



DEVELOPING A TENANT PURCHASE SCHEME FRAMEWORK

Legal Framework





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**FINANCIAL SECTOR DEEPENING, KENYA
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TABLE OF CONTENTS

| | |
|---|----|
| TABLE OF CONTENTS..... | 3 |
| TABLE OF FIGURES AND TABLES..... | 4 |
| A. KENYA'S LEGAL AND REGULATORY ENVIRONMENT IN RESPECT OF TENANT PURCHASE SCHEMES (TPS) | 6 |
| 1. The Regulatory Environment In Kenya On Tenant Purchase Schemes | 6 |
| 2. Regulation And Policy Recommendations For Market Development In Kenya..... | 9 |
| 3. Key Contractual Terms And Contracts In Tenant Purchase Schemes..... | 11 |
| B. KENYA'S LEGAL AND REGULATORY ENVIRONMENT IN RESPECT OF REAL ESTATE INVESTMENT TRUSTS (REITs)..... | 15 |
| C. STRUCTURING AND OPERATING A REAL ESTATE INVESTMENT TRUST IN KENYA | 26 |
| D. RISKS FOR INVESTORS IN THE AFFORDABLE HOUSING REIT | 32 |
| E. BENEFITS OF INVESTING IN AN TENANT PURCHASE SCHEME REIT AND THE BUILDING BLOCKS TO THE TENANT PURCHASE SCHEME REIT | 33 |
| F. APPLICATION OF ALL OUTPUTS WITH RESPECT TO TPS AND REITS TO SIC HOUSING PROJECT (STIMA HEIGHTS) IN PARKLANDS..... | 37 |

TABLE OF FIGURES AND TABLES

| | |
|--|----|
| Figure 1: Presented By The NSE At A REITs Workshop On 31 st August 2023..... | 21 |
| Figure 2: Steps For Structuring A REIT | 26 |
| Figure 3: Participants In A REIT | 27 |
| Figure 4: Projected REIT Returns..... | 31 |
| | |
| Table 1: Summary Of The Matters Provided For In The Land Acts | 8 |
| Table 2: Key Contractual Terms..... | 14 |
| Table 3: Differences Between D-REIT and I-REIT | 19 |
| Table 4: Regulatory And Non-Regulatory Steps Of Structuring A REIT With Respect To Affordable Housing Tenant Purchase Schemes..... | 27 |
| Table 5: Participants In A REIT | 28 |
| Table 6: Cost Considerations In Setting Up And Operating The REIT | 29 |
| Table 7: REIT Set-up Costs..... | 29 |
| Table 8: Maintenance Cost Per Annum..... | 30 |
| Table 9: Risks For Investors In The Affordable Housing REIT..... | 32 |
| Table 10: Building Blocks For A Growth Of The Residential REIT Market In Kenya | 36 |
| Table 11: Demand Side Characteristics Of SIC Clients | 38 |

ACRONYMS AND ABBREVIATIONS

| | |
|-------------------|--|
| Act | The Capital Markets Act |
| CBK | Central Bank of Kenya |
| CGT | Capital Gains Tax |
| CMA | Capital Markets Authority of Kenya |
| D-REIT | Development Real Estate Investment Trust |
| I-REIT | Income Real Estate Investment Trust |
| KES | Kenya Shillings |
| KMRC | Kenya Mortgage Refinance Company |
| NAV | Net Asset Value |
| NSE | Nairobi Securities Exchange |
| NSE USP | Nairobi Securities Exchange, Unquoted Securities Platform |
| OTC | Over The Counter Exchange |
| REIT | Real Estate Investment Trust |
| REITs Regulations | Capital Markets(REITs) (Collective Investment Scheme) Regulations 2013 |
| SPV | Special Purpose Vehicle |
| TAV | Total Asset Value |

A. KENYA'S LEGAL AND REGULATORY ENVIRONMENT IN RESPECT OF TENANT PURCHASE SCHEMES (TPS)

1. The Regulatory Environment In Kenya On Tenant Purchase Schemes

1.1 Background: Kenya Legal Review of Existing Regulatory Landscape

Tenant Purchase Schemes (TPS) may take various forms. In Kenya, the general understanding of a TPS is set out in the Kenyan National Housing Policyⁱ. The National Housing Policyⁱⁱ defines a TPS as a house purchase arrangement where the monthly payments for rent by the tenant purchaser or occupant contribute to offsetting the principal amount required to acquire the house. The Housing Policy provides for a TPS in the context of a social mechanism to empower urban dwellers who cannot afford to purchase their own home in the open market.

The earliest TPS programmes in Kenya were established and run by local governments, as they then were, from funding from the Local Government Loans Authority. This function was later taken up the National Housing Corporation (NHC) on the enactment of the Housing Act in 1953. NHC has therefore been the leading provider of homes for purchase through TPS programmes with the National Social Security Fund (NSSF) also being a key participant in the sector.

TPS programmes are usually provided as an alternative mode of payment to a mortgage, cash or installment payment. However, preference for other payment methods such as cash or mortgage remains as they facilitate a quick exit by the developer from the project and enable the developer avoid the administrative challenges that come with running a TPS.

1.2 Legal and Regulatory Framework

There is no overarching legislative or regulatory framework governing TPS programmes in Kenya. The schemes are primarily governed by the terms set out in the contract between the parties. However, various laws apply. We discuss these below:

a) The Constitution of Kenya, 2010

Article 43(1) (b) of the Kenya constitution provides that every person has the right to accessible and adequate housing and reasonable standards of sanitation. The Constitution of Kenya therefore sets out minimum requirements in relation to health and safety requirements applicable to homes provided under a TPS.

The Constitution also vests the function of developing the National Housing policy with the national government and that of regulating planning and development in relation to housing with the county governments.

b) The Contracts Act

The relationship between the tenant purchaser and seller will be governed by contract. The minimum requirements for a contract to be valid and enforceable in Kenya as set out in the Contracts Act, CAP 23 of the Laws of Kenya therefore apply to each and every TPS agreement.

c) Land Act and Land Registration Act, 2012

The Land Act, 2012 and the Land Registration Act, 2012 (the "Land Acts") set out various provisions that apply to TPS by reason of the housing units being classified as dwelling houses under the Act. The Land Acts also govern the mode of contract and the mode of transfer of title to the tenant purchase units to the tenant purchaser on full payment. Below is a summary of the matters provided for in the Land Acts:

i. Nature of Contract A tenant purchase agreement will provide for the disposition of land, prior to payment of the full purchase price by way of a lease and upon full payment of the purchase price, by way of sale.

The Land Act, 2012 provides minimum requirements for such contracts to be enforceable in a court of law, including that the contract must be in writing and signatures of the parties witnessed.

ii. Vendor's right to regain possession A tenant purchase agreement is a contract pursuant to which the tenant purchaser gains possession prior to completing payment. The Land Act regulates the manner in which the seller may rescind the contract and allows the seller to resume possession of the relevant home either peaceably or by obtaining an order for possession from the courts.

Key to mention here is that the Housing Act, the NHC's parent act, expressly empowers NHC, where a tenant purchaser is in default, without obtaining any order or judgement of the court to take possession using force if necessary. The option to resume possession without court orders, through the use of force, is not available to a private TPS provider. A private TPS provider may however seek damages and mesne profits.

The Land Act allows an aggrieved tenant purchaser to seek relief from the court against an application for an order of possession or an intended rescission by the seller.

iii. Landlord/Tenant Covenants The structure of a TPS agreement typically provides that the tenant purchaser is designated as tenant pending full payment of the purchase price. The Land Act provides covenants that are implied in each and every lease including:

- the tenant's right to quiet possession and enjoyment, provided they comply with their obligations under the Lease;
- Landlord's obligation to keep the roof, all external and main walls and main drains, and the common parts in a proper state of repair, if tenancy is in respect of part of a building e.g. an apartment as is mostly the case;
- Landlord's obligation to ensure the house is fit for human habitation during the lease;
- Tenant's relief from paying rent and right to terminate the tenancy agreement where the house is destroyed by fire, flood or explosion or other accident not attributable

to their negligence of the lessee, or lessee's invitees or employees;

- Tenant's obligation to keep the interior of the premises in good condition; and
- the Landlord's obligations to pay outgoings in respect of the property i.e. rates, rents etc.

These provisions are typically replicated in tenant purchase Agreements with relevant modifications provided that the modifications do not deviate from the intent of the Acts.

| | |
|-----------------------|--|
| iv. Transfer of Title | The Land Acts and their regulations provide for the procedures and the documentation required to effect a transfer of title in a tenant purchase unit to the tenant purchaser on full completion of the purchase price |
|-----------------------|--|

Table 1: Summary Of The Matters Provided For In The Land Acts

d) Sectional Properties Act, 2020 (SPA)

The SPA and its subsidiary legislation cover ownership of units in a building such as apartments, flats, maisonettes and townhouses. It simplifies the process of registration of sectional properties and guarantees property ownership rights of unit owners by conferring to them titles to the units. The SPA also provides for apportionment of rent and rates to the unit holders as well as management of common areas through a corporation registered under the SPA. All new and existing developments that do not benefit from the exemptions under the SPA are required to comply.

e) Housing Act, CAP 117

The Civil Servants (Housing Scheme Fund) Regulations established under the Housing Act provide for the establishment of the Civil Service Housing Scheme Fund. The Civil Housing Fund may in respect of property it develops administer a TPS. A civil servant may also procure a home from a Tenant Purchase provider qualified under the regulations. The civil servant is required to pay 10% of the value of the property and 90% shall be financed through a loan payable monthly within a maximum period of 20 years or before the civil servant attains the age of retirement.

f) The Physical and Land Use Planning Act, 2019

The Physical and Land Use Planning Act, 2019 (PLUPA) provides for the planning, use, regulation and development of land and for connected purposes. PLUPA designates county governments as planning authorities. It also sets out minimum considerations that a planning authority would consider in approving a development including health and safety requirements. PLUPA also provides for national, county and inter-county land use and development plans. These provide useful information for an institution intending to undertake a TPS for example a local physical land use and development plan would be required to include a housing and infrastructure analysis including Housing occupancy rates, accommodation density, housing requirements, type of residential areas and industrial locations etc.

g) The Urban Areas and Cities Act

The Act provides for the classification, governance and management of urban areas and cities. Some of the functions of the boards of municipalities established under the Act include zoning of residential areas and considering housing requirements in formulating integrated development plans.

h) The County Governments Act, 2012

County governments are the regulatory bodies responsible for ensuring the maintenance of buildings including tenant purchase units and that developers meet minimum health and safety regulatory requirements.

2. Regulation And Policy Recommendations For Market Development In Kenya

The existing TPS programmes in Kenya adopt the interest only rent model where the developer acts as financier granting a loan to the tenant purchaser for the balance. The balance is then payable in installments, typically monthly. This model keeps the contract documentation simple and no additional costs are charged except service charge that is payable for the operation and maintenance of the common facilities. The monthly rental in addition to the interest costs may include costs such as insurance costs and management fees or these may be charged separately. The Civil Servants Housing Scheme Fund Regulations, 2014, for example, provides that a Tenant Purchase Institution may charge a management fee of upto 2% of the tenant purchase loan. The tenant purchaser is also responsible for maintaining a life and fire insurance.

To support increased adoption of the TPS model particularly by players in the private sector as well as provide oversight to protect consumers to ensure tenant purchase agreements remain equitable to the aspiring homeowner, we propose the following policy recommendations:

2.1 The Housing Bill, 2021 – Fast-tracking the enactment of the Housing Bill, 2021 will play a critical role in enhancing the legal and regulatory framework governing TPS programmes. The Bill among others provides for:

- a. the registration and regulation of housing developers. This will enhance consumer confidence in TPS programmes undertaken by private developers. Private developers given government financial constraints provide the most effective way to expand the use of TP Schemes.
- b. A Housing Developers Regulatory Board with powers to sanction/discipline rogue developers and protect the interests of developers and buyers.
- c. A Housing Tribunal to among others address disputes between buyers and developers/financiers as well as disputes relating to evictions from a housing development.
- d. A Housing data bank that would provide useful information for TP Scheme providers.

Amendments to the Bill to enhance its ability to provide a comprehensive framework for TPS programmes would be to expressly include them as schemes in respect of which the Act applies with relevant empowering provisions to the CS to develop regulations. The scope of these regulations may include provisions on:

- a) Registration and regulation of TPS institutions including reporting and eligibility requirements. Powers of inspection by the regulator who may either be the Director General Housing or the Housing Developers Regulatory Board in respect of the books of accounts of TP Scheme institutions may also be considered;

- b) Minimum disclosure requirements for inclusion in tenant purchase agreements. For example, where the TPS model adopted is one where a portion of rent is applied to settle the purchase price, the portion so applied and the manner of determining rent or service charge escalations, if any;
- c) Implied terms applicable to all tenant purchase agreement to ensure buyer protection;
- d) Minimum obligations of Tenant Purchase institutions including the provision of monthly statements and minimum notice periods prior to an eviction procedure;
- e) Special provisions applicable to TPS programmes that receive funding or are subsidized by the government such as caps on management fees and interest rates chargeable;
- f) Provide a framework applicable where a tenant purchase institution intends to exercise its powers to re-enter the premises on rescission of the agreement including relevant notice periods. While arguably, the Land Act, 2012 provides for this, the definition of Land in the Act that makes reference to the Constitution may be problematic since it may seek to exclude buildings erected on the land (a court decision on this matter is pending following an appeal from the High Court's ruling that land does not include buildings built on the land); and
- g) Provide a framework applicable where a tenant purchase institution intends to exercise its powers to sell the premises to another party on rescission of the agreement including a cap on the maximum discount from the market price that a tenant purchase institution may dispose the property. To achieve a balance, these provisions may only be triggered once the tenant purchaser has achieved a certain threshold in payment e.g. 75% of the purchase price. This enables a tenant purchaser who is unable to service the payments for reasons out of their control enjoy the benefit of the equity built over the years.

2.2 The Landlord and Tenant Bill, 2021 – While this particular Bill would not be appropriate for regulating the relationship between a tenant purchaser and a tenant purchase institution under the interest only rent model, provisions of the bill such as limitations on rent increases and a dispute resolution mechanism for dealing with such matters would be beneficial to a rent to own model where the tenant purchases an option to buy in future. These provisions would provide necessary protections to such tenants. It would also be useful that the definition of tenancies under this Bill is amended to exclude a tenant purchaser – tenant purchase institution relationship in the same way a mortgage-mortgagor relationship is excluded.

2.3 Taking cognizance that the **National Housing policy** identifies the TPS model as a tool to achieve equity in society, the government may consider providing certain government subsidies. For example, a stamp duty exemption in the transfer of residential units from a developer to a tenant purchase institution or its nominee (stamp duty costs range between 2-4% of the value of the property). This will reduce the costs associated with the exit by a developer of the units sold under a TPS to third parties with sufficient administrative and financing resources to run a TPS. It will also enable the consolidation of tenant purchase units from different developers to achieve a critical mass to support a capital market issuance. Relevant controls to avoid the misuse of the exemptions would be through the relevant regulatory authority as may be provided under the Housing Act

including periodic reporting obligations and setting out minimum qualifications for eligible schemes.

- 2.4 **Shared Ownership Schemes (Part buy, part rent)** – The government may also consider the introduction of a regulatory framework governing shared ownership scheme similar to the one provided in the UK. While this may arguably be achieved through the use of a tenancy in common and relevant contractual terms, market confidence to allow the participation of banks and other financial sector players may only be achieved where there is a regulatory framework in place.

3. Key Contractual Terms And Contracts In Tenant Purchase Schemes

The primary contract in a tenant purchase scheme is the tenant purchase agreement which defines the relationship between the tenant purchaser and the seller. The section below summarises key terms for consideration in the drafting of a tenant purchase agreement and focusses on an interest only TPS model:

| | |
|--------------------------------|--|
| 3.1 Price | The price payable for the purchase of the property which for the interest only tenant purchase model is typically the mortgage price plus interest or in an option model. |
| 3.2 Payment Terms | Details of the initial deposit amount, number and amount of installments. |
| 3.3 Title | Express provisions that title to the property only passes to the tenant purchaser on full payment of the purchase price, and nature of title i.e. leasehold or freehold. |
| 3.4 Interest Rate | The interest rate and where the rate is variable, the procedure including notice periods. |
| 3.5 Default Interest Rate | Where default interest is applicable the rate of default interest chargeable. Considerations should be given to the in-duplum rule given the lack of clear jurisprudence from Kenyan courts on its applicability (See <i>Mugure & 2 others v Higher Education Loans Board</i> (Petition E002 of 2021) [2022] KEHC 11951 (KLR)) |
| 3.6 Prepayments | Procedures for prepayment of the amounts due under the tenant purchase agreement including minimum notice periods, minimum amounts and any pre-payment charges. |
| 3.7 Tenant Covenants Purchaser | During the Tenancy Period, the Tenant Purchaser may be subject to covenants which are customary for tenancy agreements such as: <ul style="list-style-type: none"> a) Payment of monthly installments, service charge and other outgoings on the property; and b) Keeping the property in a good state of repair and condition and allowing access to seller’s agents for repairs. |

3.8 Tenant Purchaser Restrictions The Tenant Purchaser may be subject to restrictions customary for tenancy agreements such as:

- a) Restriction on assignment, sub-letting, selling or charging; and
- b) Restrictions on the use of the property and from making any alterations.

3.9 Tenant Purchase Institution Covenants The Vendor may also be subject to covenants which are customary for tenancy agreements during the Tenancy Period such as:

- a) Permitting the Tenant Purchaser peaceful and quiet possession subject to the Tenant Purchaser paying the instalments and service charge in accordance with the TPS agreement;
- b) Not to use adjoining land or premises in a way which would render leased premises unfit;
- c) Paying all rates, taxes and similar outgoings;
- d) Repairing roofs, main walls, main drains, main electric wiring and structures, and shall be responsible for all necessary renewals to the premises; and
- e) Where the premises are destroyed by fire, civil common, or accident, through no negligence on the part of the lessee, any liability to pay rent shall be suspended until the premises are again made fit and habitable.

3.10 Repair And Maintenance Provisions on where the responsibility to repair and maintain the property falls; for example in sectional units, it is typical that the obligation to keep the interior of the premises in good repair is the tenant purchaser's while obligations relating to the external roofs and wall, are the tenant purchase provider's.

3.11 Insurance Provisions on the mandatory insurance policies e.g. fire and life insurance.

3.12 Tenant Relief Where Premises Destroyed By Fire, Floods, etc. Provisions on possible tenant reliefs where the premises are destroyed including suspension of monthly installments and rescission where the premises remain unfit for habitation past certain timelines.

3.13 Outgoings Provisions identifying the party responsible for outgoings. It is standard practice that payment for utilities such as water, internet and electricity to be done by the tenant purchaser. Rates and Rents will be payable as agreed by the parties.

3.14 Transfer

Transfer provisions of the title on full payment of the purchase price i.e. timelines for provision of documents necessary to transfer title to the tenant purchaser and a description of key documents e.g. in the case of property being purchased under the SPA:

- a) Certificate of title/lease issued under the SPA;
- b) registered Sectional Plan;
- c) the Corporation's Registration Certificate;
- d) the Corporation's by-laws;
- e) Management or Recreational Agreement, where applicable; and
- f) Other customary documents such as government approvals.

3.15 Vendor Inspection Rights

Provisions on Vendor's rights, upon reasonable notice, to enter and inspect the condition and repair of the premises or for making good any defects.

3.16 Vendor's Remedies On Tenant Purchaser Default

In the event the Tenant Purchaser defaults on payment of the instalments, the Vendor may be entitled to rescind the agreement and among other rights and remedies, to:

- a) Pursue the outstanding amounts as a debt;
- b) Re-enter the premises; or
- c) Resell the premises.

The sellers maybe entitled to damages, rent and mesne profits where the Tenant Purchaser remains in possession of the premises after expiry of the rescission notice.

3.17 Seller's Right To Re-Enter Premises

The seller's right to regain possession of the premises upon notice either by resuming possession of the land peaceably or obtaining a court order.

3.18 Seller's Right To Re-Sell On Rescission

The seller's rights to sell the property on rescission either by private treaty or public auction, amounts refundable to the tenant purchaser and the adequacy of title to the subsequent purchaser

3.19 Costs

The costs to be borne by the Tenant Purchaser which customarily include stamp duty on the transfer or lease, service charge, cost of installation of water and electricity and Vendor's legal fees.

3.20 Option To Buy

Only applicable in a rent to buy model, where the tenant purchaser's option to buy only crystallizes on achievement of certain milestones including time:

- a) When and how the option may be exercised; and
- b) The manner of determining the amounts payable to exercise the option to buy.

Table 2: Key Contractual Terms

B. KENYA'S LEGAL AND REGULATORY ENVIRONMENT IN RESPECT OF REAL ESTATE INVESTMENT TRUSTS (REITS)

The defines REITs as an arrangement in respect of real estate or interest in real estate (the **REIT Assets**), structured in accordance with the rules prescribed by the CMA to enable a person participate in or receive profits or income arising from the acquisition, holding, management or disposal of the REIT Assets.¹

The rules governing the formation, registration and operation of REITs are the REITs Regulations.² The REITs Regulations contemplate the existence of REITs exempt from CMA approval and registration requirements provided they meet certain criteria. This exemption takes into account the fact that the wide definition of REITs, while intentional to protect public interest, may bring into the regulatory ambit entities that:

- i. are meant for purely private purposes like charitable trusts, family offices and estates of deceased persons holding, managing or disposing property; or
- ii. pooled funds regulated under different regulatory provisions that may hold property such as retirement benefit schemes, statutory funds and other collective investment schemes; and
- iii. qualify as REITs but are expressly exempted from the REIT Regulations by the CMA or by virtue of the offering qualifying for the private offer exemption as provided under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2023³.

Exempt REITs are not eligible for tax benefits available to REITs approved and registered by the CMA.

In addition to the REITs Regulations, listed REITs are also subject to the following regulations which are applicable to public issuers of securities:

- i. the Capital Markets (Take-Overs and Mergers) Regulations, 2002 in the event of mergers and takeovers;
- ii. the continuing obligations under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2023. And

The Capital Markets (Licensing Requirements General) Regulations 2002 and the Capital Markets (Corporate Governance Market Intermediaries) Regulations 2011 apply to REIT managers.

1. Key Stakeholders And Roles

1.1 The Promoter

The Promoter sets up a REIT and is usually the party responsible for identifying the initial real estate assets and setting up the team of professionals to be involved in the structuring of the REIT.

¹ Section 2 of the Capital Markets Act
<http://kenyalaw.org:8181/exist/rest//db/kenyalex/Kenya/Legislation/English/Acts%20and%20Regulations/C/Capital%20Markets%20Act%20-%20No.%2017%20of%201989/docs/CapitalMarketsAct17of1989.pdf>

² <https://www.cma.or.ke/download/34/regulations/4296/capital-markets-real-estate-investment-trusts-collective-investment-schemes-regulations-2013.pdf>

³ Section 17 of the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2023 provides criteria for qualification as a private offer

The promoter is regarded as the initial issuer of REIT securities and can therefore be held liable for a defective prospectus.⁴

1.2 REIT Manager

The REIT Manager manages the day-to-day operations of the REIT on behalf of investors. A REIT manager is required to have a minimum paid-up share capital of not less than KES 10,000,000. They are required to maintain a liquid capital of KES 5,000,000 or 8% of their total liabilities, whichever is higher. The REIT Manager's directors, chief executive officer or managers must be fit and proper, in the manner prescribed by the Act.

A REIT may be authorized by CMA to be self-managed by a company wholly owned and controlled by the trustee. In this case the REIT manager will not be a separate entity. This model is likely to be adopted by an approved REIT trustee that elects to set up a REIT. A bank that is a REIT trustee may for example adopt this for distressed properties where it exercises its power to buy properties as a secured lender.

The REIT Manager is considered the issuer for any subsequent issue of REIT securities and therefore liability for a defective or misleading prospectus of offering memorandum, attaches to them.

1.3 Trustee

The Trustee acts on behalf of the investors in the REIT, by assessing the feasibility of the investment proposal put forward by the REIT manager and ensuring that the assets of the scheme are invested in accordance with the trust deed. The trustee appoints the REIT manager and acquires properties on behalf of the REIT investors, oversees dividend distribution, among other oversight roles. The trustee must be licensed by CMA and have a minimum paid-up share capital of not less than KES 100,000,000.

An additional trustee called the secondary disposition trustee may be appointed by CMA at the request of the trustee, or by the trust deed or by the trustee as a joint trustee. This is for compliance with the Trustees Act where a sole trustee, except a trust corporation, does not have capacity to issue a valid receipt for the proceeds of sale or other capital money arising under a disposition on trust for the sale of land. CMA in this case may appoint the REIT manager as the secondary disposition trustee for the limited purpose of issuing a valid receipt. The possibility of this arising is however limited since REIT Trustees in Kenya must be corporate entities and the prescribed minimum share capital of REIT Managers is currently significantly above that required for an entity to be classified as a trust corporation.⁵

1.4 Valuer

The Trustee and REIT manager are required to appoint a valuer to value the real estate assets before applying for registration of the REIT and thereafter to value them on an annual basis or shorter period as is necessary for preparation of trustee and REIT manager reports. An appointed valuer can only serve for a maximum term of 3 years except where otherwise approved by the CMA.

1.5 Structural Engineer

The structural engineer independently assesses the state of repair of the property and ancillaries, ensuring adequate disclosures are made in a prospectus or offering memorandum and

⁴ A defective prospectus is defined in the Act as a false, misleading or deceptive prospectus

⁵ The minimum paid up share capital is currently KES 500,000/=

considered during valuation. The structural engineer must be appointed before the application for registration of the REIT is made.

1.6 Project Manager Certifier and Property Manager

The Project Manager certifier oversees the planning and delivery of the construction projects in D-REITs or in an I-REIT where construction or development activity form part of the authorized activities of the REIT. The property manager manages the asset acquired by the REIT.

2. Ownership Of Real Estate By REITS

REITs may invest in a variety of real estate assets where the land tenure is either leasehold or freehold. Real estate assets held on a leasehold tenure must have an unexpired residual term of at least 25 years.

REITs may invest in real estate assets either directly or hold investments in companies or trusts specifically established for purposes of the REIT. REITs may invest through investee companies which are corporate entities and may be private companies limited by shares or limited liability partnerships established under the Limited Liability Partnership Act, 2023 or investee trusts which must be unincorporated trusts. The investee company or investee trustee must fulfill the following conditions:

- 2.1 It must be recorded as the **sole owner** in the title document of the real estate asset;
- 2.2 The trustee must have the **absolute authority** to appoint and remove directors of the investee company. For investee trusts the trustee must be the REIT Trustee;
- 2.3 The REIT manager must be **appointed as the manager** of its investments;
- 2.4 The trustee, company and shareholders must have entered into a **shareholder's agreement**; and
- 2.5 Its constitutive documents shall be subject to the **REITs Regulations**.

REITs are also prohibited from partially owning property except where the property is indirectly held through the purchase of shares in a property company or REIT securities permitted under the REITs Regulations.

3. Types Of REITS

The REITs Regulations provide for two main types of REITs as follows:

3.1 Development Real Estate Investment Trusts (D-REITs)

A D-REIT is a type of REIT in which investors pool their capital to acquire real estate to undertake development and construction projects and associated activities.

3.2 Income Real Estate Investment Trust (I-REITs)

An I-REIT is a type of REIT in which investors pool their capital to acquire long term income-generating real estate including housing, commercial, and other real estate.

3.3 Islamic REITs

An I-REIT or D-REIT may be structured as an Islamic REIT if it complies with Shariah principles. A REIT manager is required to perform a compliance test before making an investment in this type of REIT to ensure it is Shariah compliant.

We summarize below the main differences between a D-REIT and an I-REIT:

| Description | D-REIT | I-REIT |
|---|--|--|
| a. Borrowing Limits | Maximum of 60% of the TAV. May be increased to 75% with the consent of the REIT securities holders, if borrowing is for a maximum term of 6 months. | Maximum of 35% of the TAV. May be increased to 40% with consent of the REIT securities holders, if borrowing is for a maximum term of 6 months. |
| b. Distribution Requirements | Distribution of income and realized capital gains is subject to the scheme documents and the REIT manager's recommendation. | Subject to the REIT manager's recommendation, scheme documents and the REITs Regulations, the realized capital gains and 80% of net after tax income within four months after the end of each financial year. |
| c. Listing | Optional. If listed, trading is limited to minimum parcel sizes of KES 100,000. | Unrestricted offers must be listed. Optional for Restricted offers. If listed, can only be listed on the Restricted Investment Market Segment of the NSE where trading is limited to minimum parcel sizes of KES 5 million. |
| d. Minimum Free Float Requirement (securities issued, offered or held by persons who are not connected with or associated with the promoter or the REIT manager). | 25% except where securities are issued to the Promoter, REIT manager or parties connected with them to fund unscheduled cost overruns on a development. Securities so issued do not have voting rights but can have the right to participate in distributions. | 25% except where securities are issued to the Promoter, REIT manager or parties connected with them to fund unscheduled cost overruns on a development. Securities so issued do not have voting rights but can have the right to participate in distributions. |
| e. Minimum Investment Prescribed Investment Category | In 30% of the TAV to be invested in development and construction projects or income-producing real estate constructed by the D-REIT, within a year of authorization. | At least 75% of the TAV in income-producing real estate within two years of the date of its authorization as a REIT scheme. |
| f. Minimum Number Of Investors⁶ | 7 | 7 or a greater number if required by the NSE |

⁶ While the Regulations provide for a minimum of 7 Investors, the CMA to spur the market allowed the listing of the LapTrust Imara I-REIT with only one investor

| Description | D-REIT | I-REIT |
|--|---|---|
| g. Minimum Subscription | KES 5 million except for listed REITs where the minimum subscription is KES 100,000. ⁷ | N/A except where restricted (KES 5 million) |
| h. Minimum Value of Initial Assets | KES 100 million. | KES 300 million |
| i. Offering Documents | Offering memorandum for approval by the CMA. | A prospectus in the case of an unrestricted offer and an offering memorandum where the offer is restricted. These must be approved by CMA. |
| j. Principal Investment Category | Development and construction projects | Income-generating real estate including housing, commercial and other real estate. |
| k. Promoter's Skin In The Game | Except where the trust documents provide a higher level: <ul style="list-style-type: none"> i. Year 1 and 2: 10% of the NAV; ii. Year 3: 0% of NAV. | Except where the trust documents provide a higher level: <ul style="list-style-type: none"> i. Year 1: 20% of NAV; ii. Year 2: 10% of NAV; iii. Beyond Year 3: 0% of NAV |
| l. Transfer of Real Estate Asset to REITs | Within 180 days from the initial offer | Within 180 days from the initial offer |
| m. Type of Fund | D-REIT may be structured as either open ended or close ended fund. | I-REIT may be structured as either open ended or close ended fund except unrestricted I-REITs which must be close-ended funds. |
| n. Types of Offers | Restricted to only Professional investors, being investors who can make a minimum investment of KES 5 Million. If listed, the minimum investment is KES 100,000. | May be Restricted or Unrestricted. |

Table 3: Differences Between D-REIT and I-REIT

⁷ Change introduced through an amendment to the REITs Regulations via the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) (Amendment) Regulations, 2023-
<https://www.cma.or.ke/download/34/regulations/4965/the-capital-markets-real-estate-investment-trust-collective-investment-schemes-amendment-regulations-2023.pdf>

4. Continuous Obligations

4.1 Reporting Obligations

REITs are required to submit periodic reports to CMA and in the case of listed REITs, to publish the reports in at least two daily newspapers of national circulation. These reports include financial statements with a compliance report, annual reports, and quarterly reports. The content and form of these reports are specified in the REITs Regulations.

4.2 Meetings

REITs must hold an annual general meeting every year to update unit holders on the REIT's financial performance, property portfolio, and other significant developments. This meeting provides investors with an opportunity to ask questions and make informed decisions.

4.3 Material Disclosures

REITs must promptly disclose any material information or events that could affect the value of their units or the rights of unit holders. This includes information on property acquisitions, disposals, and significant changes in financial performance.

4.4 Adherence to Investment Guidelines

REITs are expected to comply with the investment guidelines outlined in their offering documents and approved by the CMA such as the types of properties they can invest in, leverage limits, and other investment-related parameters.

4.5 Appointment of Trustees and Fund Managers

REITs must appoint qualified trustees and fund managers who are responsible for ensuring compliance with regulations and acting in the best interests of unit holders.

4.6 Risk Management

REITs must have robust risk management policies and procedures in place to identify, assess, and mitigate risks associated with their operations.

4.7 Connected Parties and Conflict of Interest

REITs are required to have policies and procedures in place to manage conflict of interest among the trustees, REIT Manager, and other key service providers.

Transactions by the trustee, the REIT manager or any party appointed by the trustee or REIT manager on behalf of the trust are required to be carried out at arm's length, consistent with the stated objectives and strategy of the scheme and in the best interests of the unit holders. They must also be disclosed to the unit holders.

Connected party transactions must be conducted on similar or more favourable terms than standard commercial terms and are subject to the approval of the trustee and where applicable, by the unit holders. Connected persons are defined in the REITs Regulations to include the REIT manager, valuer, trustee or their directors and officers, substantial holder of REIT securities or their associates and a controlling entity or holding company.

4.8 Compliance with Tax Obligations

REITs are subject to tax regulations in Kenya, including tax on income and capital gains. Compliance with these tax obligations is essential. The tax obligations of REITs are discussed further in paragraph 7.4.

5. Fees

5.1 Registration and Listing Fees

Except where exempt, REITs must be authorised by the CMA. The application fee is currently KES 2,500. If a REIT is listed on the NSE, an annual listing fee associated with maintaining that listing will be charged at 0.06% of the market capitalization of the listed securities subject to a minimum of KES 200,000 and a maximum of KES 1,500,000 on the main investment market segment and a minimum of KES 100,000 and a maximum of KES 1,000,000 on the alternative investment market segment. For listed REITs, other fees payable includes Registrar fees and Central Depository fees.⁸

Other costs incurred during the formation of REITs include Transaction Advisory (all REITs proposed to be listed must appoint a Transaction Advisor), legal fees and valuation fees. Below is a summary of the costs incurred by the existing REITs in Kenya on formation.


| REIT Market Highlights <small>(As at August 2023)</small> | |  | | |
|--|---|---|--|--|
| | ILAM Fahari I-REIT | Acorn D-REIT | Acorn I-REIT | Laptrust Imara I-REIT |
| Listing date | Nov-15 | | Feb-21 | Nov-22 |
| Listing Platform | Main Board, MIMS | | NSE USP | Restricted Sub Segment, MIMS |
| REIT Structure | Unrestricted, Open-Ended | | Restricted, Close-Ended | Restricted, Close-Ended |
| Pricing Mechanism | Price determined by Market | | Price based on NAV | Price based on NAV |
| Asset Portfolio Type | Diversified | | Specialized | Diversified |
| Asset Type | Commercial (Retail, Office, Semi office and light industrial) | | Purpose Built Student Accommodation (PBSA) | Commercial, Office, Residential, Educational |
| Value of Assets (Ksh. Bn) | 3.5 | 10.4 | 6.8 | 6.9 |
| Occupancy rate | 72% | N/A | 91% | 79% |
| NAV Price per unit | 18.92 | 25.31 | 21.65 | 20 |
| Trading Price | 6.60 | 25.31 | 21.65 | N/A |
| (Discount)/premium to NAV | (66%) | N/A | N/A | N/A |
| Last dividend (Dec.22) | 0.78 | | 0.73 | N/A |
| Dividend yield | 11.93% | | 8.2% | N/A |
| Years of operation(R.M) | 35+ years | | 20+ years | 9+ years |

Figure 1: Presented By The NSE At A REITs Workshop On 31st August 2023

5.2 Annual Regulatory Fees

REITs are required to pay an authorization fee on approval and thereafter, annual regulatory fees to the CMA for oversight and regulation both charged at 0.15% of the value of offer of REIT securities, subject to a maximum of KES 10,000,000.

5.3 Legal and Professional Fees

REITs often incur legal and professional fees related to conveyancing, general advisory as well as preparation and filing of regulatory documents, such as annual reports and financial statements. The fees incurred depend on the value and complexity of the transaction and the provisions of the Advocates Remuneration Order.⁹

REITs are also required to have their financial statements audited annually by independent auditors have their property portfolios independently valued regularly, and there are fees associated with these valuations, usually from 1% of the value of the property.¹⁰

⁸ <https://www.cdskenya.com/investor-education/fees>

⁹ <https://eregulations.invest.go.ke/media/Advocates%20Remuneration%20Order.2014.pdf>

¹⁰ http://kenyalaw.org/kl/fileadmin/pdfdownloads/LegalNotices/2011/LN92_2011.pdf

5.4 Trustees' Fees

In addition to trustee fees, trustees may also be reimbursed by the fund for reasonable costs and expenses incurred while fulfilling their duties as trustees. These responsibilities include safeguarding the fund's assets and protecting the interests of REIT securities holders, while overseeing trust operations and ensuring regulatory compliance. Trustee Fees typically range from 0.1% to 2% of the NAV. Performance fees may be applicable in certain cases.

5.5 Management Fees

The fee structure applicable to REITs vary and may include elements like a performance fee upon the REIT surpassing certain hurdles. REIT management fees are typically charged as a percentage of the NAV. Current REIT management fees are in the range of 1.5% to 2% of the NAV per annum with certain REITs providing for a minimum base fee payable in any given year.

6. Corporate Actions

6.1 Conversions

A REIT manager of a D-REIT may through a conversion prospectus or offering memorandum, circulated to existing REIT securities holders, apply to CMA for conversion of the D-REIT to an I-REIT. Similarly, the REITs Regulations provide for conversion from open ended to close ended and vice versa.

Open ended REITs, operate like a typical money market fund where an investor may offer their units for redemption from time to time, subject to the terms of the Scheme. For this reason, open ended funds are required to calculate and publish their NAV periodically, typically aligned to the periods where investors are eligible to redeem units or acquire units. There are currently no open-ended REITs in Kenya but in jurisdictions where they exist, unlike a money market fund due to illiquid nature of the underlying real estate assets, redemption is typically restricted to certain times for instance quarterly with extended notice periods ranging from fourteen to ninety days. The REIT manager with the trustee approval may also have the right to suspend the right of redemption on the occurrence of certain adverse circumstances typically set out in the trust deed. A possible way to further provide investor liquidity would be to allow for secondary trading on an OTC for open ended funds, so a hybrid REIT that allows for investor exit through both redemption and sale on the secondary market.

Close ended REITs on the other hand have a fixed number of securities and an investor looking to acquire their units may only do so through buying units on a secondary market such as the NSE or an OTC market, except where the REIT Manager makes a subsequent offer of units, via a Rights Issue. Rights issues by listed REITs are subject to the CMA approval process and fees. While close ended funds are not required to publish the NAV, to deal with market challenges in REIT pricing, existing REITs have elected to use the NAV pricing method for trading on OTC platforms such as the NSE USP, until the REITs achieve maturity as demonstrated by a consistent dividend yield.

A restricted I-REIT may also be converted to an unrestricted I-REIT and vice versa. An example is the proposed conversion of ILAM Fahari I-REIT from an unrestricted I-REIT to a restricted I-REIT¹¹. Conversions must be approved by the trustee and by a special resolution passed at a meeting of REIT securities holders at least 6 months prior to the intended conversion.

6.2 Redemption of REIT securities

6.1.1. Right to Redemption of REIT Securities

¹¹ http://ilamfahariireit.com/assets/files/ilam_fahari_i-reit_conversion_offering_memorandum_final.pdf

The Trust Deed may have a provision giving rights to the REIT Manager to initiate an early redemption of REIT securities, subject to notice periods. This option is similar to the share buy-back option available to companies incorporated under the Companies Act, 2015. A redemption, for listed REITs, may therefore be carried out for the same reasons a company would undertake a share buy-back, for instance, preservation of shareholder value during a challenging economic period or where the REIT Manager considers the REIT Securities are undervalued. The Units redeemed may be cancelled or held as unissued shares and holders are allowed to require the trustee to redeem them in accordance with the scheme documents. Given the illiquid nature of real estate, the right of redemption would often be restricted to certain times of the year and subject to notice requirements.

7. Recommendations To Improve REIT Regulations To Support Affordable Housing Via TPS Schemes

7.1 TPS and Mortgage REITs

The REITs Regulations limit the offering of tenant purchase schemes to D-REITs in respect of property constructed or developed by them.¹² This limits the use of REITs as financing vehicles for the purposes of Tenant Purchase Schemes considering most promoters would be existing market intermediaries not keen on taking up development risk.

We propose an amendment of the REITs Regulations to provide for hybrid REITs or Mortgage/TPS REITs to allow promoters with financing expertise but who may not be necessarily keen on taking on any development risk to establish these REITs. This may be done through the amendment of the REITs Regulations to expand the definition of eligible real estate to include income from financing the purchase of residential real estate units through interests secured by a mortgage or a progressive purchase mechanism. A special class of REITs that would therefore be allowed to hold interests secured by mortgage or a progressive purchase mechanism, which is currently restricted to units developed by the REIT itself. It is indeed worthwhile to note that the definition of REITs under the Act already contemplates an interest in real estate of any description as an eligible investment for a REIT.

We understand that during the formulation of the REIT regulations, one of the factors taken into account in restricting the types of REITs to D-REITs and I-REITs was the credit risk inherent in Mortgage REITs. Given the limited uptake of mortgages in Kenya, the opportunity we see, also taking into consideration the Government's Affordable Housing Agenda that is similarly banking on Tenant Purchase Schemes, is in TPS REITs. The Kenya Mortgage Refinance Scheme can also play a key role in mitigating these risks as set out in Paragraph 7.2 below. A test using a restricted TPS REIT is worthwhile. Other financial structuring mechanisms such as the use of a Guarantor or partial guarantee to provide investor protection or tranching of REIT securities may also be considered.

7.2 Refinancing of TPS Programmes

TPS programmes can be utilised as tools through which TPS buyers can develop their credit histories to either qualify for a mortgage or compared to traditional mortgages can allow institutions take more risk since legal ownership of the premises remains with the TPS institution until payment in full.

¹² See clause 10(a)(i) of the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations, 2013

Among the strategic objectives of the Kenya Mortgage Refinance Company (KMRC) is to refinance eligible mortgage loans.

In line with the amendments proposed at Paragraph 7.1, we propose that by notice in the Kenya Gazette TPS financiers are included by the Central Bank of Kenya (CBK) within the scope of qualified financial institutions for eligibility of refinancing under the Central Bank of Kenya (Mortgage Refinance Companies) Regulations, 2019. Access to refinancing will provide the much needed capital for financing a TPS at the favourable lending rates. It will also assist KMRC achieve its objective of improving lending practices and support housing.

7.3 Form of REITs

In Kenya, REITs must be structured as trusts to receive CMA approval, unlike in other jurisdictions such as the UK where limited liability companies and partnerships may qualify as REITs if they meet set minimum conditions. The USA, Japan and Greece also allow for REITs to be set up as either investment corporations or trusts offering some flexibility to the structure.¹³ The rationale for the trust structure in Kenya was the flexibility the constitutive documents afford the REIT unlike the restrictive constitutive document of a limited liability company. However, following the enactment of the Companies Act 2015, Insolvency Act 2015 and the Business Laws Amendment Act, 2020, companies are now more flexible entities by introduction of various changes for example the introduction of share buyback provisions.

Companies and partnerships are more familiar structures in the Kenyan market. Additionally, the use of companies allows investment grade real estate owners to retain control while selling down their interest through a REIT without the costly inefficient process of applying for a REIT Manager licence. Using corporate entities would allow a similar structure where a board of directors would provide oversight in place of a corporate trustee and dispense with the need of having investee companies to hold the assets. This is likely to increase uptake and promote success of REITs as well as address the challenges facing transfer of property to REITs by promoters following the lapse of the stamp duty exemption for transfer of properties to REITs under the Stamp Duty Act¹⁴ as well as the impact of the increased rate in Capital Gains Tax (CGT) to 15%¹⁵ since existing real estate owners may elect to transfer their properties to company SPVs enjoying stamp duty exemptions.

7.4 Tax

The Income Tax (Real Estate Investment Trusts) Rules, 2020 are still in draft form, therefore REITs cannot benefit from the tax exemptions proposed in the regulations.

Whereas CGT is exempt on sale proceeds from the sale of listed REITs securities and when a REIT sells REIT Assets, CGT is applicable on gains made by the promoter or investor through transfer of property to a REIT. It will therefore be beneficial, in the absence of a total exemption, if an indexation allowance is factored to cater for inflation adjustments when calculating CGT now charged at 15% of the net gain, where given Government financing measures, a reduction in the CGT rate or a blanket exemption is not viable.

In respect of stamp duty, the Stamp Duty Act exempted from stamp duty transfer of property between trustees or between persons in a REIT for a limited period from 1st October 2015 to 31st December 2022. The purpose of the time limit we infer was in anticipation that the Kenyan REITs market would be mature at this time. Unfortunately, this has not been the case. It may therefore

¹³ <https://www.ccllex.com/publications/a-comparison-of-the-legal-structures-of-reits>

¹⁴ Section 96A, Stamp Duty Act, CAP 480 Laws of Kenya

¹⁵ Section 34(1) j, Income Tax Act, CAP 470 Laws of Kenya. See also section 15, Finance Act, 2022

be worthwhile to consider an extension of this timeline to allow it to serve the purpose for which it was passed.

7.5 Time to Listing

To ensure liquidity for retail investors, I-REITs are required to be listed on the NSE. However, listing has been shown to erode the value of REITs particularly in their early stages where income is not yet stable. The proposed delisting of ILAM Fahari I-REIT¹⁶ and the decision by the Laptrust Imara I-REIT to suspend trading until March 2026¹⁷ shows that REITs can enjoy the advantages of listing but may benefit more by operating outside the exchange for at least 3 years. A 3-year timeline allows the REIT to enjoy the tax benefits that come with listing and allows pricing to be determined by the fair market valuation of REIT assets rather than market sentiment. This also gives the REIT time to build a strong track record before listing.

The Unquoted Securities Platform (USP) where Acorn I-REIT and D-REIT are traded also offers a more transparent over-the-counter marketplace for unlisted REITs while preserving the value of REITs.

¹⁶ <https://www.businessdailyafrica.com/bd/markets/capital-markets/icea-lion-fahari-reit-delisting-set-for-february-12-4515602>

¹⁷ <https://www.businessdailyafrica.com/bd/markets/laptrust-imara-i-reit-price-locked-at-net-asset-value--4341278>

C. STRUCTURING AND OPERATING A REAL ESTATE INVESTMENT TRUST IN KENYA

1. Steps In Structuring Real Estate Investment Trusts

The steps taken when structuring a REIT for affordable housing in Kenya are as follows:

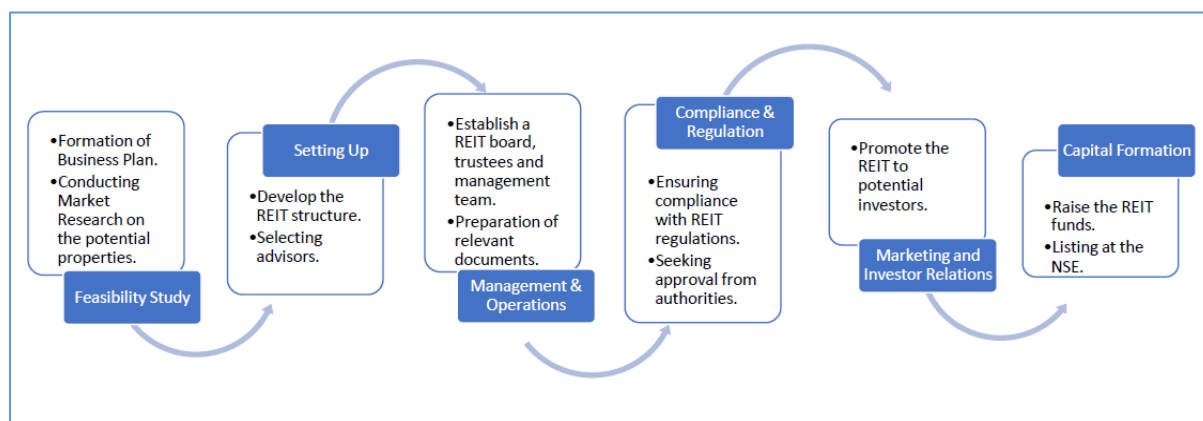


Figure 2: Steps For Structuring A REIT

2. Structuring A REIT For Affordable Housing In Kenya

Structuring a Real Estate Investment Trust (REIT) for affordable housing involves a combination of legal, financial, and strategic steps to ensure compliance with regulations and to achieve the goals of providing affordable housing to Kenyan citizens through the Tenant Purchase Scheme (TPS).

| Stage | Description | Responsibility | Regulatory Requirement |
|--|---|--------------------------------------|------------------------|
| Business Plan Development | This includes determining the project's mission and goals, establishing investment strategies, and developing financial forecasts. | REIT Sponsors / Transaction Advisors | Yes |
| Property Acquisition | Identify suitable properties that would have quick offtake and perform comprehensive property inspections and financial analysis to assess viability. | REIT Sponsors | Yes |
| Corporate Governance | Create a governance structure and establish a board of directors. | REIT Sponsors | Yes |
| Legal and Regulatory Compliance | Select the REIT structure and engage with legal professionals to ensure compliance with REIT regulator. | REIT Sponsors and Legal Advisors | Yes |
| Financing | Raise funds for the REIT. | REIT Sponsors | Yes |

| | | | |
|---------------------------------|--|------------------------------------|-----|
| Asset Management | Implement the affordable housing programmes. Implement efficient proper property management. Build tenant relations. | Fund Manager / No Property Manager | |
| Compliance and Reporting | Maintain compliance and provide regular financial reports to investors. | Trustee | Yes |
| Risk Management | Identify potential risks and develop mitigation strategies. | Fund Manager | No |
| Exit Strategy | Develop a plan that allows seamless transition of the houses to the tenants. | Trustee | No |

Table 4: Regulatory And Non-Regulatory Steps Of Structuring A REIT With Respect To Affordable Housing Tenant Purchase Schemes

3. Presentation Of REIT Participants

Below is an illustration of the REIT eco-system, the participants and their respective roles:

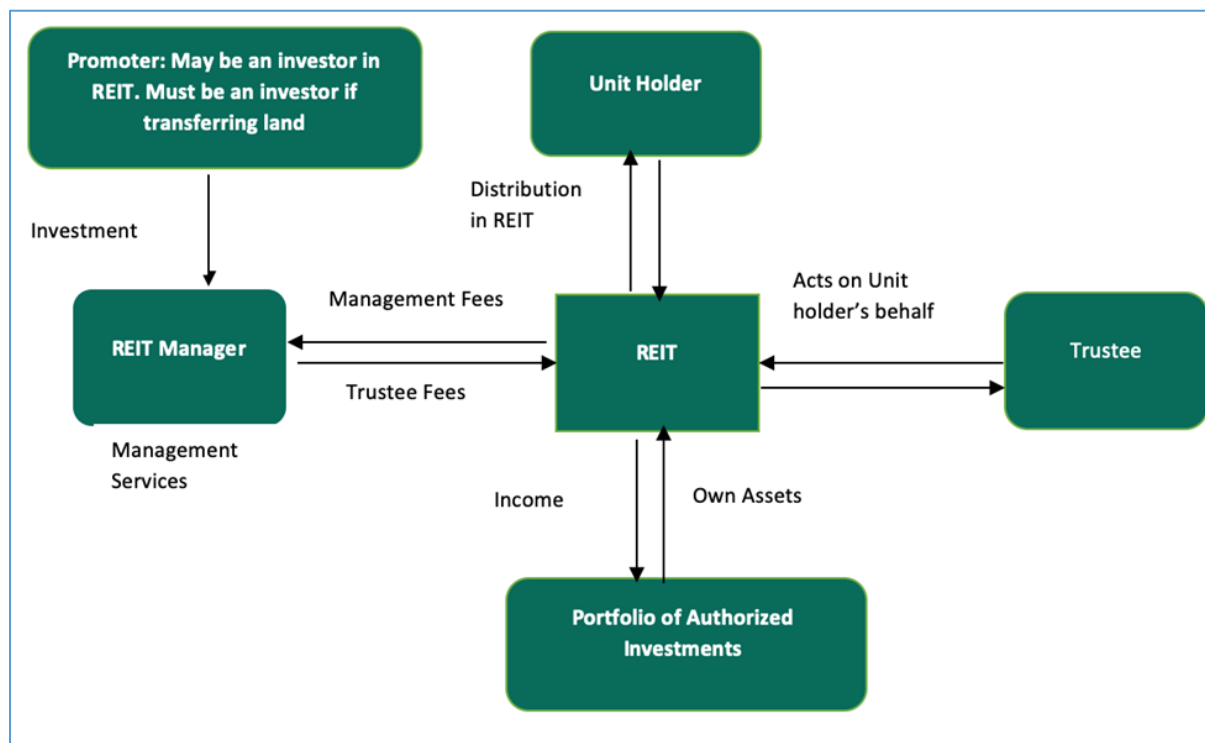


Figure 3: Participants In A REIT

4. Participants In A REIT

The participants in a REIT for affordable housing in Kenya include:

| Name | Description | Role |
|-----------------------------|--|---|
| 4.1 Trust | A trust is a legal entity that holds and manages assets, such as real estate properties, on behalf of its beneficiaries or unit holders (investors). | The trust serves as the vehicle through which real estate assets are owned and income is generated. |
| 4.2 Trustee | A trustee plays a fiduciary role, ensuring that the REIT operates in accordance with its stated objectives and legal requirements. | Responsible for overseeing and managing the trust on behalf of the REIT's shareholders or beneficiaries. |
| 4.3 REIT Sponsors | These are individuals or entities responsible for establishing and organizing a Real Estate Investment Trust (REIT). | The sponsor is crucial in the formation, development, and ongoing operation of a REIT. The sponsor plays a key role in establishing and capitalizing the trust. |
| 4.4 Unit Holders | The unit holders are the investors or individuals who own units of the trust. | Unit holders typically have ownership stake in a REIT and receive dividends. |
| 4.5 Fund Manager | A fund manager in Real Estate Investment Trust (REIT) is a professional or entity responsible for managing and overseeing the trust's investment portfolio. | The fund manager oversees and manages the trust's investment portfolio to ensure the optimal financial performance of the REIT. |
| 4.6 Property Manager | Property managers are individuals or an entity that oversees and manages the day-to-day operations of the real estate assets held within the REIT's portfolio. | Property managers are responsible for maintaining and enhancing the value of the real estate assets within the trust's portfolio. |

Table 5: Participants In A REIT

5. Cost Considerations In Setting Up And Operating The REIT

The table below shows an analysis of the expected costs involved in establishing and running a REIT for affordable housing in Kenya. These costs are for set-up and maintenance of the REIT.

| Cost | Description | Estimated Amount (KES) |
|---------------------------------|--|-------------------------------|
| 5.1 Property Acquisition | These are the costs associated with acquiring the housing properties and expenses related to property inspections and assessments to | 895,188,000 |

| | | |
|--------------------------------------|---|--------------------------|
| | ensure suitability. | |
| 5.2 Project and Maintenance | These are the costs associated with maintaining the properties' livability and general operational expenses. | 756,284,272 |
| 5.3 Operational Costs | This involves hiring a property management company to handle the day-to-day operations. | 4,600,000 |
| 5.4 Compliance and Regulatory | Affordable housing projects often come with specific regulatory requirements, which may lead to compliance costs related to advisors such as legal and transaction advisors. | 23,000,000 |
| 5.5 Life and Fire Insurance | These insurance policies cover the property in the event of loss or damages due to fire and to protect the REIT holders in the event of the death of a Tenant since it is a Tenant Purchase Scheme (TPS) Model. | 19,204,333 |
| 5.6 Tax Costs | REITs must pay property taxes on their real estate holdings, e.g., stamp duty. However, this is borne by the REIT holder. | 4% of the property value |

Table 6: Cost Considerations In Setting Up And Operating The REIT

6. REIT Set-Up Costs

The Affordable Housing Tenant Purchase Scheme (TPS) project tenure is 25 years.

The costs related to the Affordable Housing REIT include:

6.1 Set - up Costs

| Description | Amount (KES) |
|---------------------------|--------------------|
| Payment to contractor | 895,188,000 |
| Transaction Fees | 23,000,000 |
| Stamp Duty | 36,800,000 |
| Total Set-up Costs | 954,988,000 |

Table 7: REIT Set-up Costs

6.2 Maintenance Cost per annum

| Description | Amount (KES) |
|------------------------|--------------|
| Project Expenses | 28,320,000 |
| Insurance Premium Paid | 719,130 |

| | |
|--------------------------------|-------------------|
| Management Fees | 184,000 |
| Total maintenance Costs | 29,223,130 |

Table 8: Maintenance Cost Per Annum

7. Strategies To Minimize Expenses

Establishing and operating an affordable housing REIT is a complex endeavour, but with careful planning, partnerships, and a focus on efficiency, it is possible to minimize costs while still achieving the mission of providing safe and affordable housing to underserved communities.

- 7.1 Efficient Property Management:** Implementation of efficient property management practices to minimize maintenance and operational costs while ensuring properties remain safe and well-maintained.
- 7.2 Energy Efficiency and Sustainability:** Consider investing in energy-efficient upgrades and sustainable technologies to reduce utility costs such as solar and enhance the sustainability of the affordable housing properties.
- 7.3 Economies of Scale:** Acquisition of a larger portfolio of affordable housing properties to benefit from economies of scale, spreading costs across a broader base.
- 7.4 Community Partnerships:** Collaborate with local organizations and government agencies, to access subsidies, or tax incentives that can offset costs.
- 7.5 Government Programmes:** Exploring government programmes and incentives designed to support affordable housing development.
- 7.6 Asset Preservation:** Focusing on long-term asset preservation to reduce the need for costly renovations and replacements in the short term.
- 7.7 Tax Efficiency:** Working with tax experts to optimize the REIT's tax structure and identify all available tax benefits and deductions.
- 7.8 Regulatory Compliance Expertise:** Engage experts who specialize in affordable housing regulations to ensure compliance and minimize legal and regulatory costs.

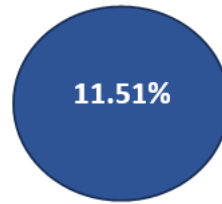
8. Projected Returns For Investors In The TPS REIT

The Projected Returns to Investors after investing in the Affordable Housing REIT include:

- 8.1 Dividend Income:** REITs are required by law to distribute at least 90% of their taxable income to shareholders in the form of dividends. This therefore makes REITs a consistent source of income for investors, especially those seeking regular cash flow.
- 8.2 Diversification:** Investing in REITs provides diversification within the real estate sector. REITs often specialize in different types of properties, in this case Affordable housing through the Tenant Purchase Scheme, allowing an investor to spread risk across various segments of the real estate market.
- 8.3 Liquidity:** REITs are publicly traded on stock exchanges; this means that they are generally more liquid than direct real estate investments. One can buy and sell REIT shares easily, unlike physical properties, which may take longer to liquidate.

8.4 Capital Appreciation: While it is not their primary focus, some REITs may appreciate in value over time, providing capital gains for investors. This can result from factors like property value appreciation, rent increases, or operational improvements.

FSD AHS REIT Project Return Rate



Projected Net Cash flows



Tenure



Figure 4: Projected REIT Returns

D. RISKS FOR INVESTORS IN THE AFFORDABLE HOUSING REIT

1. Risk Summary

Like any investment, there are risk associated with REITS. Prior to investing in REITS, it is essential to conduct thorough research, understand the specific REIT's strategy, and consider financial goals and risk tolerance.

| Risk | Description | Mitigation Strategy |
|-------------------------------------|---|---|
| 1.1 Property Market Risk | Changes in the real estate market, such as oversupply or declining property values, can affect the performance of REITs. | Conduct thorough research on the specific properties and locations that the REIT invests in. |
| 1.2 Market Risk | Like all stocks, REITs are subject to market fluctuations. Economic downturns or market volatility can lead to declines in the share prices of REITs. | Diversification of the investment portfolio by including other asset classes, such as stocks, bonds, and cash equivalents. This can reduce the overall impact of market volatility on the investment. |
| 1.3 Management Quality | The performance of a REIT is highly dependent on the management team's decisions and expertise. Poor management can lead to underperformance and lower returns for investors. | Review annual reports and earnings calls to evaluate performance regularly. |
| 1.4 Regulatory and Tax Risks | Changes in tax laws and regulations can impact the tax benefits and operating structure of REITs. | Keep abreast of changes in tax laws and regulations that may impact REITs. Consult with a tax advisor or finance professional to understand the implications, if any. |

Table 9: Risks For Investors In The Affordable Housing REIT

E. BENEFITS OF INVESTING IN AN TENANT PURCHASE SCHEME REIT AND THE BUILDING BLOCKS TO THE TENANT PURCHASE SCHEME REIT

1. Benefits

1.1 Steady Income Stream

Affordable housing properties often provide a reliable and stable income stream. The rental income from the Tenants Purchase Scheme (TPS) will be consistent because there is a consistent demand for affordable housing, making it a reliable source of dividends for REIT investors.

1.2 Diversification

Investing in an affordable housing REIT can offer diversification within a real estate portfolio. It can balance out risks associated with other property types like commercial or industrial real estate.

1.3 Social Impact

Lack of decent housing remains pain point in Kenya. Many Kenyans lack housing that is accessible and affordable. Therefore, investing in the Affordable Housing REIT supports the provision of safe and affordable housing contributes to addressing key social issues in the Kenya.

1.4 Tax Benefits

REITs often come with tax advantages. They are required to distribute at least 90% of their taxable income as dividends to shareholders, which can result in favourable tax treatment for investors in the TPS Scheme.

1.5 Low Vacancy Rates

Affordable housing units typically have lower vacancy rates because of the strong demand for such properties, reducing the risk of income interruptions. With the TPS scheme, the vacancy rates will be low due to the potential for home ownership at the end of the REIT tenure.

1.6 Resilience in Economic Downturns

Affordable housing tends to be more recession-resistant than other real estate sectors. This is because, people need places to live even during economic downturns. This therefore makes affordable housing REITs through the TPS model more resilient and hence a good investment.

2. Major Building Blocks For A Growth Of Residential REIT Market In Kenyan Market

| Description | Residential REITS | Affordable Housing REITS |
|--|--|--|
| 2.1 Enabling Regulatory Framework For REITs | | |
| Regulation permits a wider investor base to participate | Investment in REITs is accessible to the retail investor, enabling regulation limits and shareholding requirements to assist this. | Social impact investors are an essential feature to support the delivery of Affordable Housing. Adding social impact investment as an asset class within the RBA Investment Regulations and Policies and setting a minimum |

| | | |
|--|---|---|
| | | requirement would aid investment in this area. |
| Disclosure requirements | Clear understanding of requirements, with good understanding of the asset base and risk profile to support this. Strong and simple messaging from informed commentators | Regulations are not specifically designed for these tenures and therefore further understanding may be required (definitions to be included). |
| Investor's protection | Enforcement of regulation and penalties when not applied. Guarantees could be put in place. | As with residential, but further regulation/support could be provided by the government to offer increased protection. . |
| Tax Incentives to issuers and investors | Required Need sufficient distributable revenues to benefit. | Further tax incentives may be required to increase benefit of investment. |
| State government support for land concession for affordable housing program | Not applicable | Essential to ensure affordability providing restraints do not restrict fund raising. |
| Subsidy regime for capital and revenue costs. | Inappropriate for commercial REITs if they restrict market exposure and returns. | Essential but can be land concession. |
| Regulatory regime to protect affordable housing commitments in the long term. | As above | Essential but regulatory regimes should be minimised and should not be in conflict. |
| Tenancy and common parts condominium laws to ensure effective management and maintenance of blocks and estates. | Essential | Essential |
| Government policies on raft of issues including taxation, affordable housing, | These policies need to be implemented without complicating REITs and increasing overheads. | As commercial but also clarity on subsidy. |

investment, planning
etc.

| | | |
|--|--|---|
| Access to construction finance and forward commitment contracts | Essential to fast-track residential development. | Essential. Banks seeking to fund sustainable works can support. |
|--|--|---|

2.2 Developers and Operators of residential units

| | | |
|--|---|--|
| Supply of rental units and mixed income units | Active development industry required. Also, ability for REIT to develop and lock in standards and developers' profit. | Essential to possess development partners familiar with affordable housing production. Also locking in developers' profit. |
|--|---|--|

| | | |
|---|--|---|
| Low-cost building materials and modern methods of construction | Helpful if investors have confidence in these and essential, they meet planning requirements and provide long term safe and sustainable homes. | Essential if proven as a suitable method and product. |
|---|--|---|

| | | |
|--|---|--|
| Clear definition of affordable housing eligibility and assessment | Clear definition of target renter's population and returns. | Clear definition of target income for a household. Assessment is essential and these should only ever be sold to those in need and never to investors for market rent. Regulation on sales of affordable housing aiding. |
|--|---|--|

| | | |
|--|--|--|
| Good property management standards, enforcement and oversight | Required. Also, effective remedies for arrears and possession. | To ensure asset value appreciation, maximise occupancy properties need to be managed and maintained to required standards. |
|--|--|--|

| | | |
|--|---|-----------------|
| Creditable property managers with track record of professional management of residential property portfolio | Required as above. Allow REITS to manage their own property. Essential to provide investors with the confidence that income will be collected, and costs minimised. | As residential. |
|--|---|-----------------|

2.3 Investors

| | | |
|--|----------------|---|
| Social impact investors with interest in social impacts vs pure investment return | Not applicable | Essential for affordable housing. Mission driven investors and institutions committed to social purpose or social corporate responsibility play a key role. |
|--|----------------|---|

2.4 Property valuation

| | | |
|---|--|--|
| Independent authorised property appraiser linked to a professional body like the Royal Institution of Chartered surveyors. | Essential that legislation should contain detailed provisions regarding the measurement and assessment of the company's assets carried out by an independent, external real estate appraiser. There needs to be an agreed valuation which allows investors to understand volatility and compare performance. Sufficient access to a wide range of providers to reduce costs. | As with residential. |
| Access to rental market data | Essential and responsive (timely) | Essential to have portal that provide access to comparable rental data, sales prices for valuation purposes. |
| Method of measurement at fair value | A requirement of most REITs is an explicit requirement to measure properties at fair value including the regularity upon which the measurement takes place. | Similar |

Table 10: Building Blocks For A Growth Of The Residential REIT Market In Kenya

F. APPLICATION OF ALL OUTPUTS WITH RESPECT TO TPS AND REITS TO SIC HOUSING PROJECT (STIMA HEIGHTS) IN PARKLANDS

1. Project Application Overview

Stima Heights is a 20 story housing project comprising of 214 studio apartments and 235 one (1) bedroom apartments. It has two (2) level parking, in the basement and on the first floor. Ground floor will be a mini-commercial center and some additional parking space. The Project ground breaking took place in October 2022 and is expected to take 24-36 months to be completed.

This section will look at the Application of all outputs with respect to TPS and REITs to the Stima Investment Co-operative project.

The outputs will include the demand side and the supply side expounded on as follows:

1.1 Demand Side Factors

- 1.1.1 Ability to purchase
- 1.1.2 Percentage of household income used
- 1.1.3 Housing related costs
- 1.1.4 Savings vs. Debt levels
- 1.1.5 Allure of the property
- 1.1.6 Purpose of purchase: Occupation/Investment
- 1.1.7 Member of SIC: Yes/No
- 1.1.8 Gender metrics

1.2 Supply Side Factors

- 2.1.1 Total Project Cost
- 2.1.2 Cost per unit & per square meter
- 2.1.3 Infrastructure elements
- 2.1.4 Soft Costs
- 2.1.5 Financial Costs
- 2.1.6 Taxes
- 2.1.7 Timeline of the delivery of the project inclusive of regulatory approvals etc.

The demand side and supply side characteristics above are highlighted further below from the existing project clients, who will represent a sample of the ongoing sales and TPS uptake numbers.

2. Determination Of Sample Size

The sample size comprises of 40 clients who have already made the payments for their respective units. The sample size was arrived at based on the clients who have signed the reservation form, sale agreement, paid a deposit and subscribed to purchase of the units through TPS monthly instalments.

The clients' names have been left out and shall be represented numerically for confidentiality purposes.

| Clients | Typology | Employment Status | Age | Housing Characteristics | Allure of the Property | Purpose of Purchase | SIC Membership | Gender |
|---------|-------------------|---------------------|-----|-------------------------|----------------------------------|----------------------|----------------|--------|
| 1 | One Bedroom Unit | Employed | 41 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 2 | One Bedroom Unit | Employed | 43 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 3 | One Bedroom Unit | Employed | 43 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 4 | One Bedroom Unit | Employed | 43 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 5 | One Bedroom Unit | Employed | 56 | TBA | Proximity to Work/Infrastructure | To Live in | Yes | M&F |
| 6 | One Bedroom Unit | Employed | 52 | TBA | Proximity to Work/Infrastructure | Investment & live in | Yes | M&F |
| 7 | One Bedroom Unit | Employed | 52 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 8 | One Bedroom Unit | Employed | 52 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 9 | One Bedroom Unit | Employed | 52 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 10 | One Bedroom Unit | Employed | 52 | TBA | Prime area for Renting Out | Investment | Yes | M&F |
| 11 | One Bedroom Unit | Employed | 40 | TBA | Proximity to Work/Infrastructure | To live in | Yes | M&F |
| 12 | Studio Apartment | Employed | 43 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 13 | Studio Apartment | Retired:In business | 61 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 14 | Studio Apartment | Retired:In business | 55 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 15 | Studio Apartment | Employed | 45 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 16 | Studio Apartment | Employed | 50 | TBA | Proximity to Work/Infrastructure | To Live in | Yes | F |
| 17 | Studio Apartment | Employed | 43 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 18 | Studio Apartment | Retired:In business | 60 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 19 | Studio Apartment | Employed | 55 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 20 | Studio Apartment | Employed | 50 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 21 | Studio Apartment | In Business | 38 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 22 | Studio Apartment | Employed | 38 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 23 | Studio Apartment | Employed | 34 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 24 | Studio Apartment | Employed | 28 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 25 | Studio Apartment | Employed | 41 | TBA | Prime area for Renting Out | Investment | Yes | F&M |
| 26 | Studio Apartment | Retired:In business | 61 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 27 | Studio Apartment | Retired:In business | 61 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 28 | Studio Apartment | Employed | 52 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 29 | Studio Apartment | Retired:In business | 58 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 30 | Studio Apartment | Employed | 56 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 31 | Studio Apartment | Employed | 48 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 32 | Studio Apartment | Employed | 45 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 33 | Studio Apartment | Employed | 51 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 34 | Studio Apartment | Employed | 49 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 35 | Studio Apartment | Employed | 42 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 36 | Studio Apartment | Employed | 50 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 37 | Studio Apartment | Employed | 28 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 38 | Studio Apartment | Employed | 34 | TBA | Prime area for Renting Out | Investment | Yes | M |
| 39 | Studio Apartments | Employed | 40 | TBA | Prime area for Renting Out | Investment | Yes | F |
| 40 | Studio Apartments | Employed | 42 | TBA | Prime area for Renting Out | Investment | Yes | F |

Table 11: Demand Side Characteristics Of SIC Clients

3. Supply Side Characteristics Of SIC Clients

The Supply Side entails the Total Costs of delivering the project as well as an understanding of the delivery time of the project.

4. Total Project Costs

The project is estimated to cost 1.1 Billion Kenya Shillings.

5. Project Completion Timeline

The project estimated timelines are 18 to 24 months.

ⁱ Legal, Policy and Institutional Review of the Affordable Housing Sector in Kenya, FSD Kenya, 2022

ⁱⁱ National Housing Policy for Kenya, Sessional Paper 3, April 2016