Innovative Housing Finance Workshop

Developing Accessible, Affordable Mortgages in Kenya

Park Inn by Radisson Hotel, Nairobi

Tuesday March 27, 2018

Agenda

Start	End	Description	Speaker
8:45a	8:55a	Welcome Remarks	• **Elizabeth Mwangi-Oluoch** - CEO, KPDA
8:55a	9:10a	Remarks by KPDA Affordable Housing Task Force	• **Hamish Govani -** CEO, Lantana Properties
9:10a	10:15a	Opening Ceremony by Chief Guest	• **Charles Mwaura** – Principal Secretary, Transport, Infrastructure Housing & Urban Development
10:15a	10:30a	Break	
10:30a	11:15a	Overview of KPDA Innovative Finance Committee & new mortgage product initiative	• **Zoravar Singh** - Director, iJenga & Chair, KPDA Innovative Finance Committee
11:15a	12:30p	- Mortgage Refinancing in Kenya - Applying PPPs in Kenya	• **Caroline Cerruti** - Sn Financial Specialist, World Bank • **Johnstone Oltetia** - National Treasury Advisor, Financial Sector Affairs • **Hadija R.D. Kamayo** – Sn Financial Specialist, World Bank
12:30p	1:00p	Tax Incentives in the Housing Sector	• **Patrick Murimi** – Sn Tax Associate, KN Law
1:00p	1:45p	Panel on Finance in Affordable Housing	• **Raphael Mwito** – Business Development Manager, BRITAM Asset Management • **George Pande** – Relationship Manager, Kenya Commercial Bank (KCB) • **Patrick Mokaya** – Director Business Development, Housing Finance Corporation • **Samuel Kioko** – Sn Tax Associate, KN Law

Partners

Technical Partners

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Speakers

HF GROUP Dreams Made Possible

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Affordable Housing Task Force

CHIGWELL A better quality of life

iJenga

KCB

KARIBU HOMES

NACHU National Cooperative Housing Union Your Dream House Partner

LANTANA GALU BEACH BEACH FRONT HOLIDAY HOMES - GALU BEACH - KENYA

HARAMBEE

Photos of the Event

Presentations

1. Roadmap to 500k Homes in Kenya – Ministry of Transport, Infrastructure, Housing & Urban Development

2. Innovative Housing Finance – iJenga
   a) Background on KPDA Innovative Finance Committee
   b) New affordable, accessible mortgages for Kenyans

3. Kenya Mortgage Refinance Company – World Bank & National Treasury
   a) Mortgage Refinancing in Kenya - World Bank
   b) Spearheading the Kenya Mortgage Refinance Company - National Treasury, Kenya

4. Case Study: PPP Pilot project in Naivasha – World Bank

5. Tax Incentives – K&N Law

Roadmap for the 500,000 affordable homes

Mr Charles Mwaura
Principal Secretary, Ministry of Transport, infrastructure, Housing & Urban Development

March 27, 2018

Over the past few months we have engaged various stakeholders to understand the current program context...

	Current context	Our effort
Supply	Housing supply is unable to meet demand	Understanding the inefficiencies within the Housing supply market
Supply	Lack of supply within the Social and Affordable Housing range	Defining Affordable Housing and Social Housing
Supply	High cost in the delivery of Housing	Cost of construction materials and labor are key in reducing cost of constructions
Demand	Lack of mortgage financing for low income earners	Understand how to reduce mortgage costs
Demand	High income earners price out low income earners	Define a buying policy for Social, Low Income and Affordable Housing units
Demand	Low Affordable Housing availability around demand zones	Provision of land assets within demand zones

…establishing 5 key findings that form the basis of our proposal…

	Description
Land	▪ Land is a critical foundation of the implementation plan ▪ Location of the land for development is critical in developing affordable homes
Cost of Development	▪ Reduction of costs through scaled up housing projects ▪ Motivate use of alternative building/ industrial methods ▪ Lowering cost through a series of interventions on consultants

Bulk Infrastructure and Transport Oriented Design	▪ Government has to deliver:
	  ▪ Bulk infrastructure
	  ▪ Reliable Rapid Mass Transit System
	  ▪ Simplify the building code & Streamlining applications

Financing	▪ Low cost of financing development of affordable housing ▪ Aligned funding and scheme development structures ▪ Digitizing property and mortgage registrations
Legislation	▪ Enabling legislation that cuts the red tape around land transfer (Commoditize Land) sectional titling (Sectional Properties Act), strategic land acquisition (Public Land) and prohibit land speculation (Idle Land Tax/Potential Land Tax)

Project funnel- Pricing

	1 room KES	2 room KES	Bedsitter KES	1 bedroom KES	2 bedroom KES	3 bedroom KES
Social housing (Max Cost)	600,000	1,050,000	n/a	n/a	n/a	n/a
Affordable Housing (Max Cost)	n/a	n/a	800,000	1,000,000	2,000,000	3,000,000

Project Funnel

Master planner to support with identification of locations for the funnel projects and development of implementation schedule

FY2017/2018 — Lot 1

- Makongeni 145 acres (25,000)
- Shauri Moyo & Starehe (20,000)
- Park Road
- (3,400)
- Nakuru, World Bank supported (3,000)
- Private Developers (10,000)

FY2018/2019 — Lot 2

- NSSF Land Mavoko (50,000)
- Portlands Athi River 1 (50,000)
- Mombasa 1 (50,000)
- Eldoret 1 (30,000)
- Cooperatives 2 (20,000)
- Private developers 2 (20,000)
- Civil Servants 2 (10,000)
- Police 2 (10,000)
- Redevelopment of Nairobi Old Estates 1 (20,000)

FY2019/2020 — Lot 3

- Nakuru 1 (30,000)
- Kisumu 1 (30,000)
- Eldoret 2 (30,000)
- Portlands Athi River 2 (50,000)
- Cooperatives 3 (20,000)
- Private Developers 3 (20,000)
- Civil Servants 3 (10,000)
- Police 3 (10,000)
- Redevelopment of Nairobi Old Estates 2 (20,000)

FY2020/2021 — Lot 4

- Nakuru 2 (30,000)
- Kisumu 2 (30,000)
- Mavoko (12,500)
- Cooperatives 4 (20,000)
- Private Developers 4 (20,000)
- Civil Servants 4 (10,000)
- Police 4 (10,000)
- Redevelopment of Nairobi Old Estates 3 (20,000)

FY2021/2022 — Lot 5

- Mombasa 2 (30,000)
- Cooperatives 5 (20,000)
- Private Developers 5 (20,000)
- Civil Servants 5 (10,000)
- Police 5 (10,000)
- Redevelopment of Nairobi Old Estates 4 (20,000)

Phased approach

- Development of a phased approach is critical in creating trust capital in the early stages of the program
- State Department has identified projects that will act as catalysts for investor buy in and prove concept of demand and supply aggregation

Phase 1A

Roll out of Flagship Catalytic Projects

- Establishment of framework to engage with Counties
- Proof of concept
- Anchor funding by GoK and Donor partners through current programs (KUSP)

Phase 1B
Project roll out on counties mapped as follows:

- High Capacity Cities
  - (20,000 – 12,000 units)
- Medium Capacity Cities
  - (12,000 – 6,000 units)
- Low Capacity Cities
  - > 6,000 Units

Project Funnel Phase 1a - Affordable Homes

Project		Shauri Moyo & Starehe	Park Road	Naivasha
Location	Makongeni	Shauri Moyo	Park Road	Naivasha
Acreage	141 Acres	50 Acres	7.9 Acres	70 Acres
Estimated Units	25,000	20,000	3,940	3,000
Typology	1 Br, 2 Br & 3 Br	1 Br, 2 Br & 3 Br	1 Br, 2 Br & 3 Br	1 Br, 2 Br & 3 Br
Land Ownership	Railway Pension	Government	Government	Government

Project Funnel Phase 1a - Social Homes

Project			
Location	Kibera	South B	Eastleigh
Acreage	8.6 Acres	6 Acres	50 Acres
Estimated Units	4,297	2,690	4,032
Typology	1 & 2 Rooms	1 & 2 Rooms	1 & 2 Rooms
Land Ownership	Government	Government	Government

Phase 1B - Grouping

High Capacity Counties

20,000 Units – 12,000 Units per urban node

County	Urban Population
Kiambu	934.7
Nakuru	537.7
Machakos	504.8
Kisumu	383.4
Uasin Gishu	312.3
Migori	256.9
Kakamega	192.9
Kilifi	163.9
Bungoma	149.1
Trans Nzoia	148.3
Kericho	127.0
Vihiga	124.4
Kajiado	121.4
Nyeri	117.3
Garissa	115.7
Kitui	115.1

Medium Capacity Counties

12,000 Units – 6,000 Units per urban node

County	Urban Population
Nandi	87.9
Mandera	87.1
Bomet	83.4
Wajir	82.1
Kisii	81.3
Makueni	67.5
Nyandarua	67.2
Embu	59.4
Homa Bay	59.1
Meru	57.9
Nyamira	56.9
Busia	50.0
Turkana	47.1
Isiolo	46.5
Elgeyo Marakwet	44.5

Low Capacity Counties

>6,000 Units per urban node

County	Urban Population
Narok	37.1
West Pokot	36.4
Kirinyaga	35.3
Muranga	30.9
Baringo	25.9
Siaya	23.8
Kwale	21.4
Lamu	18.3
Tana River	17.1
Samburu	15.2
Marsabit	14.5
Laikipia	10.0
Taita Taveta	6.6

…and highlighting 10 major interventions across supply and demand

Delivering the program will require bold and disruptive initiatives

Demand

1 Segmentation of Affordable Homes

2 Incentivizes for Financial Institutions who lend towards Affordable Housing

3 Government as an Off-taker (Leverage Public Sector demand)

4 Tax exempt contributions for First Home Ownership to the Housing Fund

Supply

5 Selection of flag-ship projects

6 Restructuring of the National Housing Corporation

7 Unlock serviced land held by Governmental Institutions & simplify land transfer and ownership

8 Development’s subsidized by Government should have 100% affordable homes.

9 Use of alternative technology & methodology and Industrial construction Techniques

Enablers

a Formation of an Integrated Project Delivery Unit

b Implementation of the key determinations to deliver quick wins

1 To enhance program segmentation we have defined four levels of housing types with only 3 being the focus of the program

Middle to High Income

- Income Range: KES 100,000 +
- Share of Formally Employed: 2.85%
- Private Sector will meet this demand

Mortgage Gap

- Income Range: KES 50,000-KES 99,999
- Share of Formally Employed: 22.62%
- Allocation of 500,000 units : 30%

Low cost

- Income Range: KES 15,000-KES 49,999
- Share of Formally Employed: 71.82%%
- Allocation of 500,000 units : 50%

Social

- Income Range: KES 0-KES 14,999
- Share of Formally Employed: 2.62%
- Allocation of 500,000 units : 20%

Tax exempt contributions for HOSP to the Housing Fund

A provision exists under the **Income Act** where an employee is eligible for **tax exempt** contributions of up to a maximum of KES 4,000* per month for 10 years. It is called **Home Ownership Savings Plan (HOSP).**

Under this scheme only three institutions are approved to set up and operate a HOSP:

- Banks
- Insurance Companies
- Building Societies

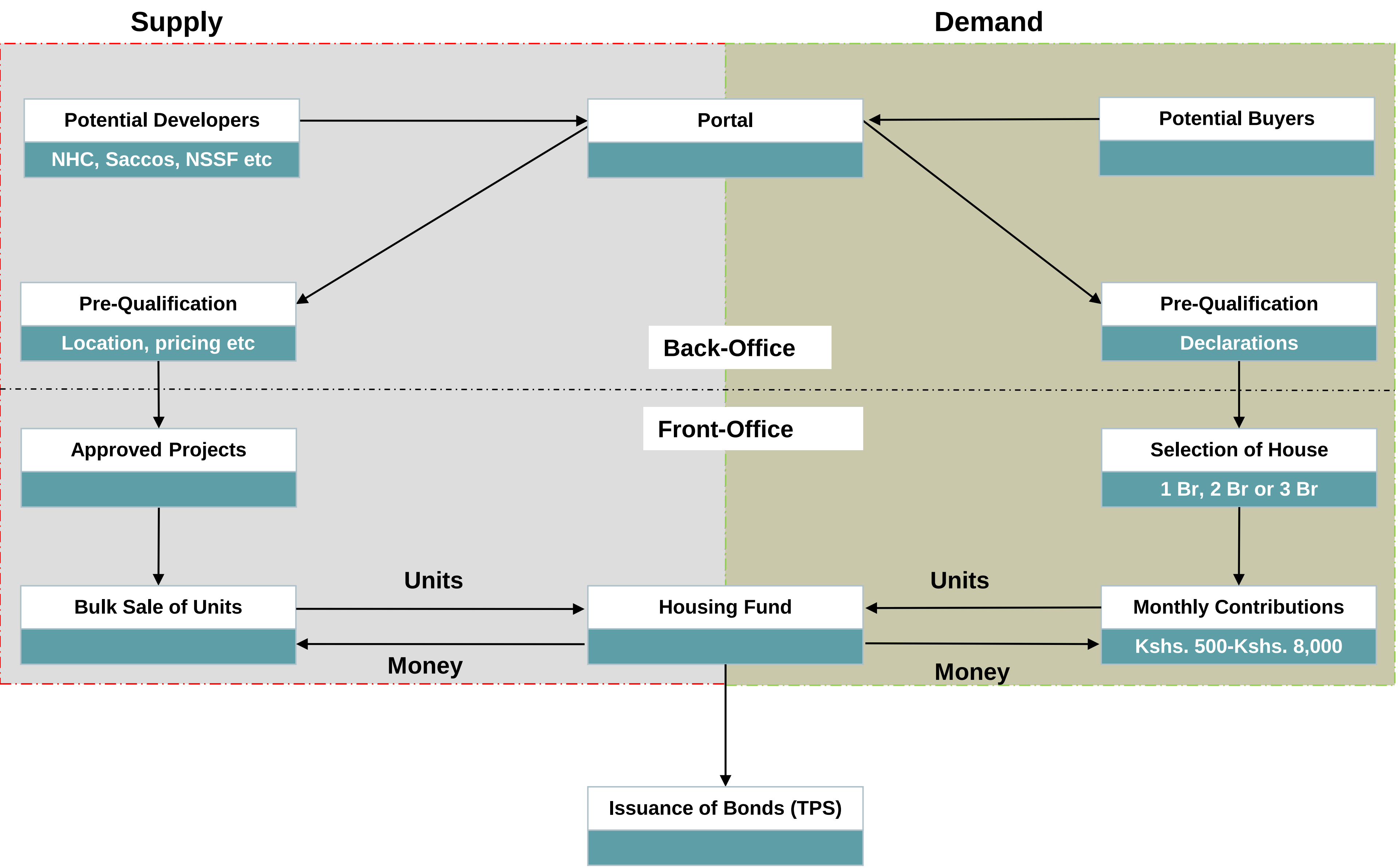
As an avenue to increase the endowments of the Housing Fund, the **Income Act** should be amended to remove the current approved institutions and include the **Housing Fund** as the **only institution** approved to establish a **Home Ownership Savings Plan**.

Aside from creating an additional source of funding, it will also concretize the demand for affordable homes which can now be estimate

Estimated Annual Contributions Under HOSP:	
Number of Households	9,937,258*
Monthly Contribution	KES 500- KES 8,000*
Participation (*Conservative*)	10%
Annual Funding from HOSP	**KES 90 Billion**

**** Contribution ceiling can be increased***

4 HOSP Flow of Pre-Qualification Process



Housing Fund Portal – Sources of Information

HOUSING FUND

Portal

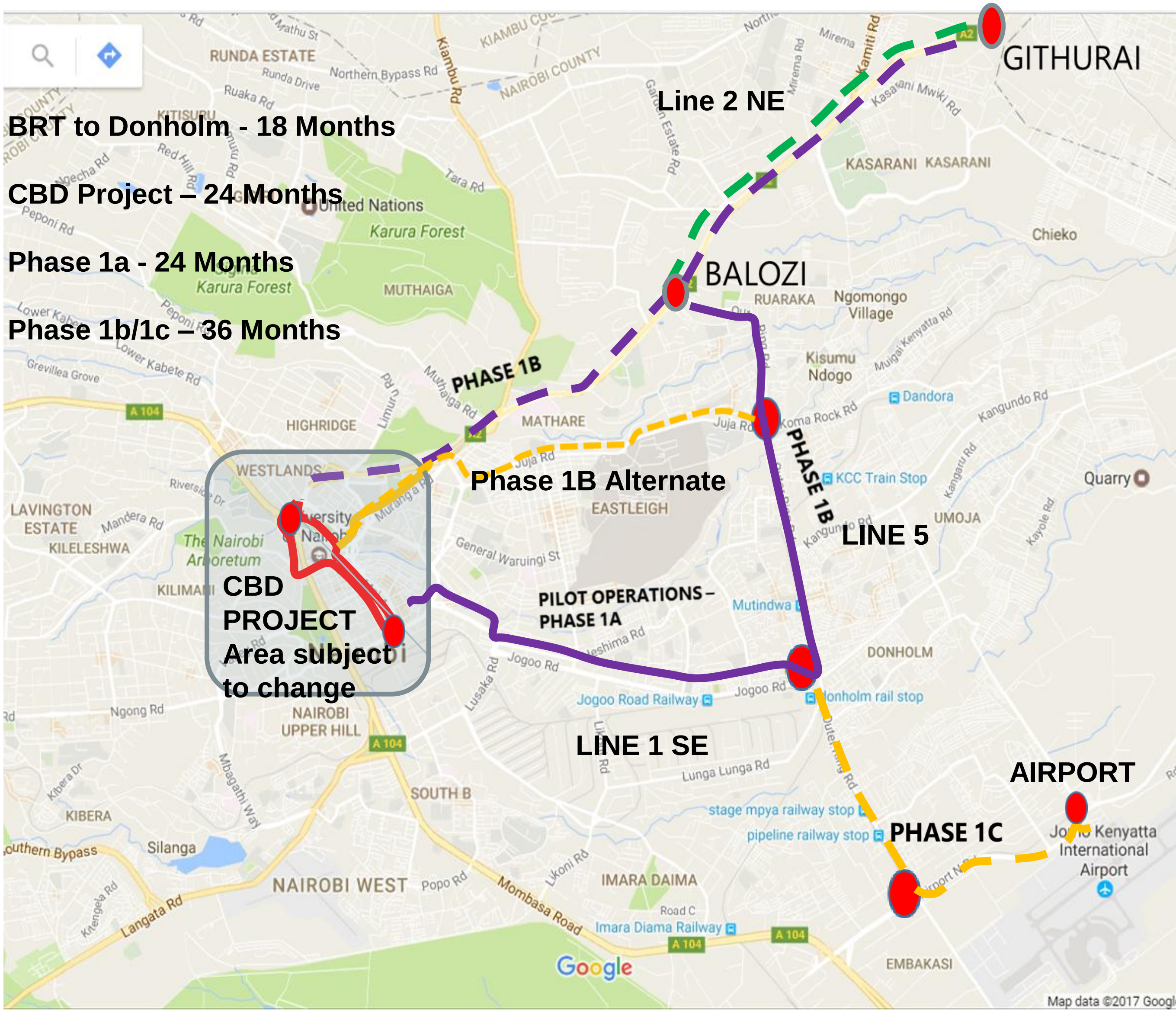
- **KRA**
  - -Tax Compliance Verification
  - - Income Verification
- **Employer/ 3rd Party Verification**
  - - Marital Status
  - - Spousal Declaration
  - - Property Ownership
- **Developers / Realtors**
  - -Showcase approved developments
  - - Price and allocate a unit to the Buyer
  - - Localized demand for marketers
- **Ministry Of Lands**
  - - Digital Records of all Land
  - - Process of Sectional Titles
  - - Process Land Transfers
- **Financier (Banks, Saccos, Fund)**
  - -Pre-Approve the purchase

Housing Fund Portal

1. Registration on the portal by potential Home Owners
2. Pre-Qualification done by the Housing Fund
3. Approved and registered under a HOSP
4. Commencement of Monthly Contributions
5. Notified and requested to select their preferred development (If Applicable)
6. Pre-approved for a unit depending of Household
7. Notified once project is complete and allocated a unit
8. Opt either for a TPS (30 Years), Cash purchase or Mortgage

Transport Oriented Design

Flagship Bus Rapid Transit Project



PHASE 1A Flagship BRT

PHASE 1B Flagship BRT

Mixed Traffic

Phase 1C

Flagship BRT Project

- Establishment of IPDU
- New signalised junctions in CBD
- Transfers of Matatu passengers at Githurai to BRT buses
- BRT Lines along Affordable Housing schemes
- 100 new articulated BRT buses
- Temp Bus Depot

Presentations

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Innovative Housing Finance

Presentation by Zoravar Singh, Director of iJenga and Chair of KPDA Innovative Finance Committee

March 27, 2018

Why we're excited about real estate development in Kenya

1 Growth in the Real Estate Sector

- Real estate contributed 8.8% of the GDP in 2016.
- Building plans approved in Nairobi increased by 43.3% in 2016.
- Roads construction, maintenance and repair increased by 38.3% in 2016.

2 Gap in the Market

- Kenya faces an estimated housing shortage of 150,000 houses annually . This is driven mainly by the Urban Population is growing at an estimated rate of 4.2% annually.
- Shortage of healthcare real estate as demand for healthcare continues to rise. Healthcare contributes to 2% of the GDP and is valued at USD 2.2 Billion.
- Shortage of quality grade A warehouses in Nairobi

3 Accessible Financing

- Entrance of new international investors and developers in the marketing.
- Increased lending to Real Estate Construction and Building estimated at 20% and 8%, respectively.
- New entrance of REIT financing regulation and the Green Bond.
- Renewed interest by pension funds.

4 Changing Dynamics

- Mega real estate projects have emerged within the period 2014-2017. These have been boosted by incentives provided by the government and the favorable economic condition in the country.

Affordability and regulations remain key challenges in housing in Kenya

A **Supply**

Large Housing Supply Deficit:

- World Bank estimates an annual deficit of 156,000 based on the current population growth and urbanization. The cumulative housing deficit is currently 2 million units.
- Suppliers cite the high cost of building products, lack of access to cheap finance and complex regulatory systems as key challenges.

B **Demand**

Lack of Affordability

- Recent housing report shows that the average sale price for a 1 – 3 bedroom property is KES 13.8mn while a 4 – 6 bedroom property sells for KES 45.4mn.
- Qualifying for a KES 13.8mn mortgage with a tenure of 12 years would require making monthly payment of KES 160,000, which is beyond the income of 99% of Kenyans.

C **Regulations**

Complexity of Legal and Regulatory Framework

- The Doing Business survey currently ranks Kenya at 121 in property registration. It takes 61 days on average to register property in Kenya.
- Land and property registration is complex mainly on account of the multiplicity of the forms of tenure and methods of transfer.
- The legal framework, though adequate in protecting investor rights, is also overly complex.

D **Infrastructure**

Growing Infrastructure

- Lack of physical planning guidelines
- Public utilities are limited and uncoordinated, including electricity, water and sewer.

… Despite these challenges real estate remains vibrant in Kenya

- ***GDP contribution:*** Sector contributed 8.8% to GDP in 2016
- ***Access to Credit:*** The real estate sector received the third largest portion of loans from banks taking up 13.58% of total gross loans
- ***Returns:*** With IRRs greater than 20%, the sector continues to earn higher returns than of bonds and equities

The Innovative Finance Committee if focused on 3 key initiatives

1. Affordable Housing Finance

The aim is to incentivize developers to increase supply of affordable housing and encourage uptake from potential home owners through developing affordable financial and mortgage products for players across the real estate chain.

2. Green Technology Finance

The aim of this program is to work with KGBS to increase the amount of environmentally real estate development by mobilizing capital, and educating developers on green building materials and technologies.

3. Activating Real Estate Finance

The aim of this program is to increase the capacity of real estate developers, by training them to produce a financial model and feasibility studies, and by working with institutional investors to develop new investment products and increase investment in the real estate sector.

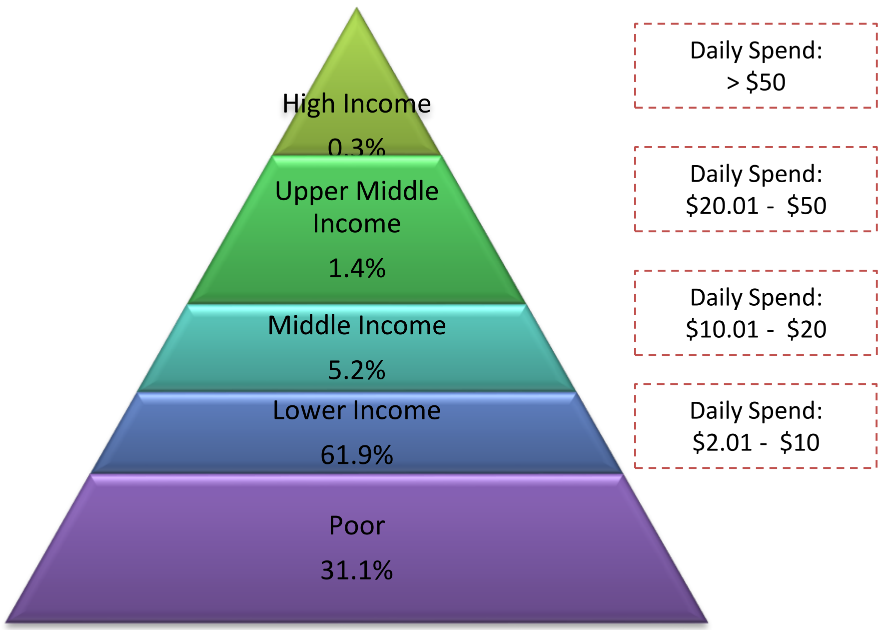
- **Training 1:** Building Financial Models for Developers & Consultants – **June 15, 2018**
- **Training 2:** Building a Feasibility Study for Developers & Consultant – **July 13, 2018**
- **Training 3:** Modelling Real Estate Risk and Returns for Investors – **October 26, 2018**

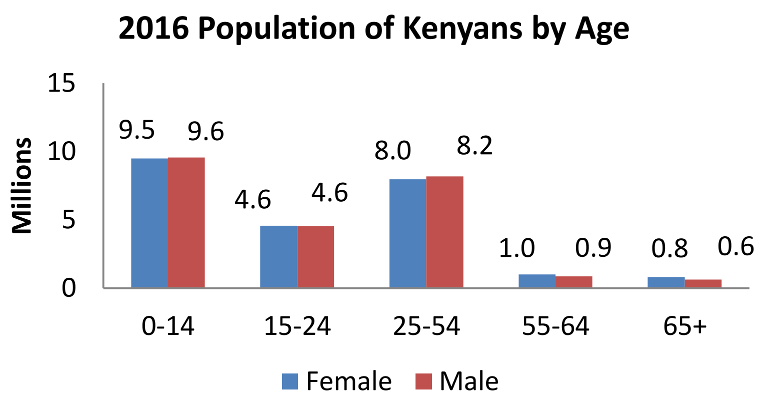
Target Customer

Observations

- Investors are faced with a paradox. They are drawn to the high end housing market where they can adequately price for risk and realize returns. However the scale opportunity waiting to be cracked is in the lower income segment.
- Demand in this segment is fuelled by a shortage in supply, increasing urbanization and a growing middle class.
- Urbanization in Kenya grows by an average of 4.3% per annum. As at 2014, the urbanization level stood at 25% and is expected to reach 50% by 2050.
- Looking at the demographics, Kenya's population is young providing a big potential housing market in the next 10-15 years as these populations start families.
- The housing market for the medium and low income population has great potential with these two demographic groups making up c.68.5% of the total population.
- The middle income segment, though growing, remains relatively small. As at 2011, the Pew Research classified the middle class in Kenya at 6.6% against a global ratio of 22%. The middle class consists of the middle income earners spending between $10.01 - $20 a day and the upper middle income earners spending between $20.01 - $50 a day.

Kenya Population Pyramid

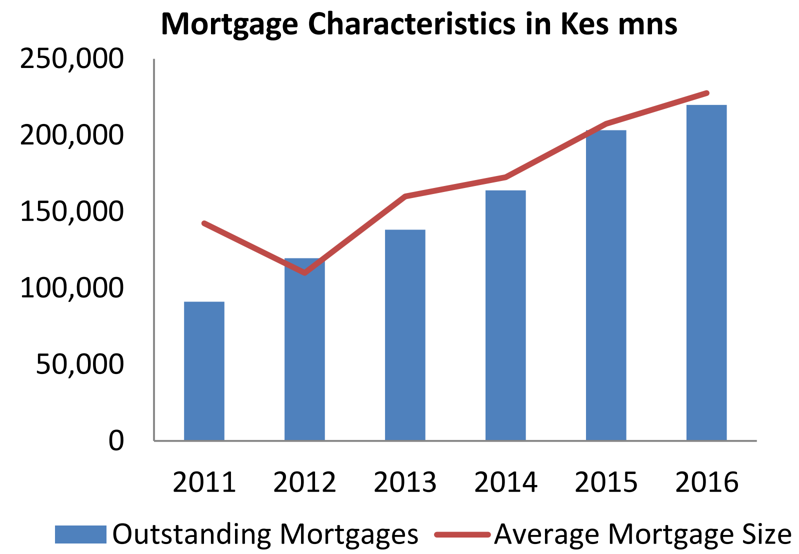


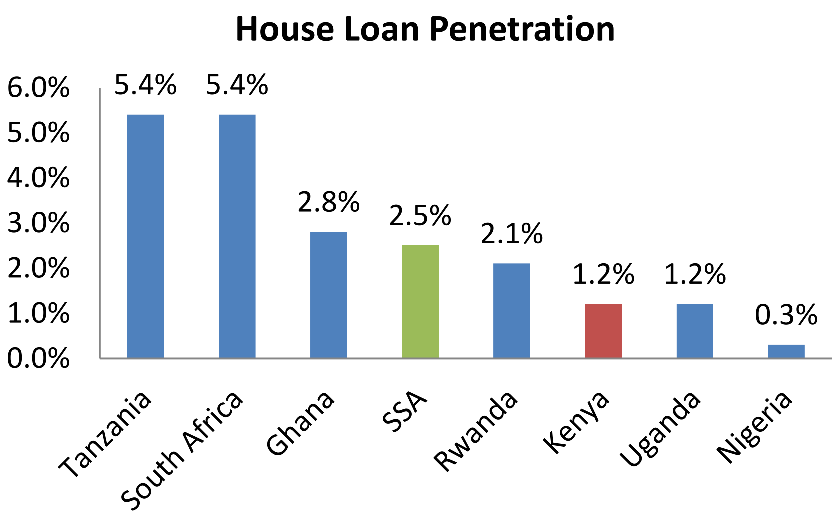


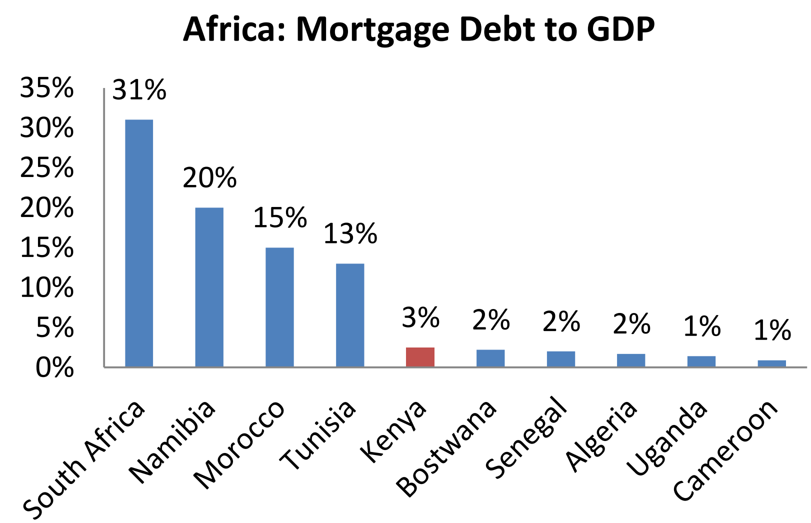
Source: World Bank, KNBS, CIA, Pew Research

Size and Scale of Mortgage Lending

- The mortgage market in Kenya, while growing, remains small by international standards. The World Bank estimates Kenya's mortgage to GDP ratio at 2.5% against an average ratio of 50% for the European countries as at 2011.
- Housing loan penetration also remains low with the percentage of adults with housing loans being recorded at 1.2% as at 2014.
- The number of outstanding mortgages within the country stood at KES 219.9bn as at the end of 2016. These mortgages originated from 35 out of the 39 operational banks in the industry.
- The average mortgage size currently stands at KES 9.1mn with an average interest rate of 13.46%.







Source: World Bank, CBK

Mortgage Financing and Asset Quality

Growing contribution to NPLs:

- As at 2016, the real estate sector contributed 12.87% to the NPLs in the Kenyan banking system. This sector has on average been among the top three contributors to non-performing loans. The construction industry's effect on asset quality has also become increasingly significant over the years.

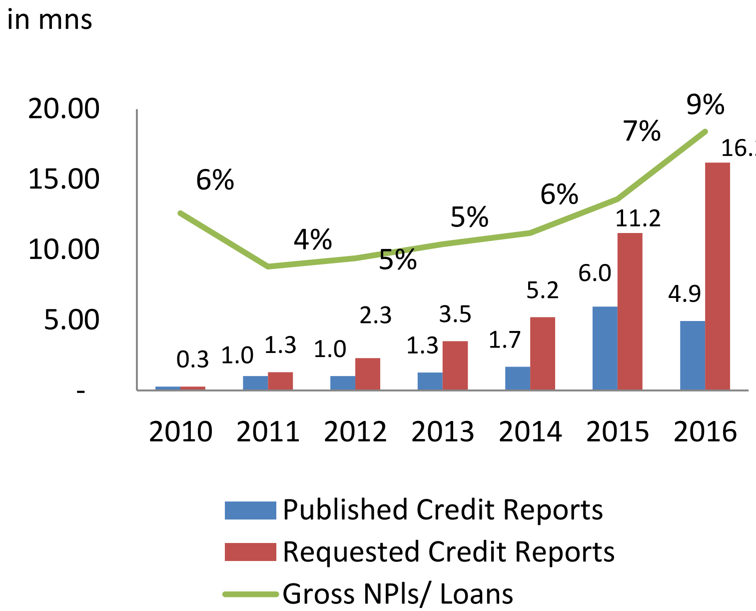
Relatively lower asset quality:

- Kenya had a gross NPL / gross loans ratio of 7% as at 2015 against a worldwide ratio of 3.9% and an estimated SSA ratio of 6.3%.
- Asset quality is largely tied to weather conditions and payments from the public sector, which affects the construction industry given the ongoing public infrastructure development.

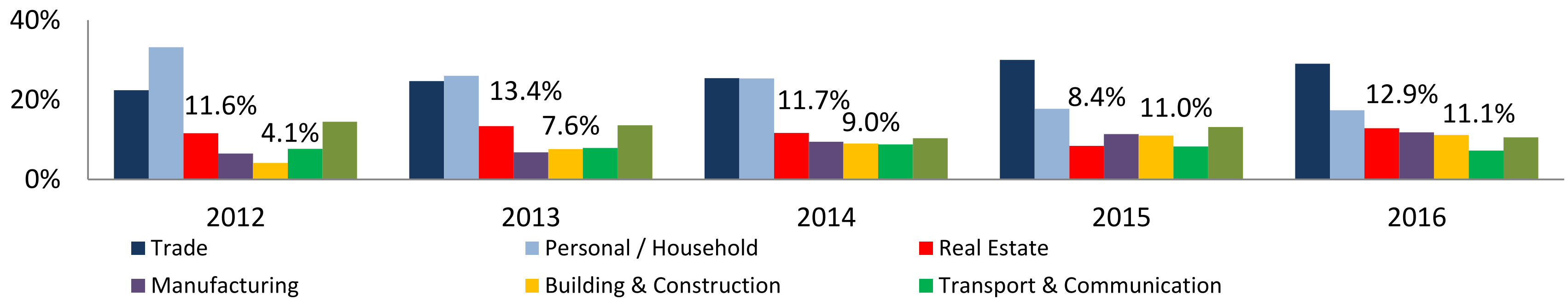
Prevalence of Credit Sharing

- As at 2016, the number of credit reports requested by users stood at 16.2 million while published reports were recorded at 4.9 million. The number of reports requested has been growing over the years.

Asset Quality & Credit Sharing Prevalence



Sectoral Distribution of NPLs



Source: iJenga Research, CBK, World Bank

Theory of Change

Committee Focus

- Innovative Finance
- Affordable Housing

1

- Mortgage loans should be designed to be more affordable
- Financial institutions need to take micro-financing approaches to assess credit worthy customers

→ **Creating more affordable & accessible mortgages**

2

- Developer friendly construction loans
- Government support in the form of tax and financial incentives to developers in the affordable housing
- Availability of serviced land for developers

→ **Increase supply of affordable homes**

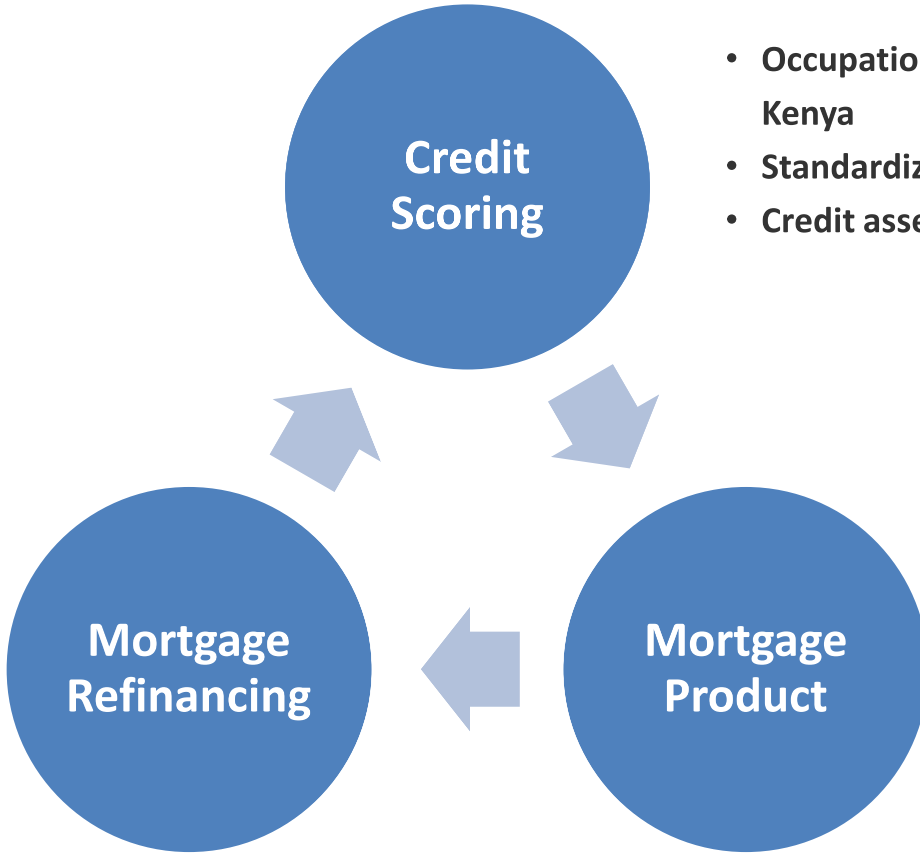
3

- Streamline the titling process for land e.g. through the introduction of e-services
- Minimize mortgage administrative costs

→ **Reduce cost & time of approvals**

Sustainable increase in home purchases

Key pillars for mortgage product innovation



- Occupation income levels for Kenya
- Standardized information
- Credit assessment & scoring

- Product design
- Marketing & customer engagement
- First loss
- Capital stack
- Applications forms
- Customers assessment
- Loan disbursement
- Loan management

- Institutional development
- Long term capital sourcing
- Refinancing
- Portfolio management

Designing Affordable Mortgages

Assumptions

Mortgage amount = KES 3mn

Household income = KES 70,000

Duration (years):

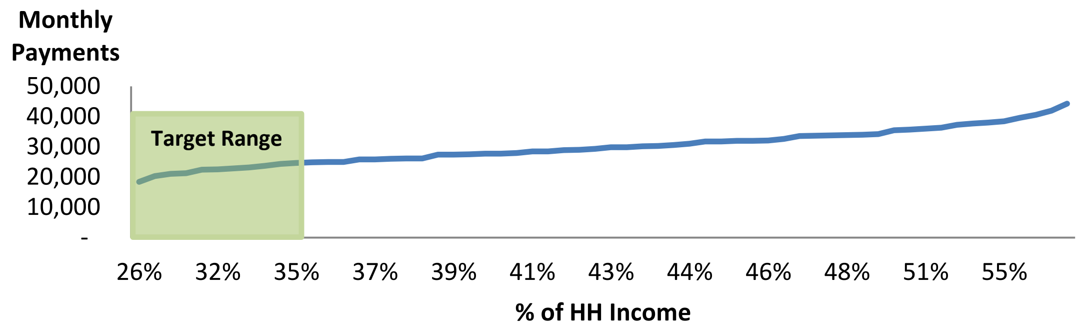
- 10
- 15
- 20
- 30

Interest rates (%)

- 10%
- 12%
- 14%

Deposit rates (%)

- 5%
- 10%
- 15%
- 20%
- 30%



Affordable Mortgages

Deposit Rate	Down Payment (KES)	Duration (years)	Interest Rates	Monthly Payment	% of HH Income
30%	900,000	30	10%	18,429	26%
30%	900,000	20	10%	20,265	29%
20%	600,000	30	10%	21,062	30%
30%	900,000	30	12%	21,278	30%
15%	450,000	30	10%	22,378	32%
30%	900,000	15	10%	22,567	32%
30%	900,000	20	12%	22,831	33%
20%	600,000	20	10%	23,161	33%
10%	300,000	30	10%	23,694	34%
20%	600,000	30	12%	24,318	35%
15%	450,000	20	10%	24,608	35%
Average **23%**	**681,818**	**25**	**10%**	**22,236**	**32%**

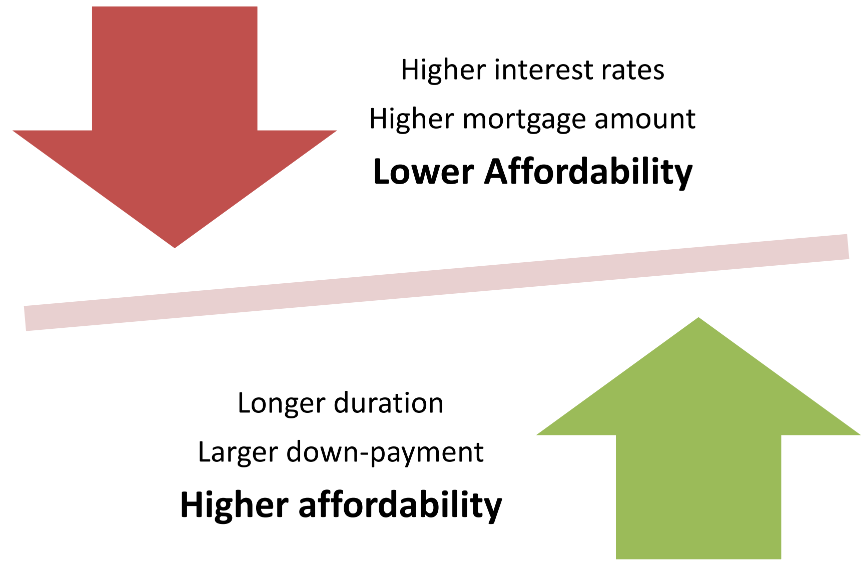
Source: iJenga Research

Designing Affordable Mortgages

Implications

- An ideal mortgage product will have a duration of between 20 -30 years and an interest rate ranging between 10 – 12%.
- Having shorter durations implies lower market interest rates to maintain the same level of affordability.
- With the current local environment, the cheapest mortgage at 14% interest would take up 36% of household income assuming a tenure of 30 years.
- The level of down payment also affects the affordability of mortgage products though market viability implies deposit rates of mainly 10 – 20%.

Effects of Elements on Mortgage Affordability



Mortgages at Market Rates

Deposit Rate	Down Payment (KES)	Duration (years)	Interest Rates	Monthly Payment	% of HH Income
30%	900,000	30	14%	24,882	36%
30%	900,000	20	14%	26,114	37%
30%	900,000	15	14%	27,967	40%
20%	600,000	30	14%	28,437	41%
20%	600,000	20	14%	29,844	43%

Source: iJenga Research

Work Plan

Current Phase

Research → Design & Data Analysis → Pilot → Dissemination

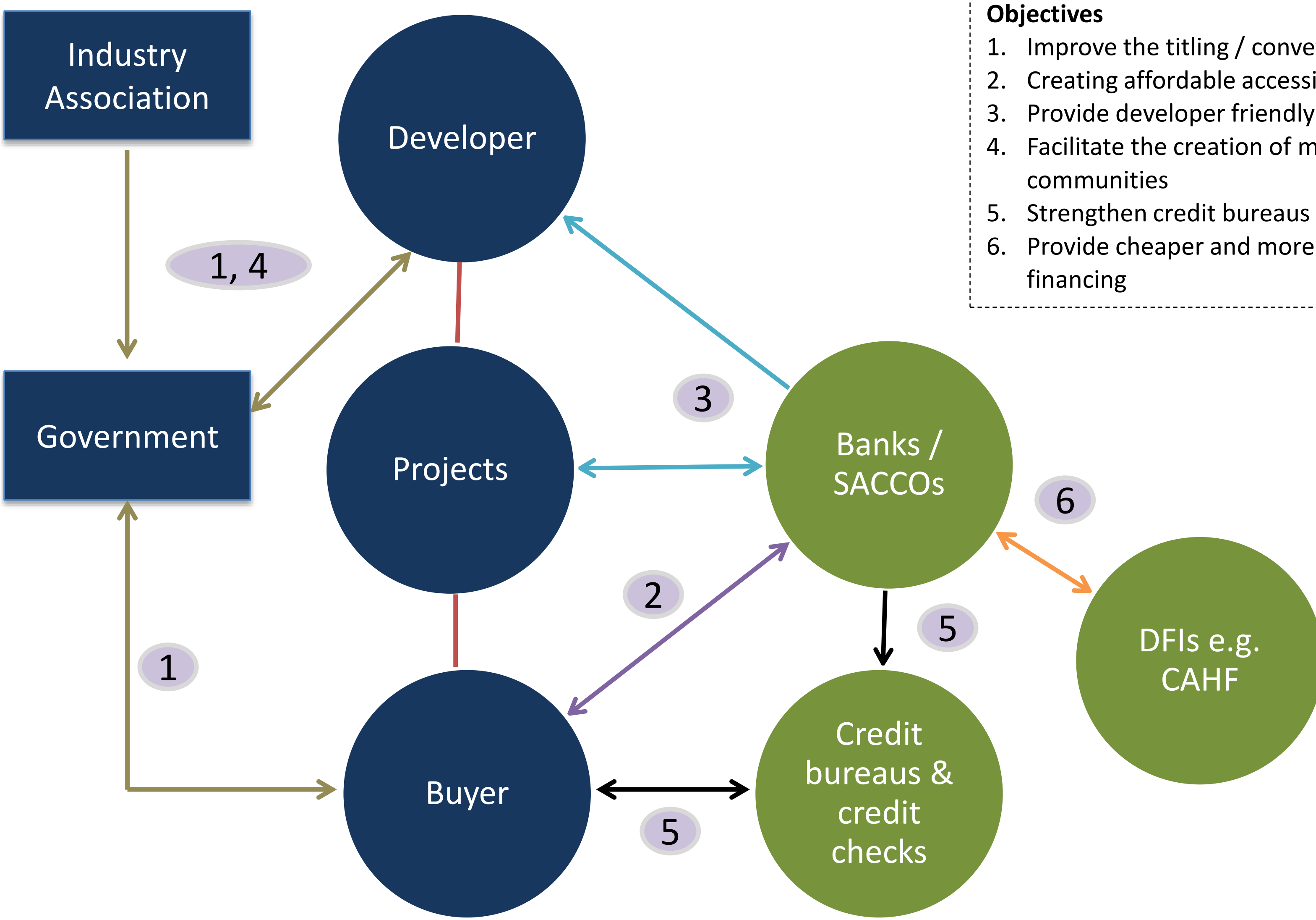
Research
Duration: 3 months
Status: Draft complete

Design & Data Analysis
Duration: 4-6 months
Status: Current Phase

Pilot
Duration: 6 months
Status: Complete

Dissemination
Duration: 12 months
Status: Complete

Key Players



Objectives

1. Improve the titling / conveyancing process
2. Creating affordable accessible mortgages
3. Provide developer friendly loans
4. Facilitate the creation of master planned communities
5. Strengthen credit bureaus
6. Provide cheaper and more long-term financing

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KENYA MORTGAGE REFINANCE COMPANY

TO SUPPORT AFFORDABLE HOUSING FINANCE



March 2018

Caroline Cerruti, World Bank

CONTEXTUALIZING THIS CRITICAL ISSUE: SUPPLY SIDE

- **What is the current level of housing production in Kenya?**

  ➡ **Less than 50,000 units per annum**

- **How many units are needed annually to keep up with demand?**

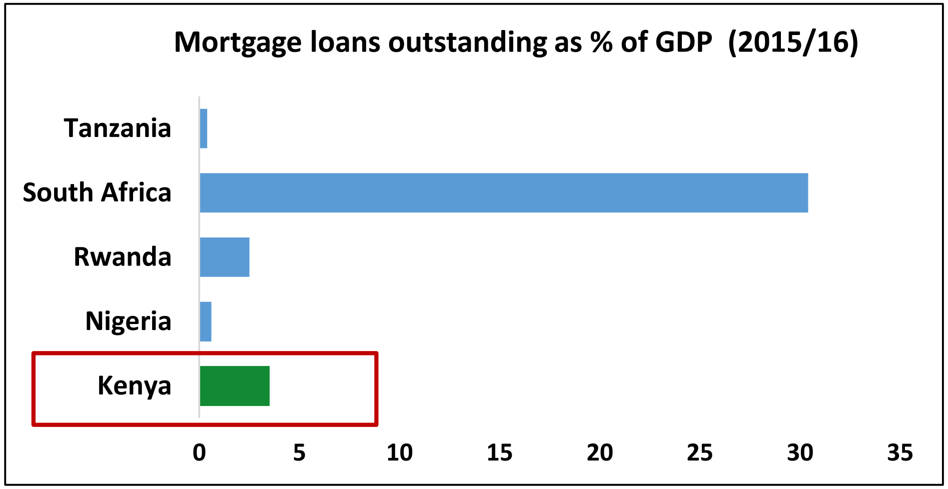
  ➡ **Approx. 150-200,000 units per annum**

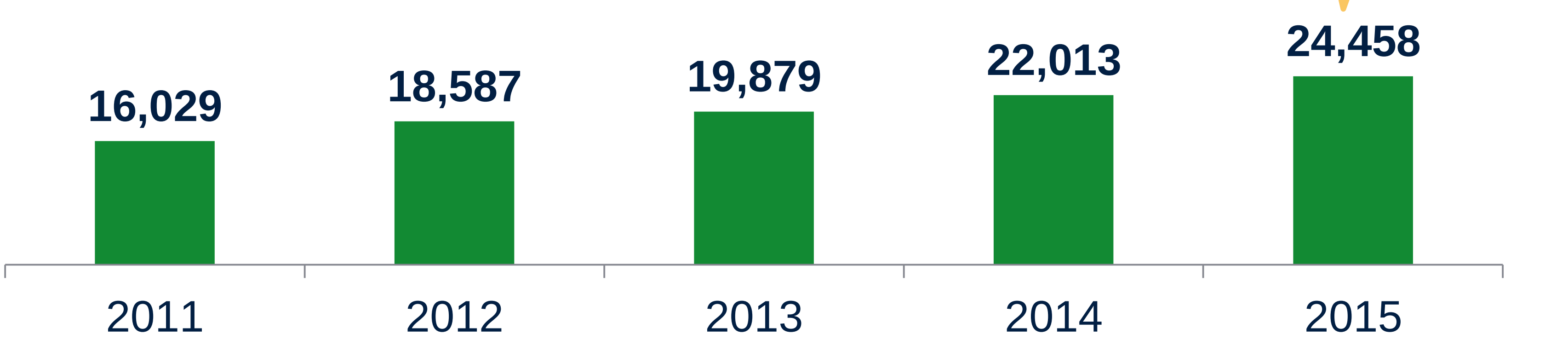
- **What is the resulting accumulated housing deficit?**

  ➡ **Over 2m units and nearly 61% of urban households live in slums**

CONTEXTUALIZING THIS CRITICAL ISSUE: DEMAND SIDE

Number of Mortgages Under CBK Regulation



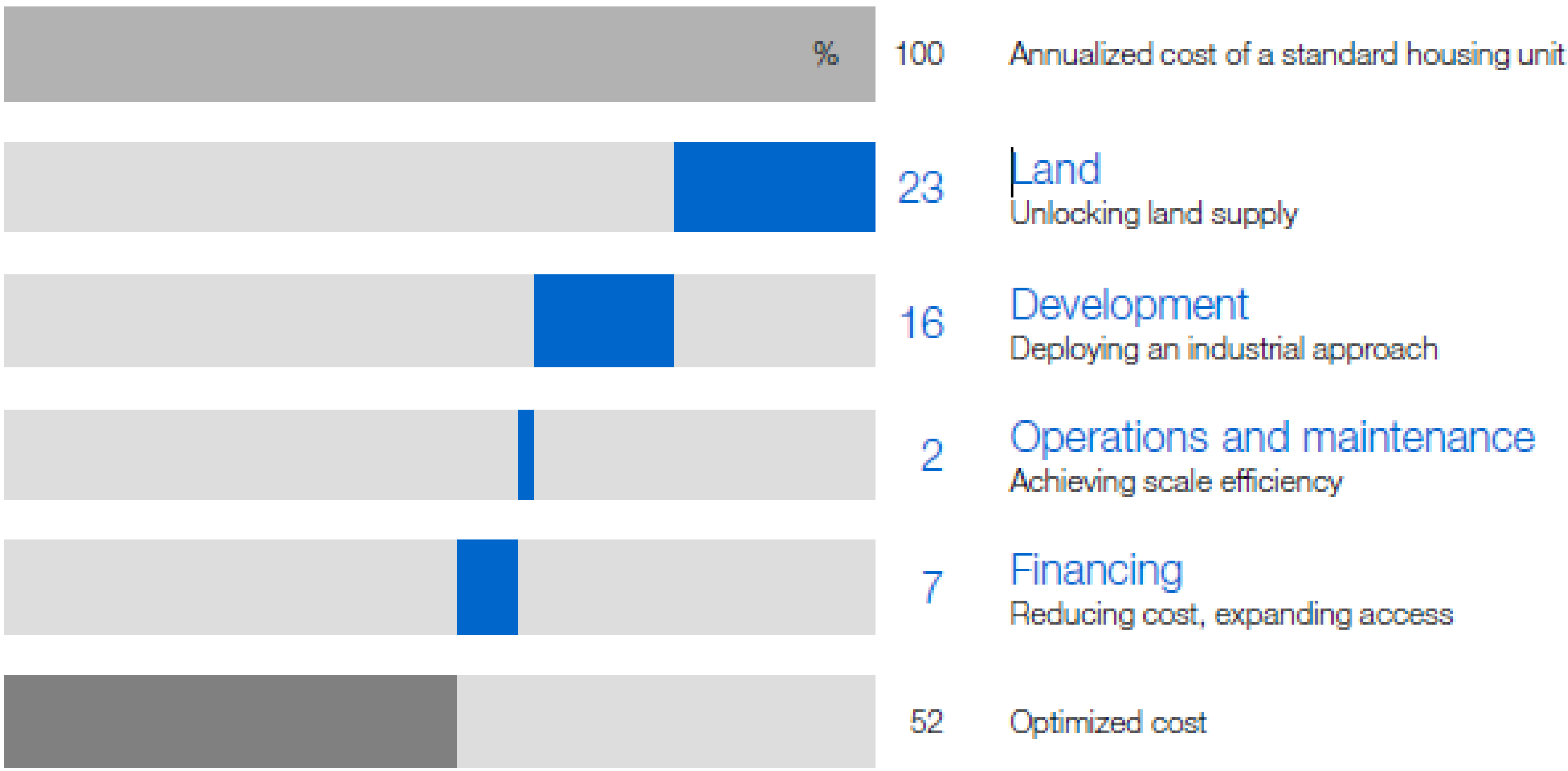


Source: Central Bank of Kenya

WHAT ARE THE KEY CONSTRAINTS OF AFFORDABLE HOUSING FINANCE IN KENYA?

- **Financing informal incomes is risky**
  - Most Kenyans have informal incomes; Does not conform with underwriting standards for mortgages
- **High prices of property**
  - Average bank mortgage loan is KES 9 million
- **Bank financing is/was expensive and variable**
  - Before the caps, over 20% and variable rates
  - After the cap, decline in lending and reduction of terms by 2/3 (15 year to 5 year)
- **Lack of long-term funds for financial institutions:**
  - Currently funded almost entirely by short-term retail and institutional deposits and only a few financial institutions have accessed the capital markets
- **Enabling regulations makes housing lending expensive and risky:**
  - Lengthy and cumbersome legal processes for property titling/registration
  - Little standardization of mortgage documentation and inefficient foreclosure processes

IMPROVING HOUSING AFFORDABILITY – FUNCTION OF FOUR LEVERS



Source: McKinsey Global Institute

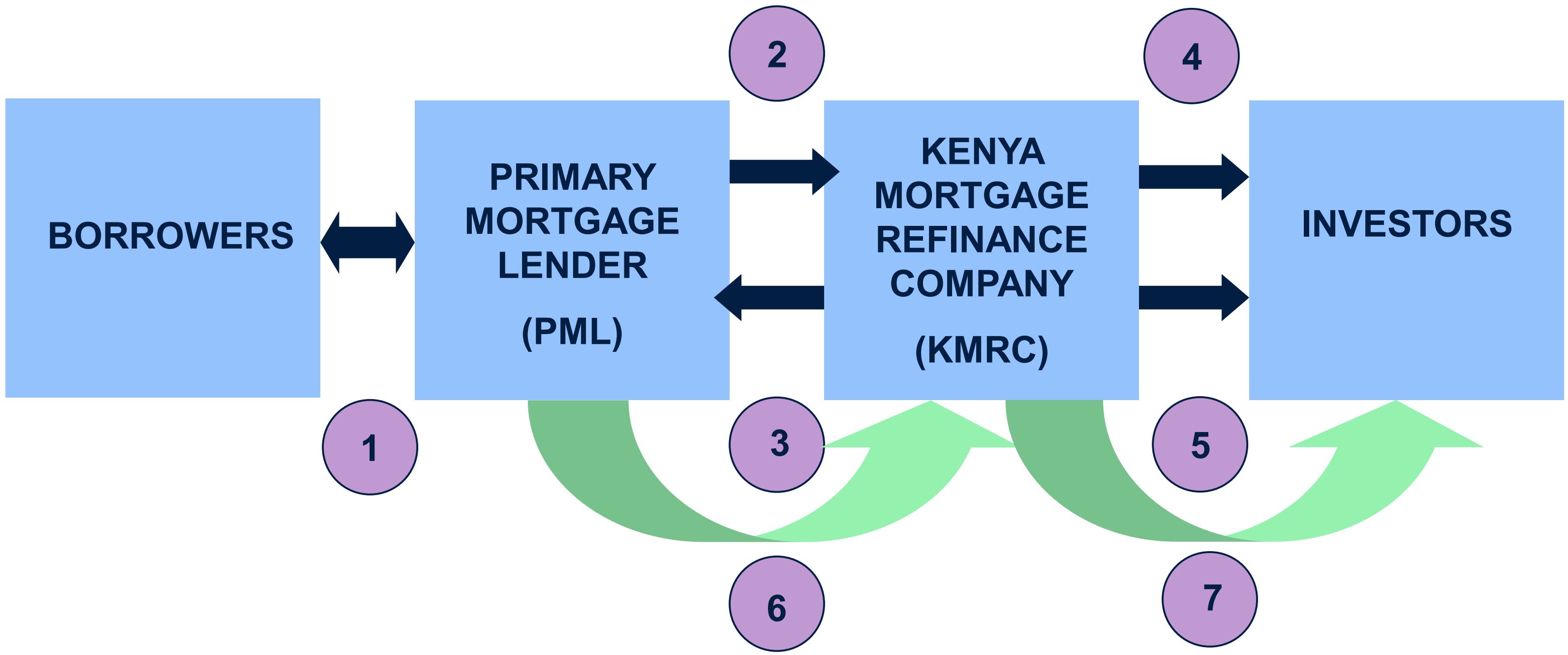
WHAT'S THE GOOD NEWS?

- ✓ **Kenya has all the preconditions for a thriving housing finance sector**
- ✓ **Housing unleashes job creation**
- ✓ **Focusing on finance can be catalytic**

WHAT IS A MORTGAGE REFINANCE COMPANY?

- Private company whose sole purpose is to provide long-term funds to the financial system and lengthen the maturity of mortgage loans
- Intermediary between lenders and investors in the bond markets – pass on the terms and conditions of the bonds
- Particularly adapted when the mortgage market is not yet well developed

MORTGAGE REFINANCE COMPANY MODEL



1. Borrowers take out “qualifying” mortgage loans and make monthly payments
2. Primary mortgage lender assign/pledges rights to mortgage loans to MRC
3. KMRC extends term loan (~5 – 7 years) to PML
4. KMRC issues term notes/bonds to investors or borrows using credit lines
5. KMRC pledges PML loans and collateral to investors
6. PML repays loan with borrowers’ mortgage payments
7. KMRC repays notes/bonds/credit lines

INTERNATIONAL MRC EXAMPLES

West Africa: CRRH

- Founded in 2012
- Shareholders: 54 commercial banks, IFC, Shelter Afrique and West Africa Development Bank
- 8,000 loans refinanced so far
- 7 bonds issues since 2012 (10 and 12-year)
- IDA USD 155 million loan to move down market

Nigeria: NMRC

- Founded in 2013
- 22 investors; 20 lenders own 60.3%; MoFI 17% and NSiA 22.7%
- Adopted Uniform Underwriting Standards
- USD $250 million IDA loan subordinated debt (Tier 2 Capital)
- First bond issue in Sep 2015: listed N8 billion ($40m) 15-year 14.9% fixed rate bond

INTERNATIONAL MRC EXAMPLES

Tanzania: TMRC

- Founded in 2010
- # of mortgage lenders increased from 3 to 29
- Mortgage growth of 50%/yr from small base
- Mortgage tenors extended from 7 to 20 years
- 13 banks accessed TMRC = 14.3% of MDO
- 1st private bond issuance underway

Malaysia: Cagamas

- Founded in 1987
- Privately owned (80%) but operated by the Central Bank (20%)
- Very innovative in adopting new products - Islamic finance, securitization, SME loans
- Major catalyst in developing bond market

MRC AND MICROFINANCE

India: Micro finance model

- Micro loan sizes vary from US$85 to US$1,100, with some loans extending to as high as US$5,300
- National Housing Bank launched a “Special Urban Housing Refinance Scheme for Low Income Housing” in May 2015
- Provides refinance for loans secured either by collateral of property financed OR “alternatively secured”
- Previously, most housing finance companies engaged only in mortgage-backed lending but clarification of the regulations was an important step to cater to alternatively secured lending such as Self Help Group security or Joint liability Group guarantee

WHAT IS NEEDED TO SUPPORT AFFORDABLE HOUSING FINANCE?

1. Efficient property registration at lower cost
2. Strong regulatory framework for KMRC by CBK
3. Participation by a wide range of financial institutions into KMRC (scale)
4. Standardization of mortgage contracts
5. Strong focus on government debt management
6. Availability of serviced land for affordable housing supply

NEED FOR AN INTEGRATED APPROACH

Expand housing finance

- KMRC
- Standardization of mortgage contracts
- Stimulate capital market investments into rental

Land/Property registration and enforcement

- Land Acts, electronic land records, electronic conveyancing
- Reduce cost of registering affordable mortgage
- Foreclosure law

Affordable Housing Supply

- Affordable Housing PPPs
- Subdivision of plots
- Provision of serviced land for affordable housing

Sound government debt management to stimulate private investment

HOW CAN THE WORLD BANK HELP?

1. Support to setting up KMRC
   - Affordable housing credit line (refinance affordable housing loans)
   - Incentives to bond issuance (sustainability)

2. Support to institutional framework for the provision of serviced land for affordable housing

3. Faster and cheaper mortgage and property registration

4. Monitoring and Evaluation

5. Prototype for Affordable Housing Public-Private Partnerships

REPUBLIC OF KENYA

Kenya Mortgage Refinance Company

EXPANDING AFFORDABLE HOUSING FINANCE IN KENYA

Government four key priorities – THE BIG 4

- Raising the share of manufacturing sector to 15% of GDP;
- Ensuring all citizens enjoy food security and nutrition;
- Achieving universal health coverage; and
- Delivering at least 500,000 affordable housing units in major cities around the country by 2022.

NATIONAL TREASURY (NT) AN ENABLER

- NT an Enabler in the BIG 4 Agenda
- NT supporting the affordable housing agenda by facilitating the establishment of a mortgage liquidity facility in Kenya (Kenya Mortgage Refinance Company (KMRC).

KENYA MORTGAGE REFINANCE COMPANY (KMRC)

- To be established on a PPP arrangement
- Private sector driven company with the public purpose of developing the primary and secondary mortgage markets by providing secure, long-term funding to primary mortgage lenders (PML)
- None deposit taking financial institution that supports long-term lending activities of PMLs, and provides temporary liquidity, if needed
- Acts as an intermediary between lenders and investors in the bond markets by issuing high quality fixed income instruments and on-lending the proceeds.

WHY A MORTGAGE REFINANCE COMPANY

- Increased long-term funding at attractive rates that allows PMLs to lengthen tenors and offer fixed rate loans
- Improved mortgage affordability and increased number of qualifying borrowers
- Blending of deposit resources with KMRC funding
- Increase overall mortgage lending volumes
- Address maturity mismatch improving liquidity management and reducing interest rate risk

WHY A MORTGAGE REFINANCE COMPANY CONT…

- Safer financial system- Better liquidity management and reduction of interest rate risks
- Standardization of lending practices from setting eligibility criteria for refinance
- Greater competition in the mortgage market, development of secondary market
- Creation of a regular issuer of long-term, high quality fixed income investments needed by institutions with long term liabilities such as pension funds, social security funds and insurance companies
- Capital market development

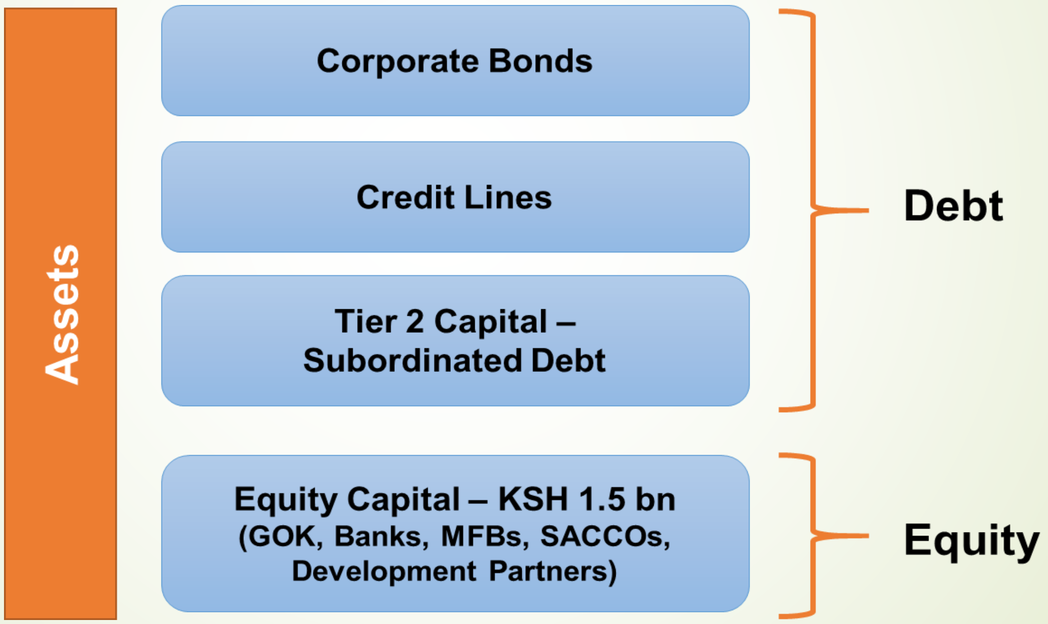
WHY A MORTGAGE REFINANCE COMPANY CONT…

- Reduced barriers to entry for smaller lenders, which can now access the capital markets on the same terms and conditions as large lenders.
- Greater competition in the mortgage market with new institutions, a more diversified set of lenders and broader product offerings.

PROPOSED STRUCTURE OF KMRC

- Legal structure – Limited liability company;
  - non bank financial institution restricted to providing long-term funding and capital market access to PML
- Shareholding – 20:80% Government and Private sector respectively. Private sector institutions may include DFIs, banks/microfinance banks and Sacco's
- Capital
  - Equity – Tier I capital
  - Debt – Tier II capital

Funding structure



REGULATION

- CBK – Primary regulators
- CMA – oversight of Bond issuance operation

ONGOING INITIATIVES

- Incorporation of Company ongoing with engagement of corporate finance lawyer – registration to be completed shortly
- Engagement with DFIs and PML who are potential shareholders in progress
- Other reforms to support affordable housing in discussion with other key stakeholders

Presentations

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UNLOCKING THE AFFORDABLE HOUSING MARKET IN KENYA

THE NAIVASHA PROTOTYPE

WORLD BANK GROUP

March 27, 2018

World Bank (WB) Support Initiatives

Supply Model

Affordable, bankable, replicable, therefore scalable that:

- Satisfies the target end-users needs and affordability constraints, and the risk/reward constraints of developers and lending institutions
- Off Government balance sheet solution
- Sustainable in the long-term
- Catalyze private sector finance

Role of the WB:

- Technical assistance to design this concept with scale and continuity in mind.
- Real impact in housing will not come from addressing one community in one area, but from designing a robust template which can then be launched in counties across the country and attract a larger pool of the domestic market and long-term finance from the institutional investors.

- Mortgage Refinance Facility
- Institutionalize Land Supply
- Enabling Policy Environment

Complimentary support

Project Site

Location, location, location:

In light of the envisaged development initiatives in the area i.e.:

- Expansion of the Nairobi – Nakuru – Mau Summit road
- Extension of the Mombasa-Nairobi Standard Gauge Railway (SGR) line to Naivasha
- Establishment of a mega industrial park/SEZ near the Mai Mahiu Freight Exchange Centre (dry port)
- Proposed business park by KenGen at Olkaria

Naivasha is expected to turn into a magnet for investors and their tenants.

Title documentation: rights – Low cost housing
Limited encumbrance: County Government abattoir

Approach

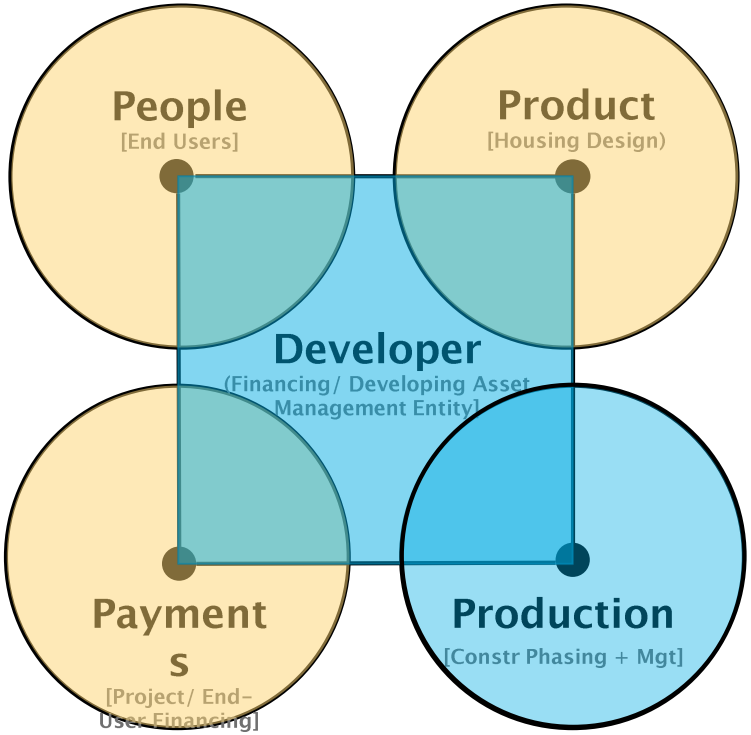
People – The End Users or Future Residents
- Specification not Speculation
- Profiling/Product matching (Affordability)

Product
- Flexible Urban Plan/ Modular/Phasing
- Flexible Unit Design (Type and Tenure)

Payments/ Financing
- How we will finance construction/
- How households will finance their purchase or rent of unit

Production
- How we phase the development
- Synchronise with Sales
- Lower peak capital/ Max ROI

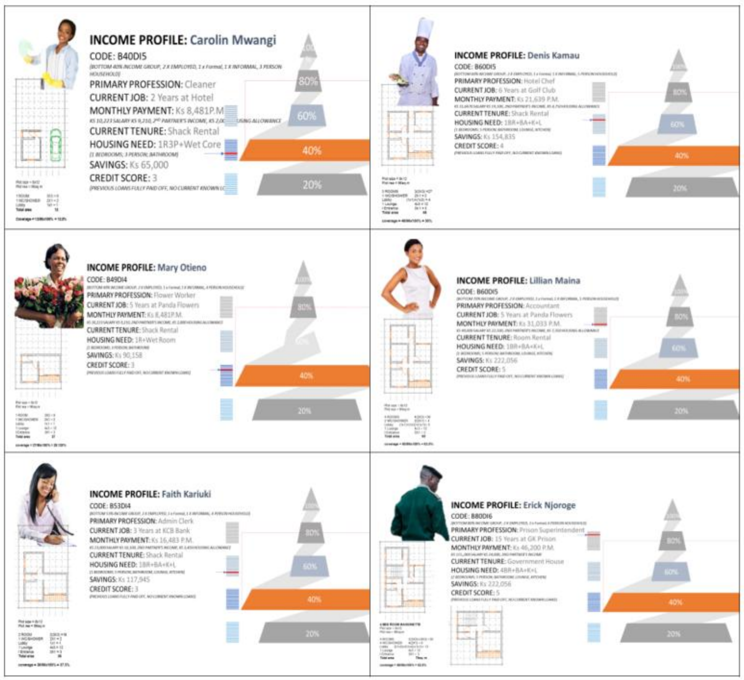
Developer/ Development and Management Entity
- Who will develop and manage the living environment over the short and long term

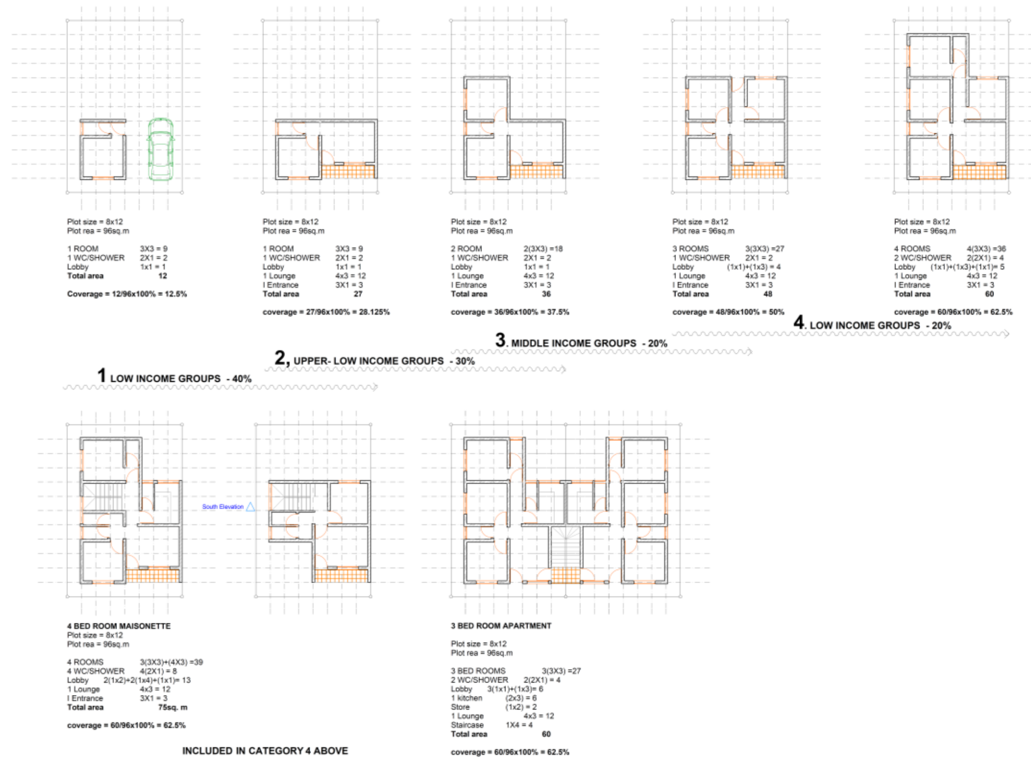


Housing Conditions – Karagita

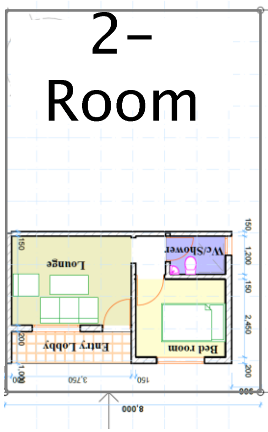
Single Room Rental: KES 3-5000 + Communal Toilet, Communal Water
Rents increased 70% since 2010

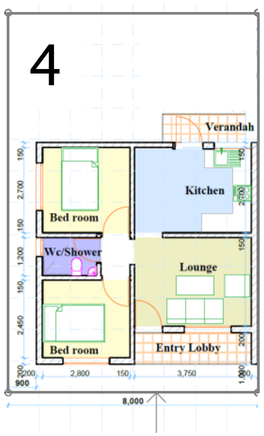
People–Product Matching

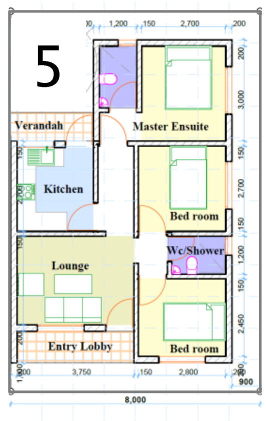




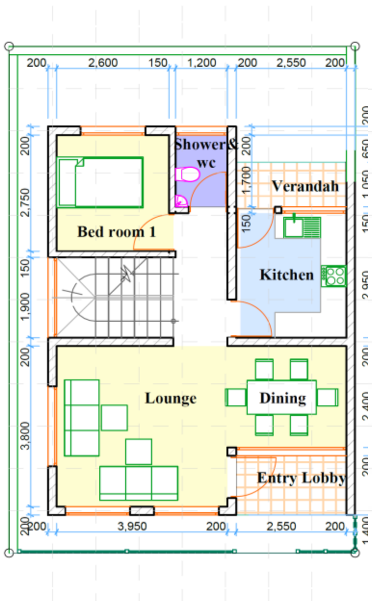
Corresponding House Unit Types: 1-Storey



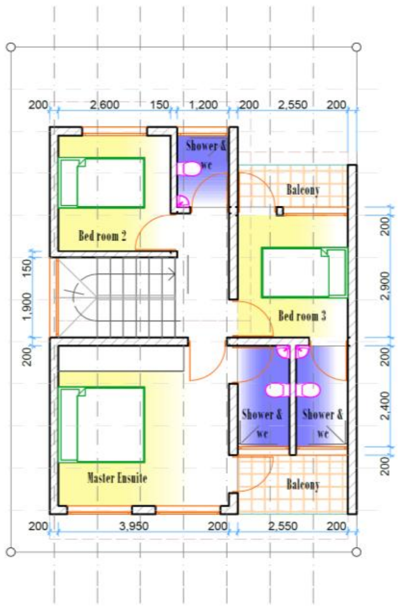




Corresponding House Unit Types: 2-Storey



GROUND FLOOR



FIRST FLOOR

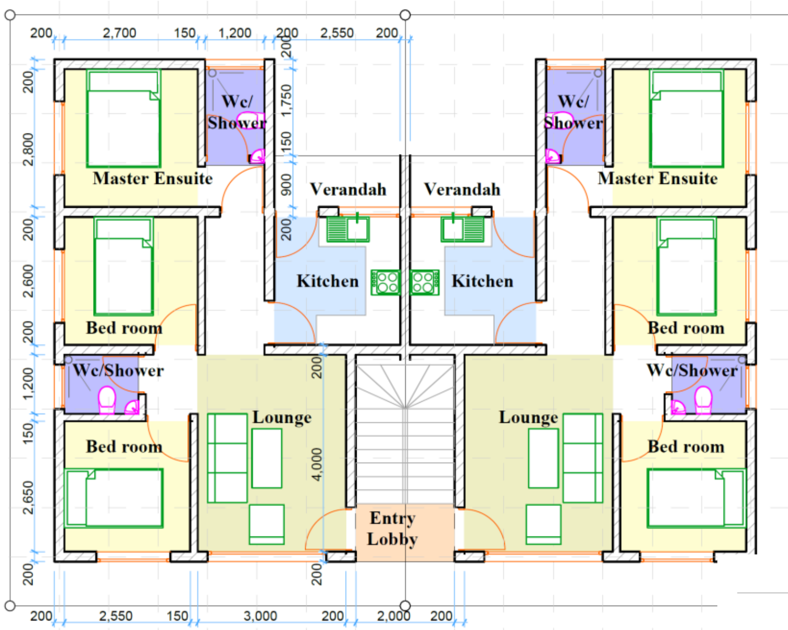
4 BED ROOM MAISONETTE

Plot size = 8x12
Plot rea = 96sq.m

4 ROOMS	3(3X3)+(4X3) =39
4 WC/SHOWER	4(2X1) = 8
Lobby	2(1x2)+2(1x4)+(1x1)= 13
1 Lounge	4x3 = 12
I Entrance	3X1 = 3
Total area	**75sq. m**

coverage = 60/96x100% = 62.5%

Corresponding House Unit Types – Apartments



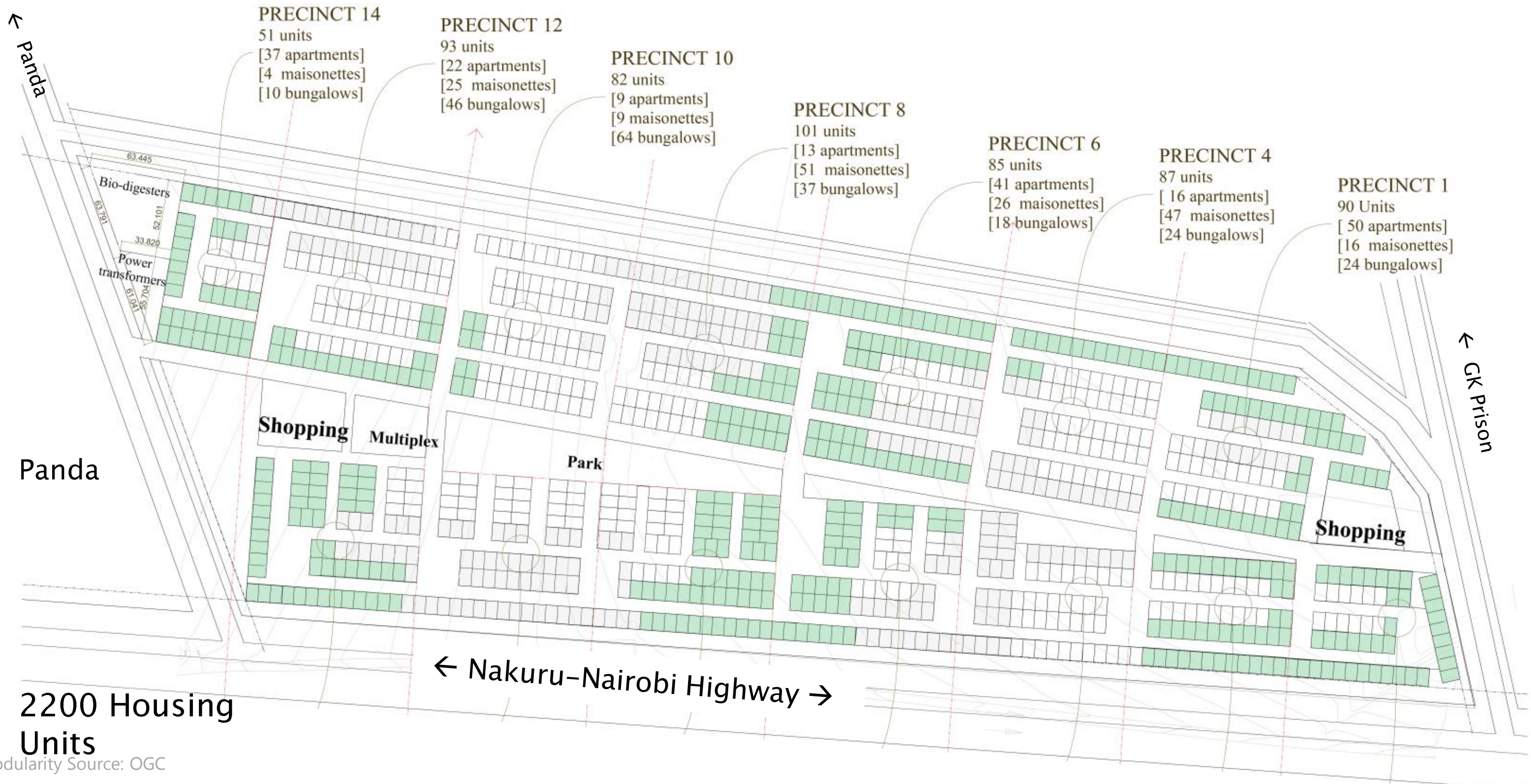
3 BED ROOM APARTMENT

Plot size = 8x12
Plot rea = 96sq.m

3 BED ROOMS 3(3X3) =27
2 WC/SHOWER 2(2X1) = 4
Lobby 3(1x1)+(1x3)= 6
1 kitchen (2x3) = 6
Store (1x2) = 2
1 Lounge 4x3 = 12
Staircase 1X4 = 4
Total area 60

coverage = 60/96x100% = 62.5%

Site Layout



2200 Housing Units

Sub-divisional Modularity Source: OGC

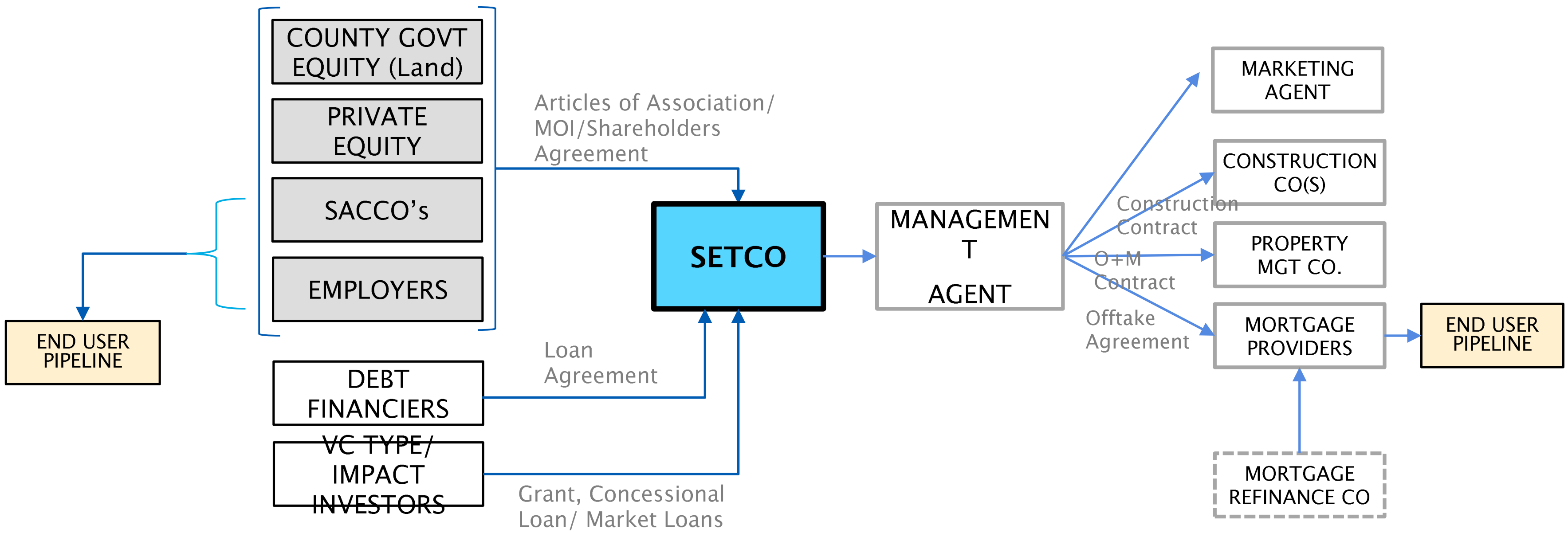
Precinct	1	2	3	4	5	6	7	8	9	10	11	12	13	14	Total units/type for G+2	Total units/type for G+3
- Apartments	50(x3) =150	39(x3) =117	16(x3) =48	16(x3) =48	0	41(x3) =123	36(x3) =108	13(x3) =39	52(x3) =156	9(x3) =27	0	22(x3) =66	52(x3) =156	37(x3) =111	1149	1532
- Maisonettes	16	0	0	47	31	26	22	51	9	9	44	25	15	4	299	299

[21 bungalows]

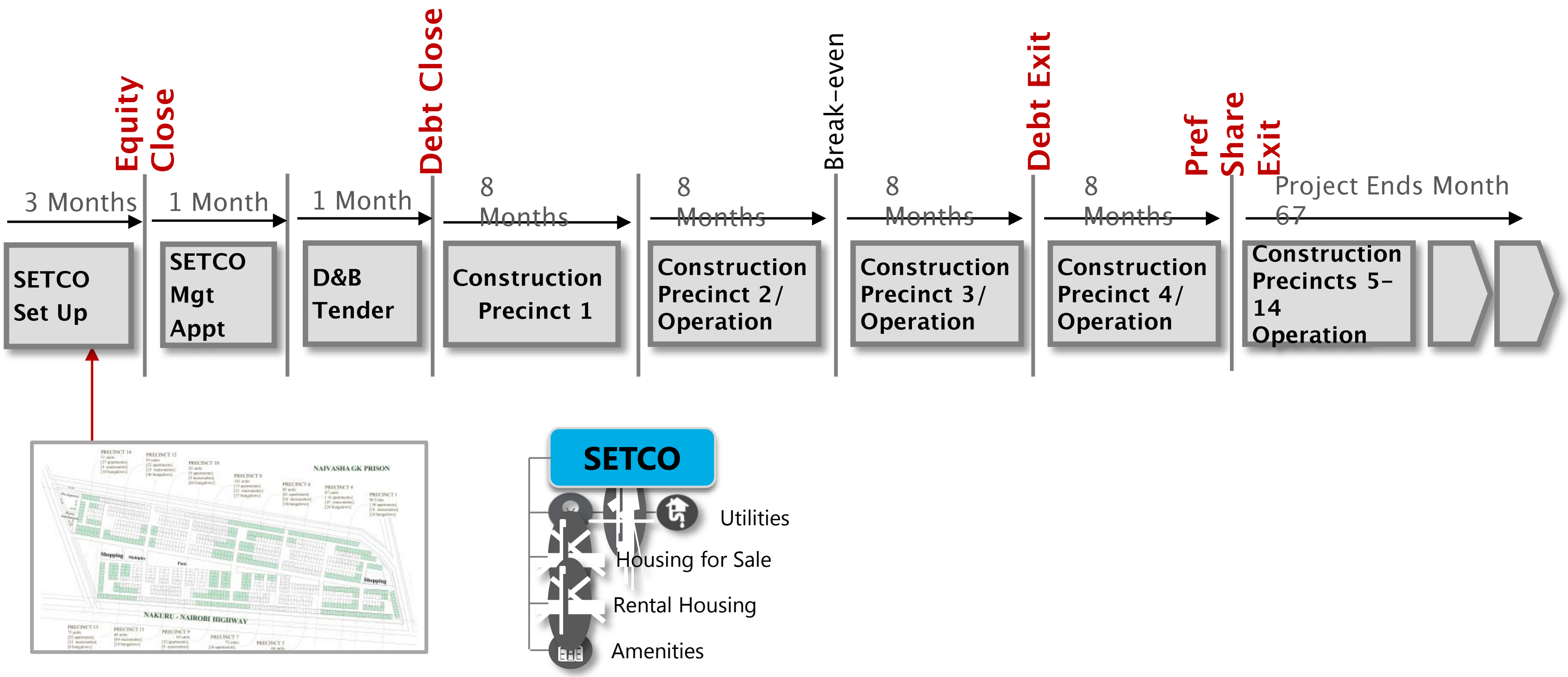
[39 apartments]
[12 bungalows]

Settlement Layout - Precinct setting

SETCO Company Structure



Production



Method Source: OGC '17 SOP

Conclusion

Structured as a Phase 1 effort, current activities on the Naivasha Prototype are focused on testing the feasibility of bringing Kenya's first affordable housing county project to market by June, 2018, which could prove to be a catalytic demonstration pilot, and an important solution to unlocking the affordable housing market in Kenya thus complementing the Government of Kenya's 500,000 housing by 2022 agenda.

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KN

LAW LLP

Advocates & Notaries Public

TAX INCENTIVES IN THE HOUSING SECTOR

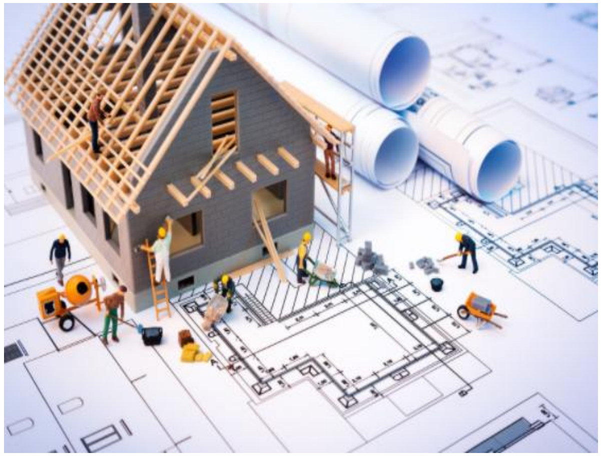
Tax Incentives in Housing Development

- Capital Allowances- Industrial Building Deduction
- Preferential Income Tax Regimes
- Tax considerations in financing arrangements

Industrial Building Deduction (IBD)

- Capital expenditure on construction of rental residential buildings in a planned development area approved by the Cabinet Secretary.
- Rate of 5%.
- 25% where developer provides roads, power, water, sewer etc.

Preferential Tax Regimes



- Simplified Residential Rental Income Regime
- Reduced Corporation Tax Rates for Low Cost Housing Developers

Simplified Residential Rental Income Regime

- A lower tax rate of 10% on the gross rental income from residential properties.
- Only to resident landlords who earn rental income of between KES. 144,000/- and KES. 10,000,000/- per annum.
- Payable at the time of receipt of the rent.

Low Corporation Tax Rates for Developers

- Available to developers who construct at least 400 low cost houses in a year.
- 15% corporation tax instead of the normal 30% of the net profits.
- Subject to the approval of the Cabinet Secretary for Housing.

Tax Considerations in Innovative Financing in the Housing Sector

Innovative Financing Models

Public Private Partnerships (PPPs)

Debt-Equity Mix

Real Estate Bonds

Sukuk

Tax Considerations in PPPs

- PPP are incorporated as companies in Kenya and as such are taxed at the resident corporation tax rate of 30%.
- Carrying forward of losses for a maximum of 9 years, subject to further extension upon application to the Commissioner.

- WHT is payable at the normal resident rates.
- PPPs can claim Capital allowances if they qualify.

Tax implications on Debt-Equity Mix

- Debt financing is more tax efficient than equity financing.
- Interest expense on corporate debt is tax deductible.
- Optimum debt-equity ratio for tax efficiency and financial sustainability.
- However, deductibility of interest expense is limited for thinly capitalised companies.
- These are companies controlled (25%) by a non resident or together with 4 or fewer other persons.
- Thin capitalization ratio for debt to equity is 3:1 in Kenya.

Taxation of Real Estate Bonds

- Developers can raise funding for their projects through issuing bonds.
- The bonds issued may also be listed and traded in the Capital Markets.
- In return, the developer (the borrower) will repay the lender the full amount plus interest over the life of the bond.
- The interest paid is subject to withholding tax at the rate of 15%.

Taxation of Sukuk

- A *Sukuk* is a sharia compliant fixed income capital markets instrument.
- Since Islamic law prohibits interest, Sukuk bonds offer investors a share in the returns generated by an underlying asset.
- However, the returns from a *sukuk* are subject to withholding tax just like interest earned from non-Islamic bonds.

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