



HOW VARIOUS REAL ESTATE SECTORS HAVE BEEN AFFECTED BY COVID-19

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COVID-19 and the Kenyan Commercial Property Market

As the Kenyan government slowly re-opens the economy, the key questions for our industry are how has the outbreak of the pandemic impacted the local commercial property market and what will be the long term effect?

The built environment is a pillar of the country's economy, and its very nature as a physical asset poses unique challenges in both its management and utility during a period in history where restriction of proximity to physical locations has underpinned the intention of the government's efforts.

To understand the impact of the pandemic on property, it is therefore important to first consider the actions resulting from the pandemic and their implications on economic activity.

Since the outbreak of the pandemic, various measures implemented by the government include dusk to dawn curfews, cessation of movement in and out of Nairobi and Mombasa, and restrictions on public gatherings. Eateries, bars and hotels were allowed to operate under strict health protocols that in part require COVID screening of staff and frequent sanitizing, while resumption of the education calendar will only commence in 2021.

The government announced on the 6th of July the phased reopening from the COVID lockdown by allowing resumption of travel in and out of restricted counties. Air travel will resume on the 15th of July with international air travel to start on the 1st of August. Mosques and churches are allowed to open for services not lasting more than an hour and restricted to 100 people.

The nationwide nightly curfew remains in place for a further 30 days. The government has warned, however, that the spread of the virus will be monitored over a 21-day period and if there are signs of infections increasing, they may impose more stringent lockdown restrictions again.

Projections for the Kenyan economy now indicate that economic growth will slow to 2.5% this year down from 5.4% in 2019. The challenging times require practical and pragmatic conversations between landlords and tenants. The global nature of the pandemic means that everyone has a role to play, and the most successful outcomes will come from solutions where everyone shares the problem. It will be unsustainable for only one sector of the value chain to bear the full burden. So we emphasize the need for discussions right throughout the value chain - from tenant, to landlord, to financial institution, to government.



Retail Sector

Following the government's directive in March banning public gatherings, many tenancies such as cinemas, kids' play area and other leisure tenants have been closed. Sit-down restaurants are now operational but have to take into account social distancing requirements. By contrast, supermarkets, grocery butchery and fast food outlets have been thriving in business. Consumers now have the option of online shopping from various outlets. Non-essential tenants have initiated discussions with their respective landlords on rent waivers or discounts and an extension on rent-free months. Property managers are now at task to minimize operational costs so as to contain outgoings to be balanced against the resulting limited income.

Tenants' gross sales and footfall traffic within their individual stores/premises have declined due to the consumers avoiding crowded areas such as mall, retail and shopping centres as a result of social distancing directives. With a slowing economy and employment levels under pressure, the resulting economic constraints have shifted consumer spending away from impulse expenditure and luxury purchases, and towards a focus on essential items, most especially food.

In terms of rent concession, reductions and holidays, there has been no single basic formula applied by landlords. Rather, each and every landlord is dealing with their individual tenants on a case-to-case basis. In some cases, for example, landlords are requesting turnover sales figures in order to review a tenant's performance/trading densities during the pandemic in order to grant rent concessions based on this information. Generally, new retailers have extended fit-out, while existing tenants are negotiating rent concessions, however, in almost all cases service charges are still required to be paid in full.



As one of the hardest-hit segment, food and beverage outlets (especially sit down restaurants) have often been extended lengthy concessions ranging between 50% - 100%, even after the government directive to allow these outlets to open and continue trading as long as they maintain social distancing within their premises. By contrast, supermarkets/ hypermarkets have been given little to none rent concessions as they have been considered as essential services. The range is usually between 0% and 10%. Telecommunication brands have generally seen rent concession ranging between 12.5% and 20%.



Consumer behaviours are clearly being forced to change, which will result in a very different demand profile for property going forward. For example, retailers will need to invest in online and delivery capability, which will in turn fuel growth in the logistics sector. We expect to see more retailers taking a hybrid approach to expansion and market entry going forward, by combining online platforms and delivery channels with a smaller traditional "bricks and mortar" footprint. We are also moving towards more community-focused retail, where centres will fulfil multiple social roles for the areas that they serve.

Industrial Sector

The impact of the pandemic has not been so severe on the industrial sector with the warehousing market continuing to be buoyant. There has been an increased interest for short term storage especially for medical facilities and goods with manufactures of medical and PPE related items thriving. However, with the closure of international trades, cargo movement has slowed down, but the opening of air travel bodes well for increased cargo movement between the country and the rest of the world. The sector still experiences enquiries from various users who are planning to take up occupancy in the next 6 months.



Office Sector

There were no clear guidelines by the government on workplace protocols – in fact, there have been no restrictions on the private sector on working in the offices. The mandate on safety and guidelines is, therefore, the responsibility of companies to enforce social distancing and hygiene.

Many office inquiries have been put on hold as companies are now reviewing their space requirements, taking into consideration social distancing and ability to work from home. Heating Ventilation and Air Conditioning (HVAC) has become an important requirement as tenants now require controlled air circulation. Some rent concessions for both existing and new tenants for three months have been granted in some instances, while landlords are offering longer rent-free periods of between two and six months depending on the space occupied. They also offer tenants the option of early termination after a period of three years.

However, the lockdown has revealed to both employers and employees on how effective remote working can be. Saying this, employees also noted the value of social interaction workplaces create. These trends will play a role in an employer's decisions on the nature and format of office space. The outbreak of the pandemic will result in a change in the way office space is utilized.

Although the need for social distancing will change the way space is utilised in a building, it is not expected that any increase from these measures will offset the total reduction as more employees change the way they work and the location from which they work. When assessing their real estate portfolios, we expect that corporates will shift their thinking from a 'total cost of occupation' model to a 'total cost of production' model, which takes into account multiple types of work. We also have to bear in mind that the overall expectation of reduced space requirements may well play out in phases, due to the rigidity of some traditional leases.



Shared Workspaces

Over the last decade, there has been an increased demand for co-working offices from both local and international office space users. This has resulted in most of the operators focusing their business strategy to cater to the higher end of quality in terms of offering and location. With the ongoing travel restrictions, however, we have seen that the immediate demand for shared workspaces has shifted from international to local users, especially those requiring smaller spaces.

In the short term, the relative flexibility of shared workspace licenses may lead to an initial reduction in occupation, as this space is the first option to exit for some companies due to the statutory requirement of fixed minimum lease terms in Kenya. In the longer term, however, it is anticipated that the interest for shared workspaces may rise, as tenants occupying shell and core spaces may downsize in favour of more flexible space options.

The future may be uncertain, but for most, there is optimism in rethinking the way we grow business.

THE PROPERTY DEVELOPERS VIEWS ON THE **COVID 19** SITUATION

CEO of Kenya Property Developers Association – Elizabeth Mwangi interviews John Rogers, East Africa Regional Director for Turner & Townsend, on the current and short term states of the real estate market in East Africa and what he thinks the post Covid-19 future might look like in the medium term.

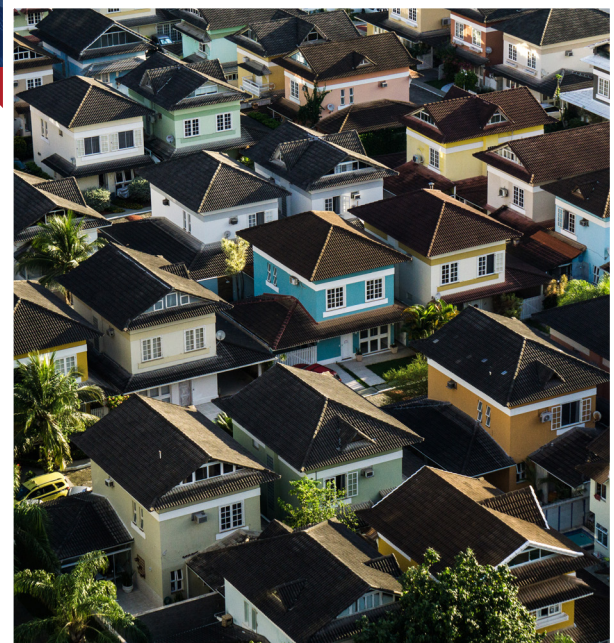
1) What is the current state of developer-led projects due to the current pandemic and how have they needed to adapt?

When the pandemic first hit East Africa in early March, majority of developers hibernated their projects due to supply chain disruptions and isolation measures put in place by governments across the region. In Kenya for instance, inter-county travel restrictions greatly impacted supply chain resilience and getting construction materials from the port of Mombasa to Nairobi had become difficult. More recently with the realisation that the situation is unlikely to change in the short term, developers have started to get their construction sites up and running again.

As isolation efforts – lockdowns and curfews, continue around the world, supply chain disturbances are impacted not only by logistics constraints, but also people. The reduced workforce availability due to COVID-19 restrictions will remain in the coming months and developers, and their contractors, are impacted.

Projects involving contractors with liquidity constraints are at risk and in some instances, developers who understand the lose-lose situation this brings have been proactive in facilitating early cash flow payments to support their supply chains. Examples of this are direct payments to sub-vendors or advanced payment mechanisms to contractors.

The projects hit the hardest are the ones reliant on pre-sales or offtake to fund construction. Due to the uncertainties surrounding the pandemic home buyers are sceptical about the market and have put their buying plans on hold.



We have advised our developer partners to focus on planning and assessing the impact of supply chain delays on completion dates, to allow greater clarity for when full operation returns. Various developers have also used the downtime to negotiate with contractors and close out contracts.

2) What is your short term outlook for real estate projects

There will be delays on programmes, loss of efficiencies, and cost impacts because of COVID-19 and related regulatory responses. While it is impossible to determine the size and scale of government-enforced lockdowns in the short term, a change in shift patterns has already been implemented on live sites, with fewer people achieving the same results and a tangible optimisation of effort is evident.

Whilst health, safety and wellbeing of workers on sites remains the number one priority for developers and consultants, there is of course a huge cost, both economic and social to limiting or halting business operations and generally developers are doing all they can to get sites back up and running.

3) What does the future of commercial real estate look like given the changes brought about by COVID 19

The design will change drastically. For instance, floor plan management in the new workplace will change to ensure social distancing and other compliances are maintained. New designs will place emphasis on proper sanitization in high touch areas such as receptions, elevators and lobbies. Which begs the question; will future buildings become COVID-19 rated?

Tenants, likely to be focused on liquidity needs and effective operations will negotiate for shorter lease periods.

The COVID -19 pandemic has shone a light on IT as critical infrastructure. Developers are going to need to better understand how their tenants plan to integrate Information Technology into their “new normal” ways of working and what that means for the workspaces they provide.

4) Where there are threats there are also opportunities, what do those look like for the real estate sector beyond COVID 19?

COVID-19 poses an unprecedented challenge to all sectors within real estate, but even in difficult times, there is still opportunity.

Opportunities in the long term will not change drastically. While some sectors, particularly hospitality and retail must adapt to a scenario where they may have little or no short-term income, we are seeing demand increase for sectors providing critical goods and services, such as food and grocery, ecommerce, life sciences and data centres.

In countries and cities that have allowed particular businesses to reopen, we are seeing these companies offer more flexibility in where their employees choose to work. This will open up opportunities for the establishment of satellite offices and hubs out of Central Business Districts.

Developers will also need to keep up with an increase in demand for affordable housing. The demand will not only be due to the impact of CV-19 on people's income, but also because of the opportunities brought about by an update to legislation that previously hindered the development of the housing mark.

5) What do you anticipate the recovery period for the real estate sector across East Africa to be?

As governments worldwide contend with how to re-start economic activity safely, uncertainty looms large over future investment into real estate by a range of sectors struggling with anticipated recession.

Despite relapses of the virus for example in Asia where they are experiencing a second wave of growing infections, COVID-19 like other pandemics will eventually come under control and things will start to return to a new normal. My guess is; it will take 12 months to 24 months before the East Africa real estate market bounces back and we are helping our clients plan and get ready for this – there will be strong demand as markets start to return.



ABOUT TURNER & TOWNSEND

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REITS ASSOCIATION OF KENYA (RAK) OPINION PIECE ON THE **CORONA VIRUS** **PANDEMIC**

Global Impact

The ongoing Corona Virus (COVID -19) pandemic has affected various sectors of the economy globally resulting in projected shrinkage in Gross Domestic Product (GDP) growth across regions, disruption of global supply chains, slow-down in tourism and travel-related industries, the projected decrease in foreign direct investments (FDIs) by 5% – 15% according to United Nations Conference on Trade and Development (UNCTAD) and an overall decline in the performance of the capital markets sector.

Kenyan Impact

It is RAK's opinion that the COVID-19 pandemic will impact and disrupt the Kenyan economy in many ways including a plunge in the key sectors of the economy such as real estate, hospitality, tourism and manufacturing. Consequentially, we anticipate and are already witnessing temporary slow-down of companies' operations arising from reduced number of staff at any instance in a bid to observe social distancing.

Evidently, we believe that there will be a decreased investments caused by lower discretionary expenditure by both investors and consumers, a situation that has necessitated precautionary measures by the Central Bank of Kenya (CBK) aimed at increasing liquidity, such as reduction in the cash reserve ratios to 4.25% from 5.25% and reduction in the CBK rate to 7.0% from 8.25%.



Cash reserve ratios to

4.25% from 5.25%



Reduction in the CBK rate to

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Impact on the Real Estate and REITs Sector

According to an article by Calvin Shnure, Senior Vice President of Research and Economic Analysis at the National Association of Real Estate Investment Trusts (NAREIT), *"REITs are exposed to the crisis largely through the economic health of their tenants and their ability to make payments on their lease. Many REIT property sectors may gain some protection through their long-term leases with investment grade tenants. Nevertheless, the full magnitude of the financial impact is still unknown."*

Our projections on the effects of the COVID-19 pandemic on real estate market are as follows:

- **The retail sector may be impacted as a result of reduced foot-fall to the malls and social spaces**, due to the social-distancing measures put in place by the government. Supermarkets, hospitals, offices and other essential service providers located within the malls are expected to continue operations; however, restaurants and other non-essential service providers are expected to continue to operate on a need basis.
- **Significant increase in unforeseen operating costs** for income REITs to support containment efforts of the virus on their various properties.
- **Generally projected decline inability of tenants to continue to pay rent on time or pay rent at all, hesitation to renew leases** during this period and **possible renegotiation of better lease terms** by tenants in the event of non-renewal. Landlords may also need to restructure leases and consider some leniency in tenant payment terms.
- **Logistics and warehouse companies are projected to hold up well** due to the fact that supply chains remain critical even during the pandemic.
- **Offices are expected to uphold in the medium term**, given that most employers have embraced flexi-working arrangements for most of their employees; although most still hold their office spaces in the short run, many could consider downsizing while fully embracing the new work arrangements.

"REITs are exposed to the crisis largely through the economic health of their tenants and their ability to make payments on their lease. Many REIT property sectors may gain some protection through their long-term leases with investment grade tenants. Nevertheless, the full magnitude of the financial impact is still unknown."

- **Construction companies are expected to significantly reduce construction activities** due to supply chain disruptions, especially where raw materials are sourced from China.
- **On the capital markets front, and similar to other listed companies, listed REITs, listed construction and allied companies and listed investment companies with significant real estate as part of their portfolios, are witnessing a decline in the value of listed units.**

From a global capital market perspective, the FTSE REIT index has been on the decline since quarter 1 of 2020. During the same period, the FTSE Nareit Mortgage REITs Index decreased most significantly by 41.73%. However, during the first week of April, the FTSE Nareit all REITs index recorded gains following policy measures including the federal reserve pledging to purchase treasury and agency securities. Markedly all FTSE REIT indices have gained over the last few days, based on end of day data on 17th July 2020, the highest gains being realized by the FTSE Nareit Equity REITs index.

Nevertheless, **it is our opinion that investors in the real estate market may withstand the COVID-19 situation given that property is a long-term investment. Furthermore, it is our view that the capital markets currently present an opportunity for investors who are willing to take advantage of reduced prices of listed units of REITs and other listed real estate-related companies.** Indeed, RAK has already witnessed a spike in local market participation. Foreign participation decreased from an average of 68.49% to 59.08% in March 2020. According to a press release by the Nairobi Securities Exchange dated 16th March 2020, *“Local investors at the Nairobi Securities Exchange (NSE) took up positions accounting for 49.4% of market activity. Equity turnover stood at Kshs. 1.5 billion compared to a previous Kshs. 1.2 billion. Market capitalization stabilized at Kshs. 2 Trillion.”* – due to aftereffects of announcement of the first coronavirus case in the country.

Conclusion

The Kenyan REITs market will be detrimentally affected by COVID-19 as the pandemic will slow down real estate activities. We urge all our members and stakeholders to follow the government's directives and take precautionary measures to curb the spread of COVID-19.

We also encourage members contributions to the government's efforts, and where possible offer support to vulnerable communities that have been affected during this period.

Lastly, RAK is very keen on hearing from members' their opinions about the current situation; we welcome members' views and expectations, business impacts and outlooks during this period to see how we navigate this period together as an industry in partnership.

**Share your
comments and
opinions:**

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**Stay Tuned for more
information on the REIT
Virtual Conference to be
announced soon.**

The conference will aim to bring together the demand and supply sides of the real estate sector to highlight investable opportunities within the industry. The event will be highly interactive, informative and engaging.

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Layout and Design: [Jabari Creative Studios Limited](#)