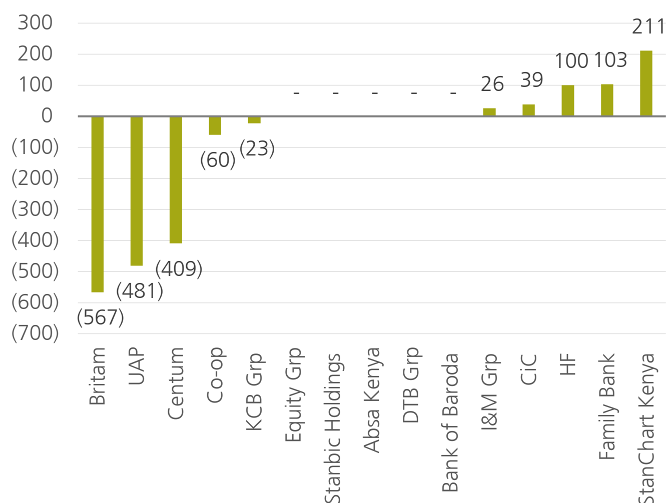
Combined	2017	2018	2019	2020
Start period	**17,043**	**21,185**	**21,738**	**22,942**
Additions	243	296	395	623
Disposals	(14)	(24)	(289)	(40)
FV G&L	418	(378)	(986)	812
Other	3,495	659	2,083	6,434
End period	**21,185**	**21,738**	**22,942**	**30,770**
End period (USDmn)	*205*	*213*	*227*	*282*

Source: Company data, EFG Hermes calculations.

Interestingly, the higher cumulative net fair value losses over the past three years (2018-20) are concentrated in the insurers and Centum, while the banks appear to have booked (cumulative) net fair value gains over the same period (see charts below). This is because the banks generally use their holding company structures to limit any volatility in property valuations at the subsidiary level.

Figure 36: Collective fair value gains/ (losses), 2018-20

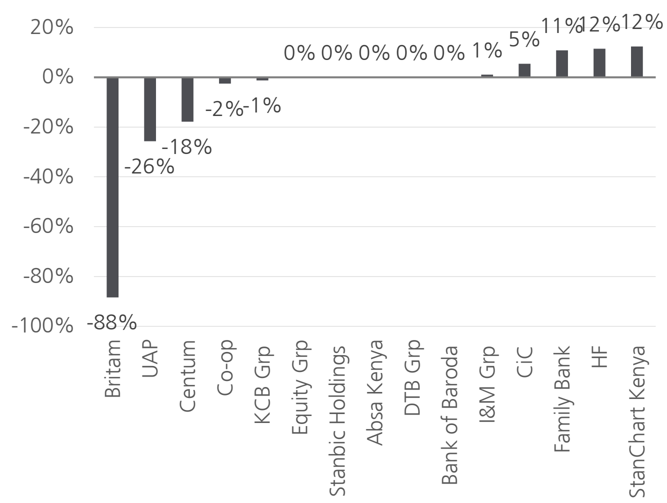
In KESmn



Source: Company data.

Figure 37: Collective fair value gains/ (losses)/ property investments

2018-20 collective fair value gains/ (losses)/ 2017 property investment (%)



Source: Company data.

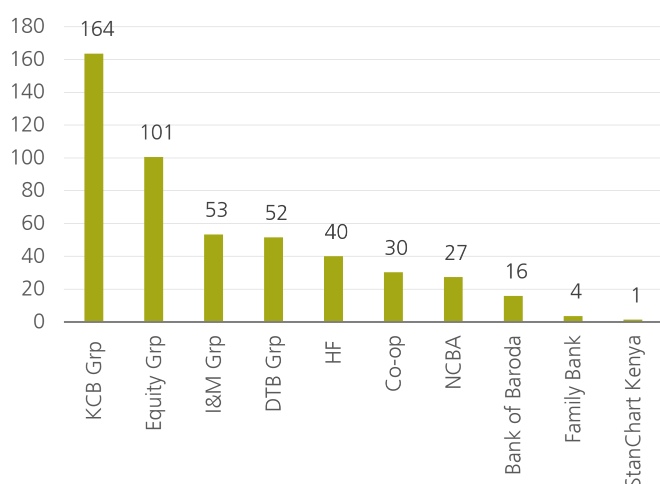
Lastly on land & building asset trends, we note that while the cumulative net fair value loss over the past four years (2017-20) was only KES-134mn (-1% of collective 2017 land & building assets), the total 'other' additions to collective land & buildings assets have been very significant (KES12.7bn or 74% of collective 2017 land & building assets) over the same period. On these 'other' additions to land & buildings, the larger additions tend to be acquisitions. For example, the 'other' additions of KES4.6bn and KES789mn booked by Equity Group and Co-op in 2020 included acquisitions of KES4.5bn and KES788mn, respectively. With regard to Equity Group, we note that their collective property investments and land & building assets increased from KES1.6bn (USD16mn) in 2019 to KES11.8bn (USD108mn) in 2020.

Real estate loans

With three insurers (Britam, Jubilee and CiC) representing only KES1.4bn of total real estate loans (KES489bn), we focus exclusively on the banks in this section. As shown below, 10 of the 12 banks reviewed in our universe publish their real estate exposures in their annual reports. It is important to note that we define real estate loans as exposure to building & construction and real estate. Based on this definition, the banks with the largest absolute exposures are KCB Group, Equity Group and I&M Group (see below).

Figure 38: Bank real estate loans, 2020

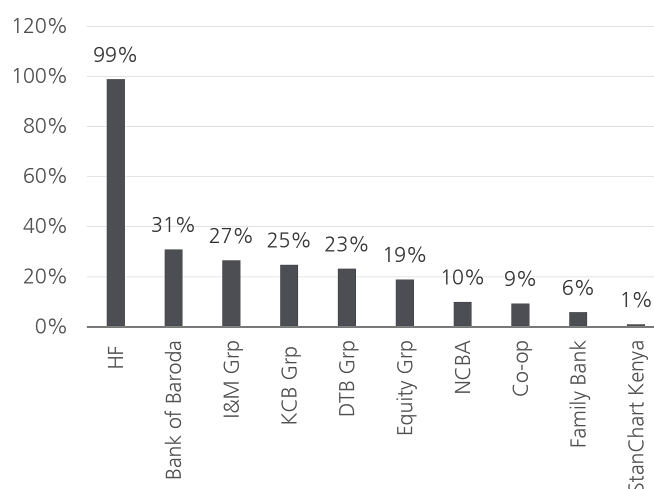
In KESbn



Source: Company data.

Figure 39: Bank real estate loans/ total loans, 2020

% of total



Source: Company data.

However, the banks with the highest relative exposures are HF (99% of total), Bank of Baroda (31% of total) and I&M Group (27% of total). Although KCB Group and Equity Group do not rank in the top three (on a relative basis), their real estate books are fairly large at 25% and 19% of their total loans, in our view.

With collective real estate loans of KES488bn (USD4.5bn) in 2020, our banks represented 87% of total system real estate (adjusted) loans in Kenya (KES562bn or USD5.1bn) in 2020. The high contribution of our banks to system trends is important, as it reaffirms our view that system trends are very indicative of what is happening amongst our banks.

Figure 40: Kenya – System gross loans, 2015-20

In KESmn

	2015	2016	2017	2018	2019	2020	2015-20 CAGR
Building & construction	100,200	93,057	87,834	102,837	108,973	117,426	3%
Real estate	293,989	357,558	346,394	376,237	396,350	444,705	9%
Trade	423,626	438,856	416,135	475,423	512,314	517,729	4%
Personal & household	551,063	584,549	842,107	661,460	745,048	843,599	9%
Other	796,451	819,170	466,360	867,561	928,225	1,082,645	6%
Total	**2,165,329**	**2,293,190**	**2,158,830**	**2,483,518**	**2,690,910**	**3,006,104**	**7%**
Adj. real estate (1)	*394,189*	*450,615*	*434,228*	*479,074*	*505,323*	*562,131*	*7%*

Source: Central Bank of Kenya. (1) Adjusted real estate = building & construction + real estate

As shown above, the banking systems total exposure to real estate (adjusted) loans has increased at a 2015-20 CAGR of 7% (in line with total system loan growth over this period). This growth in real estate (adjusted) loans over the past five years has meant that their contributions to total loans have been relatively stable over the same period (18-20% and currently at 19%).

Figure 41: Kenya – System gross loan mix, 2015-20

% of Total

	2015	2016	2017	2018	2019	2020
Building & construction	5%	4%	4%	4%	4%	4%
Real estate	14%	16%	16%	15%	15%	15%
Trade	20%	19%	19%	19%	19%	17%
Personal & household	25%	25%	39%	27%	28%	28%
Other	37%	36%	22%	35%	34%	36%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Adj. real estate (1)	*18%*	*20%*	*20%*	*19%*	*19%*	*19%*

Source: Central Bank of Kenya. (1) Adjusted real estate = building & construction + real estate

While the 2015-20 CAGR in real estate (adjusted) and system loans was only 7%, the CAGRs in real estate (adjusted) and system NPLs have been very high at 28% and 24% (over the same period), respectively (see below).

Figure 42: Kenya – System gross NPLs, 2015-20

In KESmn

	2015	2016	2017	2018	2019	2020	2015-20 CAGR
Building & construction	16,243	23,872	19,230	23,692	24,386	28,492	12%
Real estate	12,426	27,600	37,799	47,033	48,065	68,448	41%
Trade	44,294	62,232	78,337	81,622	88,453	101,884	18%
Personal & household	26,096	37,172	43,101	45,672	56,954	70,198	22%
Other	48,272	63,498	86,150	118,693	118,070	167,045	28%
Total	**147,331**	**214,374**	**264,617**	**316,712**	**335,929**	**436,067**	**24%**
Adj. real estate (1)	*28,669*	*51,472*	*57,029*	*70,725*	*72,451*	*96,940*	*28%*

Source: Central Bank of Kenya. (1) Adjusted real estate = building & construction + real estate

The strong system growth in real estate NPLs has meant that the system's real estate (adjusted) NPL ratio has increased from 7% in 2015 to 17% in 2020 (see below). Notably, the 2020 NPL ratio for real estate (adjusted) loans was 2ppt above the system's 2020 NPL ratio (15%).

Figure 43: Kenya – system NPL ratios, 2015-20

Gross NPLs/ gross loans (%)

	2015	2016	2017	2018	2019	2020
Building & construction	16%	26%	22%	23%	22%	24%
Real estate	4%	8%	11%	13%	12%	15%
Trade	10%	14%	19%	17%	17%	20%
Personal & household	5%	6%	5%	7%	8%	8%
Other	6%	8%	18%	14%	13%	15%
Total	**7%**	**9%**	**12%**	**13%**	**12%**	**15%**
Adj. real estate (1)	*7%*	*11%*	*13%*	*15%*	*14%*	*17%*

Source: Central Bank of Kenya. (1) Adjusted real estate = building & construction + real estate

Real estate collateral

Although the real collateral used to secure a loan to a client is not a direct risk for the banking system, it is a significant indirect risk because collateral is used to calculate the loss given default (LGD). The LGD represents the bank's expectation of the extent of loss on a defaulted exposure (net of collateral or other credit support) and it is expressed as a percentage of the exposure at default (EAD). The EAD is based on the amount the bank expects to be owed at the time of default, over the next 12 months or over the remaining lifetime of the loan. The EAD and LGD are important because, when they are combined with the PD (probability of default) and discounted, they determine the expected credit loss (ECL) of the bank.

To highlight the importance of collateral to the lending process, we first show much collateral our banks are holding against their gross loan books in 2020 (see the table below).

Figure 44: Kenyan banks – gross loans vs collateral values, 2020

In KESbn, unless otherwise stated

	Gross loans	Collateral	Collateral/ gross loans
KCB Group	660	2,522	382%
Equity Group	530	594	112%
Co-op	323	458	142%
Absa Kenya	225	107	47%
DTB Group	221	294	133%
Stanbic Holdings	177	139	79%
StanChart Kenya	131	116	89%
Family Bank	63	122	195%
HF	41	72	177%
Total	**2,370**	**4,424**	**187%**
Total (USDbn)	*22*	*41*	*187%*

Note: Bank of Baroda, I&M Group and NCBA do not publish their total collateral values.
Source: Company data.

As shown above, the nine banks that disclosed their 2020 total collateral values held KES4,424bn (USD41bn) in collateral against a collective 2020 gross loan book of KES2,370bn (USD22bn). Notably, KCB Group posted the highest ratio of collateral-to-gross loans (382% or USD23bn of collateral against USD6bn of gross loans). Worryingly, the bank with the lowest ratio of collateral-to-gross loans was Absa Kenya (47% or USD1.0bn of collateral against USD2.1bn of gross loans).

To provide a historical context, we show the annual evolution in collateral-to-gross loans for banks over the past four years (2017-20) in the table below.

Figure 45: Kenyan banks – collateral-to-gross loans, 2017-20 (%)

	2017	2018	2019	2020
KCB Group	414%	409%	373%	382%
Family Bank	57%	66%	65%	195%
HF	314%	297%	272%	177%
Co-op	262%	230%	155%	142%
DTB Group	141%	165%	142%	133%
Equity Group	156%	127%	153%	112%
StanChart Kenya	61%	59%	67%	89%
Stanbic Holdings	90%	85%	87%	79%
Absa Kenya	N/A	9%	8%	47%
Average	**187%**	**161%**	**147%**	**151%**

Source: Company data.

After having outlined the amount of collateral held against gross loans, we show how much of this collateral is property (real estate and/or land & buildings). Unfortunately, only four (Absa Kenya, Co-op, Equity Group and HF) of the nine banks that disclose their total collateral values provide a detailed split as to the types of collateral that they hold. As shown below, the vast bulk of the collateral held against loans is property. In 2020, we estimate that property accounted for 75% of bank collateral on average (excluding HF, which is 100% collateralised by property).

Figure 46: Kenyan banks – Property collateral as a percentage of total collateral, 2017-20 (%)

	2017	2018	2019	2020
HF	100%	100%	100%	100%
Equity Group	91%	90%	74%	88%
Absa Kenya	N/A	78%	82%	82%
Co-op	41%	42%	52%	54%
Average (ex-HF)	**66%**	**70%**	**69%**	**75%**

Source: Company data

Although, only four banks provide a detailed split in the types of collateral that they hold, eight banks (Absa Kenya, Bank of Baroda, Co-op, HF, KCB Group, I&M Group, NCBA and StanChart Kenya) do identify how much of their collateral is allocated to impaired and unimpaired loans. In the table below, we track the evolution in the ratio of collateral backing impaired loans-to-stage 3 loans.

Figure 47: Kenyan banks – collateral backing impaired loans/ Stage 3 loans, 2017-20 (%)

	2017	2018	2019	2020
HF	161%	177%	148%	105%
Co-op	56%	34%	47%	97%
Bank of Baroda	44%	52%	42%	57%
I&M Group	30%	54%	52%	53%
KCB Group	38%	25%	63%	50%
NCBA	N/A	20%	55%	48%
Absa Kenya	N/A	9%	9%	47%
StanChart Kenya	45%	38%	36%	46%
Average	**62%**	**51%**	**57%**	**63%**

Note: DTB Group, Equity Group, Family Bank and Stanbic Holdings do not provide a split in collateral between impaired and unimpaired loans
Source: Company data

As shown above, the average ratio of collateral backing impaired loans-to-stage 3 loans in 2020 was 63% and over the past four years (2017-20) this figure has averaged 58% for the eight banks that provide these figures. Notably, the two banks with the highest levels of 2020 ratio of collateral backing impaired loans-to-stage 3 loans were HF (105%) and Co-op (97%), whilst the lowest were NCBA (48%), Absa Kenya (47%) and StanChart Kenya (46%).

To keep risk charges as low as possible, Kenyan banks have generally tended to grow the absolute levels of collateral backing impaired loans at a much faster rate than the growth in impaired loans. In the table below, we illustrate this by comparing the 2017-20 CAGRs of stage 3 loans and collateral for our banks.

Figure 48: Kenyan banks – stage 3 loans vs collateral, 2017-20 CAGR (%)

		Collateral		
	Stage 3	Impaired	Non-impaired	Total
NCBA (1)	80%	179%	N/A	N/A
Equity Group	56%	N/A	N/A	10%
Co-op	48%	77%	-16%	-13%
KCB Group	42%	55%	11%	12%
Stanbic Holdings	42%	N/A	N/A	4%
Bank of Baroda	33%	46%	N/A	N/A
Absa Kenya (1)	26%	193%	146%	149%
DTB Group	19%	N/A	N/A	0%
HF	10%	-5%	-26%	-24%
Family Bank	9%	N/A	N/A	67%
I&M Group	7%	28%	N/A	N/A
StanChart Kenya	5%	6%	13%	12%

Source: Company data. (1) 2018-20 CAGR, as data for 2017 was not available.

The relationship between a bank's risk charge and the level of collateral it has backing stage 3 loans is outlined in the table below.

Figure 49: Kenyan banks – asset quality profiles, 2020 (%)

	NPL ratio	Collateral (1)/ Stage 3 loans	Risk charge	Coverage (reported)	Coverage (incl. collateral (1))
HF	27%	105%	1.0%	34%	139%
Co-op	18%	97%	2.5%	52%	149%
Bank of Baroda	12%	57%	1.6%	55%	112%
I&M Group	12%	53%	1.2%	55%	108%
KCB Group	16%	50%	4.2%	60%	110%
NCBA	12%	48%	7.4%	96%	144%
Absa Kenya	7%	47%	3.8%	100%	146%
StanChart Kenya	10%	46%	2.7%	70%	116%

Source: Company data. (1) This is the collateral backing impaired loans only.

Taking HF as an example, we would argue that its 2020 risk charge (1.0%) is so low because the value of its collateral backing stage 3 loans is very high (105%) and its coverage ratio (including collateral backing impaired loans) is also very high (139%). This is important, because if one were to only focus on the reported coverage ratio of HF (34%), it would be very difficult to understand why its risk charge is so low. At the other end of the spectrum, we would argue that the 2020 risk charges of NCBA, KCB Group and Absa Kenya were higher than their peers because of the relative low levels of collateral backing their stage 3 loans. Additionally, we believe that the discount applied to these collaterals must have been more aggressive than their peers. Having said that, we must stress that this assumption cannot be confirmed based on the public disclosure provided by the banks. To confirm this, we would need to know what discounted values of collateral were being used to calculate their LGDs.

4. Appendix – Kenyan banks, asset quality trends

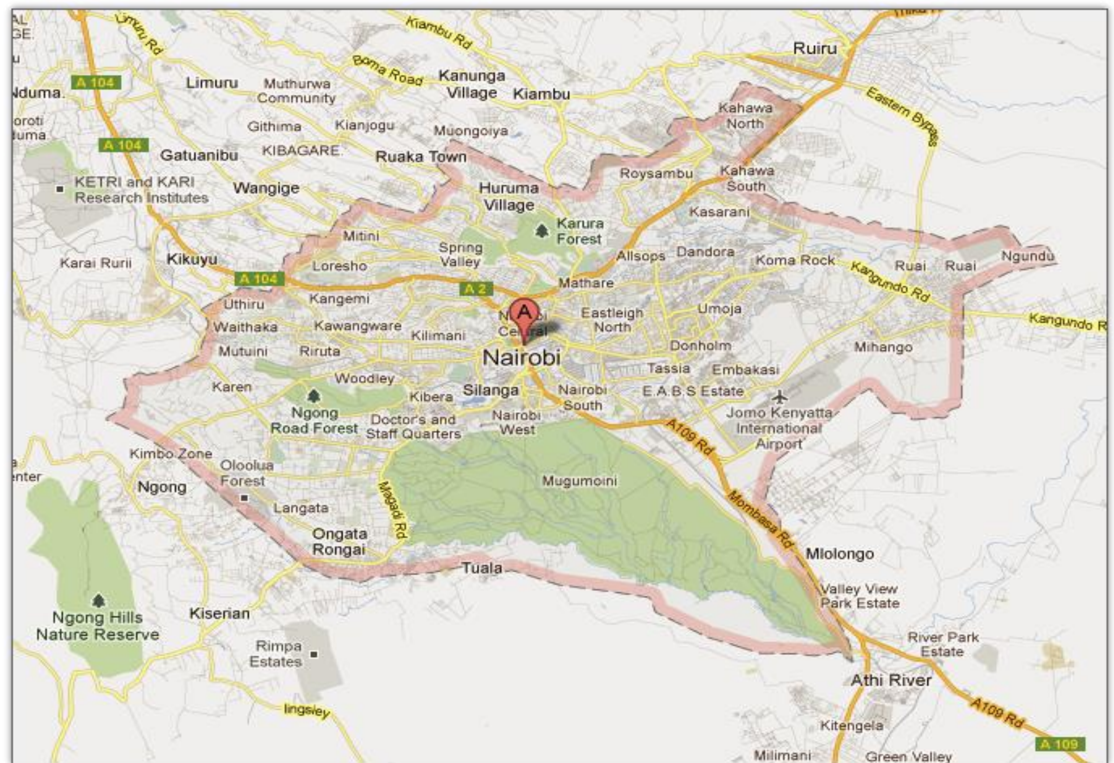
Figure 50: Kenyan banks – Asset quality trends, 2017-20

	2017	2018	2019	2020
HF				
- NPL ratio	16%	29%	29%	27%
- Coverage ratio	36%	24%	29%	34%
- Coverage ratio (incl. collateral)	197%	201%	177%	139%
- Implied cost of risk	1.1%	0.8%	0.7%	1.0%
Co-op				
- NPL ratio	7%	11%	11%	18%
- Coverage ratio	92%	57%	59%	52%
- Coverage ratio (incl. collateral)	148%	91%	106%	149%
- Implied cost of risk	1.4%	0.6%	0.9%	2.5%
KCB Group				
- NPL ratio	9%	12%	12%	16%
- Coverage ratio	43%	35%	68%	60%
- Coverage ratio (incl. collateral)	81%	60%	131%	110%
- Implied cost of risk	1.3%	0.6%	1.5%	4.2%
Equity Group				
- NPL ratio	5%	7%	9%	11%
- Coverage ratio	48%	85%	68%	89%
- Coverage ratio (incl. collateral)	NM	NM	NM	NM
- Implied cost of risk	0.9%	0.9%	0.9%	4.3%
Stanbic Holdings				
- NPL ratio	6%	11%	12%	14%
- Coverage ratio	60%	67%	73%	74%
- Coverage ratio (incl. collateral)	NM	NM	NM	NM
- Implied cost of risk	2.0%	1.3%	1.9%	2.8%
StanChart Kenya				
- NPL ratio	8%	11%	9%	10%
- Coverage ratio	87%	66%	64%	70%
- Coverage ratio (incl. collateral)	132%	105%	100%	116%
- Implied cost of risk	2.8%	1.1%	0.2%	2.7%
Absa Kenya				
- NPL ratio	4%	5%	5%	7%
- Coverage ratio	108%	99%	102%	100%
- Coverage ratio (incl. collateral)	108%	108%	111%	146%
- Implied cost of risk	1.8%	2.1%	2.0%	3.8%
Family Bank				
- NPL ratio	18%	15%	14%	17%
- Coverage ratio	29%	35%	49%	56%
- Coverage ratio (incl. collateral)	29%	35%	49%	56%
- Implied cost of risk	3.1%	2.6%	2.4%	3.6%
DTB Group				
- NPL ratio	6%	6%	7%	10%
- Coverage ratio	85%	64%	100%	56%
- Coverage ratio (incl. collateral)	85%	64%	100%	56%
- Implied cost of risk	2.0%	1.3%	0.5%	3.2%
I&M Group				
- NPL ratio	12%	13%	11%	12%
- Coverage ratio	37%	53%	52%	55%
- Coverage ratio (incl. collateral)	67%	106%	104%	108%
- Implied cost of risk	2.6%	2.1%	0.3%	1.2%
NCBA				
- NPL ratio	NA	8%	10%	12%
- Coverage ratio	NA	89%	83%	96%
- Coverage ratio (incl. collateral)	NA	109%	138%	144%
- Implied cost of risk	NA	2.9%	2.1%	7.4%
Bank of Baroda				
- NPL ratio	6%	9%	8%	12%
- Coverage ratio	65%	67%	75%	55%
- Coverage ratio (incl. collateral)	109%	119%	117%	112%
- Implied cost of risk	0.8%	1.0%	1.5%	1.6%

Source: Company data

5. Appendix – Map of Nairobi & video of its new road network

Figure 51: Map of Nairobi



Source: Microsoft Bing

For those of you interested in the new road network that has been built around Nairobi to connect its suburbs and satellite towns, please see the following video - The marvelous Nairobi Road Network. - YouTube

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