KENYA MORTGAGE REFINANCE COMPANY

REAL ESTATE INVESTMENT TRUSTS

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EXECUTIVE SUMMARY

- A REIT is a tax-efficient investment vehicle designed to aggregate diverse sources of funding (from international and institutional investors through to households) and target them into a real estate portfolio that extends beyond the limitations of individual projects.

- Residential REITs targeting affordable housing represent an intriguing conduit for channelling investment into the under-served market.

- The global REITs market is estimated to be worth around US$4 trillion and 44 countries are recognized as having legislation that could be described as REIT-based, with that number likely to increase in the near future according to CAHF.

- Global statistics show that REITs have been able to outperform various asset classes consistently. In 2021 REITs were the best-performing asset class globally, as the sector recovered from the lows of COVID-19 in 2020.

- When analyzed by sector, over 85% of the assets held by REITs are industrial, commercial, or real estate-based financial instruments.

- The US REIT market is the largest in the world. Currently, there are over 200 listed REITs in the US.

- Today, approximately 145 million Americans live in the roughly 43% of American households that own REIT stocks (directly or indirectly) through mutual funds, Exchange-Traded Funds, or target date funds according to Research by the National Association of Real Estate Investment Trusts.

- The Singapore REIT (S-REIT) industry has since grown to occupy 12% of the entire Exchange's market with a capitalization of nearly S$100 billion.

- A defining component of the S-REIT is that over 80% of

S-REITs have some or all properties outside Singapore panning over Asia Pacific, North Asia, America, and Europe, making Singapore the largest global REIT hub.

- The underlying trend of increasing GDP, wider and diversified economic growth, as well as urbanization, will lead to more demand for sustainable affordable housing to own and rent.

- REITs markets in sub-Saharan Africa are still at a nascent stage. The recent adoption of REITs legislation in Kenya, Ghana and Uganda is set to contribute to continued real estate market formalization and deepening in Africa.

- South Africa REITs rank 9th largest in the S&P 500 market globally with a market capitalization of USD 29 billion (KES 3.650 trillion).

- The structure of SA REITs is a mixed-asset portfolio that ensures investors operate in an environment where they can maximize returns while minimizing risk through holding optimum asset combinations.

- Kenya became the 3rd African country to establish REITs as an investment vehicle in 2013 with the REIT Regulations providing for Income-REITs, Development-REITs, and Islamic-REITs.

- The purpose of REITs was to encourage construction and property investment as well as enable access to real estate investment for lower-income earners and bodies typically exempt from taxation, such as pension funds and charities.

- REITs, though still a nascent sector, is well placed to complement the successful delivery of affordable housing by catalyzing supply and demand.

- Kenya's Real Estate sector contribution to GDP has grown exponentially in recent years, expanding at a CAGR of 6.2% over the past five years.

- The REITS market has grown by 6.4% with an estimated market capitalization of 0.07% of the country's GDP.

- The use of REITs for affordable housing is expected to enhance liquidity and offer investors good returns.

- According to the Capital Markets Authority (CMA)'s Capital Markets Soundness Report, the financing for construction in Kenya was majorly sourced from the banking sector at 95.0% while capital markets contributed only 5.0%, highlighting the overreliance on banks and pointing to the crucial role that REITS can play in closing the funding gap for real estate.

- Privately held or listed D-REITs could be part of the solution to increasing the supply of housing for sale or rent to low or middle-income households. This would be an alternative to the existing developers who concentrate on the higher-value end of the market.

- The conceptualized Kenya National REIT is aligned with the Government's Economic Transformation Agenda to deliver affordable housing units across the country through Special Purpose Vehicles.

- Regulations on REITs in Kenya also present a good opportunity for the development of green buildings, hence increasing financing in form of REITs green bonds.

- Globally, publicly traded REITs issued $7.2 billion in green bonds in 2021, setting the pace for a new annual record according to Morgan Stanley Research.

- The vast majority of asset managers and owners (88%) globally reported an increase in ESG investing interest, reporting and disclosure since May 2020 driven by shifting public sentiment, regulatory developments and pressures from clients and investors, according to a survey from Morgan Stanley Institute for Sustainable Investing.

- A study published in the Journal of Sustainable Real Estate in 2019 noted that 34% of Singapore REITs (S-REITs) were Green Mark-certified. The study found that there was a good relationship between the "greenness" of a REIT portfolio and its operating performance.

- The top 100 U.S. equity REITs by equity market cap reported ESG efforts publicly in 2021, up from 60 in 2017, according to NAReit. More than 80% of those REITs owned certified-green buildings in 2021.

- The KES 5.7 billion Green Bond by Acorn Holdings floated in 2020 has been feted at the Europe, Middle East, and Africa (EMEA) Finance 2021 Awards.

- A surge in REIT green bond issuance is providing further proof of the growing appetite for sustainable initiatives from REITs and demand for green investment products on behalf of investors.

- It is recommended that Kenya adopts some of the practices of developing and developed countries through partnering and transfer of information for benchmarking.

- The REITs market in Kenya presents an opportunity to boost the Real Estate sector, allowing for an alternative way to finance real estate away from scarce and expensive debt financing while providing returns for both developers and investors.

INTRODUCTION

Real Estate Investment Trust is defined as a collective investment where investors come together to contribute money or value for money to acquire rights or interests. REITs have been marginally successful within many of the African countries that have established REIT frameworks partially due to early development stages of African REIT markets. REITs were introduced by CMA in 2013, making Kenya the third African country to establish REITs as an investment vehicle. Since the industry's formation in 2013, several regulations have been passed to promote transparency and an overall attractive real estate market.

The market in Kenya for REITs is a primary market, as currently there is no provision for a secondary market. REITs provide an opportunity for investors to invest in real estate with their interests safeguarded in an institutionalized manner. REITs introduce a new investment asset class to large institutions as well as individual investors. Developers can access funds and overcome challenges associated with construction. REIT managers source funds to build or acquire real estate properties that are expected to generate income for distribution to investors.

The REITs Association of Kenya was formed in 2017 to act as the representative body for REITs to create a framework for the industry and form partnerships with investors and other REITs Associations to encourage knowledge transfer. The main alternative model to private investment in affordable housing through a REIT is using capital markets to provide long-term debt or targeted investment funds that include an equity element, according to CAHF.

The introduction of a regulatory framework and regulations by CMA authorized four REITs that are mainly structured as close-ended in the Kenyan market, namely:

- Income REITs (I-REITs): This is a form of REIT in which investors pool their resources for purposes of acquiring long-term, income-generating real estate including residential and commercial properties.

- Development Real Estate Investment Trust (D-REITs): This is a trust where resources are pooled together for the sole mandate of investing in and developing real estate projects. On completion of a project, D-REITs can be converted to I-REITs. Alternatively, to exit the investment, the units can be disposed of through sale, lease, or lease of shares.

- Islamic Real Estate Investment Trusts: This is a REIT compliant trust guided by Shari'ah laws where a manager conducts compliance checks before making an investment to ensure compliance with Shari'ah principles. An Islamic REIT is a unique type of REIT that invests primarily in income-producing, Shari'ah-compliant real estate.

Authorized REITs in Kenya

	Issuer	Name	Type of REIT	Issuing Date	Market Segment	Status
1	ICEA Lion Asset Management (ILAM)	Fahari	I-REIT	October 2015	Main Investment Market	Trading
2	Acorn Holdings Limited	Acorn Student Accommodation (ASA) – Acorn ASA	I-REIT	February 2021	Unquoted Securities Platform (USP)	Trading
3	Acorn Holdings Limited	Acorn Student Accommodation (ASA) – Acorn ASA	D-REIT	February 2021	Unquoted Securities Platform (USP)	Trading
4	Local Authorities Pension Trust (LAPTrust)	Imara	I-REIT	November 2022	Main Investment Market: Restricted Sub-segment	Restricted

Source: Nairobi Securities Exchange, CMA

The conceptualized Kenya National REIT is aligned with the Government's Economic Transformation Agenda to deliver affordable housing units across the country.

REITs are exempt from income tax provided they distribute 80% of their net income; however, the exemption does not apply to the payment of withholding tax on interest income and dividends.

PERFORMANCE OF REITs IN KENYA

Historically, REITs have performed positively during high inflationary periods. This performance stems from the strong economic growth evident during rising inflation periods. Consequently, investors consider real estate an inflation hedge since property values appreciate with increased inflation according to Morgan Stanley Research.

Global statistics show that REITs have been able to outperform various asset classes consistently. In 2021, REITs were the best-performing asset class globally as the sector recovered from the lows of COVID-19 in 2020 according to Sterling Research 2022.

From the ten major asset classes globally, Equity REITs (VNQ) ranked best-performing asset class in 2021 with a total return of 40.1%, a major improvement from -4.7% in 2020 that deemed them worst performing asset class according to Sterling Research.

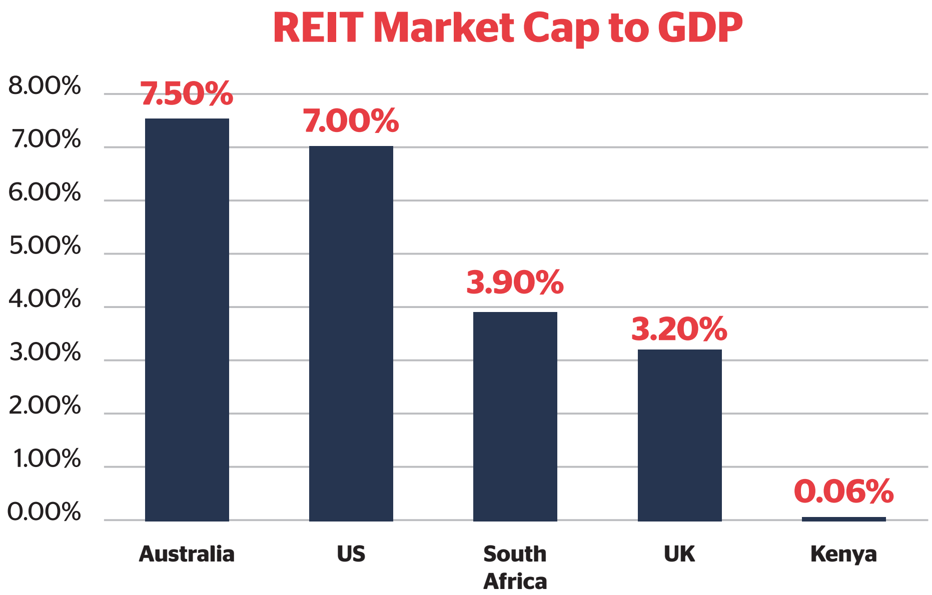
Since the formation of the regulatory framework, REITs, in 2013, the framework has remained relatively underdeveloped with one I-REIT, one D-REIT and Acorn Holdings that issued one I-REIT and D-REIT to invest in construction and acquisition of properties in Kenya. There are several REIT managers in Kenya through which the public can access REITs products, including Nabo Capital, UAP Investment Limited, CIC Asset Management Limited, Stanlib Kenya Limited, ICEA Lion Asset Management Limited, Sterling REIT Asset Management Limited and HF Development and Investment Limited.

REITs are listed on the Nairobi Securities Exchange and regulated by the Capital Market Authority. Listed REITs are exempt from corporate tax, which is very lucrative especially since corporate tax in Kenya is at 30% hence an improvement in net profit return by saving on tax. In 2022, the REITs Association of Kenya (RAK) and the Centre for Affordable Housing (CAHF) signed a memorandum of understanding to collaborate in the identification and development of affordable real estate as well as future project portfolios.

The REITs market has grown by 6.4% according to (Cytonn Report , n.d.), with an estimated market capitalization of 0.07% of the country's GDP (CentWarrior, n.d.). With the demand for housing in Kenya being double the supply, REITs are estimated to provide a housing finance solution to developers and curb the gap in supply of housing in Kenya. REITs are easily accessible since one can invest in the market with as little as KES 1,000.

Most of the developed REIT industries have an economic niche that contributes to the differentiating nature that attracts investors. Developing the market through regulation and private equity with a specialization in mind will exponentially develop the industry.

In summary, there is a lot of opportunity in the REIT market in Kenya as evidenced by the low REIT Market Cap to GDP at less than 0.1%, compared to more developed markets such as South Africa at 3.9%. Should the investments in real estate be packaged into securities that provide the public with an opportunity to own real estate, REITs will open up to investors and, in turn, lead to deepening of our capital markets.



Source; Cytonn 2022, CBK, European Public Real Estate Association (EPRA), World Bank

Access to credit in the real estate sector has been recovering gradually, with the banking system net domestic credit to the Real Estate sector increasing by 0.5% to KES.414Bn in June 2022 from KES.411.8Bn in June 2021, according to the latest Monthly Economic Indicators Report June 2022 by the Central Bank of Kenya.

The table below indicates that the ILAM Fahari I-REIT, Acorn ASA I-REIT, and Acorn ASA D-REITs have a positive correlation with the CBR Rate. Though there is a correlation/ relationship between the REITs and the CBR rate, it is not a causal relationship.

REIT	Correlation Co-efficient
ILAM Fahari I-REIT	0.85
Acorn ASA I-REIT	0.51
Acorn ASA D-REIT	0.58

Source; CBK, NSE

The REITs to market capitalization for Kenya remains very low compared to other jurisdictions. A total of only 4 REITs in Kenya is low compared to a country like South Africa that has 33 listed REITs despite its REITs regulations becoming operational after Kenya's in 2013.

Further, according to the Capital Markets Authority (CMA)'s Capital Markets Soundness Report, the financing for construction in Kenya was majorly sourced from the banking sector at 95.0% while capital markets contributed only 5.0%, further highlighting the overreliance on banks and pointing to the crucial role that REITS can play in closing the funding gap for real estate.

The 2022 outlook is more conservative compared to 2021, considering the elevated valuations and rising interest rates that will insert downward pressure on REITs performance according to Sterling Research.

There is significant progress towards the creation of a Kenya National REIT (KNR) aligned to the Government's Economic Transformation Agenda to deliver affordable housing units across the country through Special Purpose Vehicles. The capital markets initiative is expected to complement fund raising efforts for the ongoing joint affordable housing programme spearheaded by the National and County Governments.

Legal Framework in Kenya

Tax Exemption – REITs in Kenya have a number of tax benefits, including; -

1. A listed REIT also allows underlying owners of the real estate assets to enjoy corporate tax exemption, currently at 30% per annum. The only taxation is on distribution of profits to the unitholders, which would be subject to withholding tax ("WHT") at the rate of 5% for resident unitholders and 10% for non-resident unitholders.

2. The amendment of Section 20 of the Income Tax Act as per Finance Bill 2019 also saw REITs' investee companies being exempted from income tax. This will allow REITs to invest more in companies that develop real estate, rather than going though the process of transferring properties to the REIT.

3. Transfer of properties to a REIT also attracts a stamp duty exemption, as per Section 96A (1) (b) of the Stamp Duty Act.

Green REITs

The United Nations (UN) notes that the housing sector contributes to 37% of annual greenhouse gas emissions and consumes around 36% of the world's energy.

A study published in the Journal of Sustainable Real Estate in 2019 noted that 34% of Singapore REITs (S-REITs) were Green Mark-certified. The study found that there was a good relationship between the "greenness" of a REIT portfolio and its operating performance. This means that the more sustainable a REIT is, the better the management of overall energy usage and greenhouse gas emissions with better tenant retention and higher occupancy rates. This in turn translates to greater cost savings, higher revenues, and higher profitability.

The vast majority of asset managers and owners (88%) globally reported an increase in ESG investing interest, reporting and disclosure since May 2020 driven by shifting public sentiment, regulatory developments and pressures from clients and investors, according to a survey from Morgan Stanley Institute for Sustainable Investing.

Globally, publicly traded REITs have issued $7.2 billion in green bonds in 2021, putting the sector on pace to set a new annual record according Morgan Stanley Research.

The IFC report highlights the potential for green buildings to make good business sense. It expects a green building to be 12% more expensive to build, but subsequent operational costs would decrease by 37%, sales premiums would increase by up to 31%, occupancy rates would rise by 23% and rental income would be 8% higher.

The top 100 U.S. equity REITs by equity market cap reported ESG efforts publicly in 2021, up from 60 in 2017, according to NAReit. More than 80% of those REITs owned certified-green buildings in 2021.

The Status of the Built Environment Report 2023 in Kenya noted that the pandemic was an eye-opener, making people appreciate the need for spacious rooms, clean air, and sufficient parking, leading to improved quality of spaces in property development.

The Safari Green Building Index tool developed by AAK can be used as a rating tool to assess the qualification for incentives for those who adopt green buildings in their developments.

Regulations on REITs in Kenya present a good opportunity for development of green buildings, hence increasing financing in the form of REITs green bonds. An example is Acorn Holding's listed green bond approved by the Capital Markets Authority in 2019 and the Acorn Student Accommodation Development REIT (ASA D-REIT) and Income REIT (ASA I-REIT) approved in 2020. Acorn Holdings, which issued the country's and East Africa's first green bond and is listed in the NSE and the London Stock Exchange, has had a monumental impact on the building industry as it aims to provide university students with environmentally friendly accommodation.

The KES 5.7 billion Green Bond by Acorn Holdings floated in 2020 has been feted at the Europe, Middle East, and Africa (EMEA) Finance 2021 Awards.

The oversubscription of the green bond is an indicator of investors' confidence in Acorn's performance as well as the improved inclination of Kenyans towards green financing in real estate.

Acorn developments under the program will focus on the IFC EDGE green building standards as a benchmark, particularly for water, energy, and material use efficiency.

The real estate sector has put ESG as a point of focus in recent development and construction. This is evident with the Safari Green Building Index launched late last year, which is a green building certification tool that assesses construction projects to establish their environmental performance.

A surge in REIT green bond issuance is providing further proof of the growing appetite for sustainable initiatives from REITs and demand for green investment products on behalf of investors.

Case Studies of REITS in other Countries

Overall, the REIT market stakeholders of Singapore, Australia, South Africa, China, and the UK create an enabling environment for REITs through various incentives to market participants, which potentially increases their attractiveness compared to other investment instruments.

Kenya should adopt some of the practices of developing and developed countries through partnerships and transfer of information for benchmarking.

A flexible approach in the formulation of REITs should be employed to adopt to changes in the current environment while encouraging more REITs to be listed to attract more investors, including embedding greening in REITs.

Summary of Case studies of REITs in Various Countries	
Country	**Key Take-outs**
 **United Kingdom**	• United Kingdom REITs (UK-REITs) were legally established in 2007 through the Finance Act 2006. UK-REITs are listed on the London Stock Exchange (LSE). As of December 2022, there were 55 listed UK-REITs on the LSE investing across industrial, office, residential, retail, hotel and lodging real estate. • UK-REITs can be quoted on the Alternative Investment Market (AIM), a submarket of the LSE's international market for smaller growing companies that offers reduced listing costs and allows more flexibility, thereby making it more attractive. • Her Majesty's Revenue and Customs (HMRC) determines the qualifying conditions that a company needs to meet to become a UK-REIT. These include: - i) Must be UK resident company, ii) Must be a close-ended investment company, iii) Must own at least three properties and, iv) Must have at least 75.0% of income flows from assets within rental property. Once in operation, UK-REITs must distribute, within 12 months of each accounting period, 90.0% of its net property rental income to investors. • In addition, the UK's Corporation Tax Act 2020 sets out the regulatory framework for the UK-REITs regime that includes; the types of assets that can be held by UK-REITs, the disclosure requirements for UK-REITs, the rules for the transfer of UK-REITs between shareholders, and the rules for the management of UK-REITs. • For new UK-REITs, there is a grace period of three accounting periods (up to three years) in relation to the listed or traded requirements. This allows the company to achieve attractive returns without being subdued by the regime's stipulated regulations. • When UK-REITs acquire companies owning property investments, the assets are rebased to market value. This means that UK-REITs do not need to seek a discount for any latent capital gain inherent in the target company.

Summary of Case studies of REITs in Various Countries

Country	Key Take-outs
 **Australia**	• The first Australian REIT (A-REIT) was the General Property Trust – a listed property trust started in 1971. A-REITs are normally listed on the Australian Stock Exchange (ASX), with 49 A-REITs listed on the platform as of 18th December 2022. The Bendigo Stock Exchange, the Newcastle Stock Exchange, and the Australia Pacific Exchange are also capable of hosting trusts. • In Australia, listed A-REITs can be classified into several subsectors namely: - i) Retail (45.0% of market capitalization of all A-REITs), ii) Office (12.0%), iii) Industrial (12.0%), iv) Mixed-use developments (27.0%), and v) Alternatives (4.0%) • Australian investors have focused on two common A-REITs investment areas namely, i) the equity A-REITs that invest in and own properties where typically, income is generated through leasing out of properties and colleting rent, and ii) mortgage A-REITs where investors are involved in the investment and ownership of property mortgages. • A-REITs are regulated by the Australian Securities and Investments Commission (ASIC). The ASIC has developed an Operational and Policy Framework (O&P) to ensure that A-REITs are managed and operated in a manner that is consistent with the interests of their investors by monitoring trading activity, ensuring compliance with disclosure obligations, and preventing insider trading. • The ASIC requires that listed A-REITs must comply with various operational policies such as having at least 75.0% of its assets invested in real estate assets and distributing at least 90% of its taxable income to investors. • Geographic diversification offers A-REITs exposure to differing local economies where assets are located in different states or are diversified between states. The geographic diversification is sometimes across national borders, which allows A-REITs to cushion themselves against market shocks.

Summary of Case studies of REITs in Various Countries

Country	Key Take-outs
 **China**	• The Chinese REIT market was launched in 2021 by the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC). In 2021, the first batch of 9 public REITs was listed on the Shanghai Stock Exchange (SSE). As of December 2022, there were 15 publicly offered REITs listed on the SSE. • REITs listed are subject to the SSE's Business Rules. The regulations cover aspects of listing, issuance, and trading of REITs, including minimum requirements for REITs to be publicly listed, disclosure requirements, and rules regarding asset management and trading. • The Chinese government instituted REITs to invest particularly in infrastructure projects through special purpose vehicles such as infrastructure asset-backed securities. The underlying assets developed by the Chinese REITs include warehouses, industrial parks, highways, data centers, ecological environmental protection, and affordable rental housing. • Within the Chinese REIT regime, over 80.0% of the fund's assets are invested in infrastructure asset-backed securities and hold the entirety of the shares. In addition, the REIT holds all the equity of the infrastructure project company. • REIT funds obtain full ownership or operating rights of infrastructure projects through special purpose vehicles such as asset-backed securities and project companies. REIT managers take the initiative to operate and manage infrastructure projects, with the main purpose of obtaining stable cash flows such as rent and fees for infrastructure projects.

Summary of Case studies of REITs in Various Countries

Country	Key Take-outs
 **South Africa**	• South African REITs (SA-REITs) are listed on the Johannesburg Stock Exchange (JSE). The country's first focused residential REIT was listed on the JSE in June 2015. As of December 2022, there were 33 SA-REITs and 3 non-SA-REITs listed on the JSE. • SA REITs rank 9th largest in the S&P 500 market globally with a market capitalization of USD 29 billion (3.650 trillion KES). Due to the mixed asset portfolio, the industry is trading at a Price to Earnings Ratio of 7.9x growing over 49% in the past 3 years. • Since 2013, the JSE SA-REIT listing requirements set out certain policies that must be followed by SA-REITs, such as the disclosure of information to investors and the appointment of a committee to monitor risk. This is meant to ensure that SA-REITs operate in a transparent and responsible manner and act in the best interests of investors. In addition, these policies are regularly reviewed and amended as necessary to ensure that SA-REITs operate in an efficient and effective manner. • In addition, the South African Financial Markets Act 2012 sets out the requirements for the operation of JSE listed SA-REITs, namely; i) Must pay at least 75.0% of their taxable earnings available for distribution out to investors as dividends, ii) Must keep debt below 60.0% of the gross asset value (leverage ratio), iii) Must earn 75.0% of their income from rentals or property owned or investment income from indirect property ownership, and, iv) must own at least R 300.0 mn (KES. 2.2 bn) of property. • Growth opportunities in the larger SA-REIT sector in South Africa have been shrinking. This is because economic growth has slowed attributed to rising cost of capital. Nonetheless, many REITs have responded to these challenges by investing offshore, particularly in Australia, Europe, and the US. This diversification allows the sector to shield itself from market shocks in the country.

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<tr><th>Country</th><th>Key Take-outs</th></tr>
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Singapore</td><td>

Singapore Real Estate Investment Trusts (S-REITs) are regulated as Collective Investment Schemes under the Monetary Authority of Singapore’s Code on Collective Investment Schemes or alternatively as Business Trusts.
When REITS were initially introduced to Singapore, they were meant to provide an alternative retirement investment asset.
The first S-REIT to be traded in Singapore was CapitaLand Mall Trust (CMT), which made its debut in 2002. As of 18th December 2022, there were 37 S-REITs listed in the Singapore Stock Exchange (SGX), making up a market capitalization of USD 80.0 bn (KES. 9.8 tn) and 13.0% of the entire Singapore stock market.
The main regulatory body of the S-REITs, the Monetary Authority of Singapore, has made major efforts to strengthen the corporate governance in the S-REIT market. These include: - i) Requirement by S-REIT managers to prioritize the interests of investors over the managers’ and other sponsors’ when there is a conflict of interest, ii) Higher leverage limit and deferral of interest coverage requirement, and iii) Extension of permissible period for distribution of taxable income.
In addition, the authority has made efforts to ensure that there is increased investor knowledge of S-REITs in the market. This has been achieved through publishing relevant information aimed at increasing investor knowledge, and creating an environment where S-REIT managers can compete freely thereby expanding investor knowledge.
S-REITs that own properties are required to distribute at least 90.0% of their specified taxable income (generally income derived from the Singapore Real Estate properties) to unitholders as dividends to qualify for tax transparency treatment.
The S-REITs market is well diversified across various sub sectors which includes retail, hospitality, industrial, land, and health care among others. There are some REITs in Singapore that have invested in more than one Real estate sub-sector, and this accounts for more than half of the S-REITs in the Market.
Offshore Investments, Good Corporate Governance, and the presence of Internal and External Management are some of the features that contributed to the development of the S-REIT industry.

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Conclusion

The REITs market in Kenya presents an opportunity to boost the Real Estate sector, allowing for an alternative way to finance real estate away from scarce and expensive debt financing while providing returns for both developers and investors. With the ongoing drive by the government to provide decent housing to Kenyans, the REIT market could go a long way to boost the Affordable Housing Initiative by increasing the supply of housing units.

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