KMRC

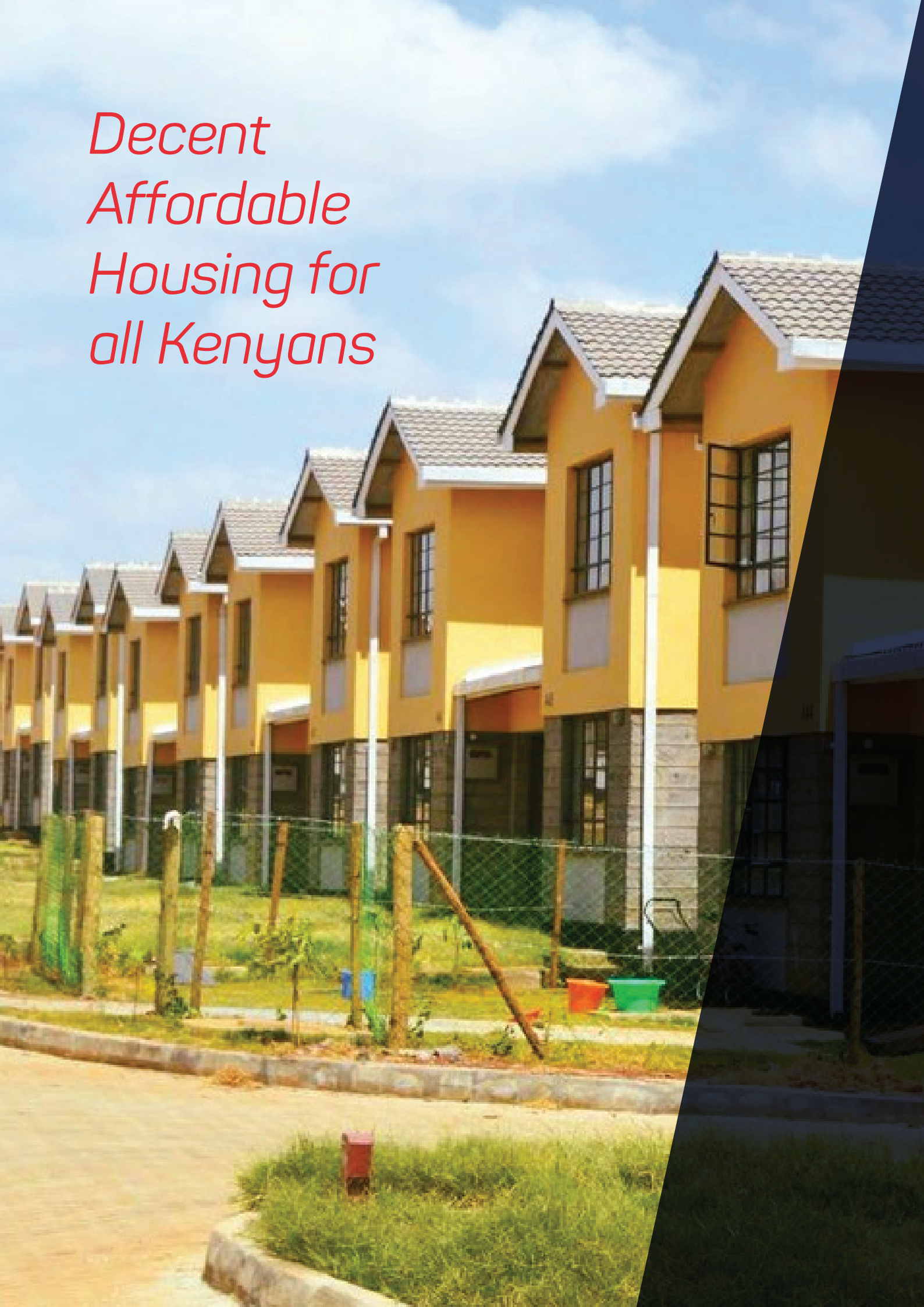
KENYA MORTGAGE REFINANCE COMPANY

2019

ANNUAL REPORT AND FINANCIAL STATEMENTS

Unlocking Liquidity for Affordable Housing

Decent Affordable Housing for all Kenyans



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KMRC
KENYA MORTGAGE REFINANCE COMPANY

(PLC-LXSM9G)
NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the first Annual General Meeting of **KENYA MORTGAGE REFINANCE COMPANY PLC** ("the Company") will be held on **30th June 2020** at the Company's offices 27th Floor UAP/Old Mutual Tower, Nairobi, Kenya and through video- conferencing at **11:00am** to transact the following business:

ORDINARY BUSINESS

1. To table the proxies and note the presence of quorum;
2. The Chair to read the Notice convening the Meeting;
3. To table the Chairperson's Report;
4. To receive, consider and, if thought fit, adopt the audited financial statements for the year ended 31st December 2019, together with the Directors' and Auditors' reports thereon;
5. To determine the Directors' remuneration;
6. To appoint Messers Mazars Kenya, having expressed their willingness, to perform in office as auditors of the Company in accordance with the provisions of section 721 of the Companies Act, No. 17 of 2015 and to authorise the Directors to fix their remuneration.

SPECIAL BUSINESS:

7. To consider and, if thought fit, pass the following resolutions:

AS ORDINARY RESOLUTION

a. **THAT** in accordance with section 329 of the Companies Act 2015 ("the Act"), the directors of the Company be authorised to allot shares in the Company or grant rights to subscribe for shares in the Company up to an aggregate nominal amount of **8,000,000** provided that this authority shall, unless renewed, varied or revoked by the Company, expire five years from the date of this Resolution save that the Company may, before such expiry, make an offer or agreement which would or might require shares to be allotted and the directors may allot shares in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution has expired.

AS SPECIAL RESOLUTIONS

b. Changes to the Company's Articles of Association:

THAT the Articles of Association of the Company be amended in the manner set out in the amended Articles of Association available on the Company's website, www.kmrc.co.ke and also made available through electronic means prior to the meeting, the rationale being to allow for the entry of the International Finance Corporation ("IFC") and the Company for Habitat and Housing in Africa ("Shelter Afrique") as shareholders, and the increase of the shareholding of KCB Group Limited ("KCB") pursuant to Subscription Agreements entered into between these investors and the Company.

c. **THAT** In accordance with section 348 of the Act and the authority conferred by Resolution (a) above, the directors be and hereby authorized to allot shares (credited as fully paid) to IFC, Shelter Afrique and KCB, such allotments to be made as if section 338 of Act (requiring the exercise of pre- emption rights), did not apply.

d. **THAT** the directors and Management of the Company be and hereby authorized to do all acts and things necessary, and prepare all necessary documentations and returns consequent upon and to effect these resolutions.

8. To transact any other business which may legally be transacted at an Annual General Meeting.

BY ORDER OF THE BOARD

GODWIN WANGONG'U
Company Secretary
5th June 2020

NOTE:

1. *A member entitled to attend and vote at a meeting is entitled to appoint any other person to vote instead of him. The instrument appointing the proxy must be delivered to the Secretary not less than forty-eight (48) hours before the meeting.*
2. *In view of the Covid-19 Pandemic and the related Public Health Regulations and directives passed by the Government of Kenya precluding inter alia public gatherings, its impracticable for KMRC PLC to hold a physical Annual General Meeting (AGM). KMRC has therefore convened and will conduct its first AGM via virtual/electronic means. A member may attend the meeting at such location as he/she chooses through the video-conferencing facilities to be provided by the Company for this purpose. Access details for the video-conferencing facilities shall be provided to each member prior to the date of the meeting. The video-conference may be recorded.*

Photo Gallery

Shareholder representatives during the signing of the Master Refinance Agreement with His Excellency President Uhuru Kenyatta looking on

The Kenya Mortgage Refinance Company shareholders' representatives with His Excellency President Uhuru Kenyatta

Front row· His Excellency President Uhuru Kenyatta with (L-R) Dr. Patrick Njoroge - CBK Governor, Dr. Kamau Thugge – Former PS at the National Treasury, James Macharia – CS Transport, Infrastructure, Housing, Urban Development and Public Works, Henry Rotich – Former CS National Treasury, Charles Hinga – PS Housing and Urban Development and Dr. Joseph Kinyua – Head of Public Service.
Back row· The inaugural members of the KMRC Board

Corporate Information

BOARD OF DIRECTORS

Dr. Haron Sirima	Director representing the National Treasury
Ms. Susan Maira	Independent director
Mr. Samuel Mwangi Makome	Member Representing Banks
Mr. Robert Ngugi Kibaara	Member, Representing Banks
Mr. Asman Kiloh Khatolwa	Member, Representing Saccos
Ms. Sarah Bonaya	Independent director
Mr. Johnstone Oltetia	Ag. Chief Executive Officer

PRINCIPAL PLACE OF BUSINESS

UAP Old Mutual Tower, 27th Floor
Upperhill Road, Upperhill
P.O Box 15494 - 00100
NAIROBI

REGISTERED OFFICE

National Treasury building
Harambee avenue
Nairobi

COMPANY SECRETARY

Mboya Wangong'u & Waiyaki Advocates
Lex chambers
Maji Mazuri Road, off James Gichuru Road
P.O. Box 74041 - 00200
Lavington, Nairobi

PRINCIPAL BANKERS

Cooperative Bank of Kenya,
Moi Avenue,
P.O Box 48231 – 00100
Nairobi

KCB Bank Kenya Limited,
Moi Avenue,
P.O Box 48400 – 00100
Nairobi

INDEPENDENT AUDITOR

MAZARS
Certified Public Accountants (K)
3 Floor, The Green House, Ngong Road
P.O. Box 61120 - 00200
Nairobi City Square.
Kenya.

Board of Directors

DR. HARON SIRIMA
Ag. Chairman

MS. SUSAN MAIRA
Independent Non-Executive Director

MR. SAMUEL MAKOME
Non-executive Director

MR. ROBERT KIBAARA
Non-executive Director

MR. ASMAN KHATOLWA
Non-executive Director

MS. SARAH BONAYA
Independent Non-Executive Director

MR. JOHNSTONE OLTETIA
Ag. Chief Executive Officer

Statement from the Ag. Chairman

Introduction

I am delighted to welcome you all to the first Annual General Meeting of the Kenya Mortgage Refinance Company (KMRC). We are holding this important event at a time when the global economic and social environment is adversely affected by the Covid – 19 pandemic. We remain optimistic that the actions taken by the public and private sector to mitigate the effects of the pandemic will yield the desired outcome. KMRC was incorporated on 19 April 2018 as a non-deposit taking financial institution to provide long term finance to primary mortgage lenders to increase the availability and affordability of mortgage loans to *wananchi*. The Government of Kenya through the National Treasury established KMRC through a public-private-partnership arrangement with the private sector ownership. The intention is to crowd-in private sector funding to support affordable housing development. The operation of the institution is aligned with the Affordable Housing pillar of the Government's Big 4 Agenda. It is modelled along other existing mortgage refinance companies globally such as the Nigeria Mortgage Refinance Company, Tanzania Mortgage Refinance Company and the Pakistan Mortgage Refinance Company among others. Unlike other mortgage refinance companies, KMRC shareholding includes Savings and Credit Cooperative Societies and a Micro- Finance Institution. The Company will be licensed and regulated by the Central Bank of Kenya.

Operationalization of KMRC

KMRC was launched on 22nd May 2019 by HE the President Uhuru Kenyatta and the Board thereafter constituted and became functional in July 2019. The operationalization of the Company was intensified following the launch. Since its inaugural meeting a year ago, the Board has considered and approved policies, organizational structure, budget and recruitment of key human resources to facilitate commencement of the company's operations. The key actions constitute conditions precedent for issuance of license by the Central Bank of Kenya. We expect the Company to be fully operational in the third quarter of 2020.

Resource mobilization

KMRC, a non-deposit taking financial institution, mobilizes financial resources for business operations through debt and equity. In the first quarter of 2019, the Company had a capital call which successfully raised KES. 1.97 billion from the 21 shareholders. The shareholders include Government of Kenya through National Treasury, 8 commercial banks, one microfinance bank and 11 Saccos. Two development finance institutions (DFI) namely the International Finance Corporation (IFC) and Shelter Afrique are expected to participate as shareholders and will be allotted shares in due course raising the number of shareholders to 23. In addition, to ensure the Company has adequate financial resources to achieve its objectives, KES. 35 billion has been mobilized in form of debt finance from the World Bank and African Development Bank through the National Treasury. The Company's audited financial statements for the year ended 31 December 2019 reflects a healthy financial position.

Corporate Governance

The Company's Articles provide for a Board of seven (7) non-executive directors and one executive (the Chief Executive Officer - CEO) as ex-officio.

Statement from the Ag. Chairman (Continued)

Currently, the Board comprise six non-executive directors and an Acting CEO. A director representing DFI's will be appointed in due course. The Board will appoint the substantive Chairperson and constitute the necessary committees of the Board once 'fit & proper' clearance for all directors has been obtained from the regulator. Recruitment of a substantive CEO has commenced and expected to be completed within the third quarter of 2020.

KMRC Board of Directors is committed to good corporate governance and ethical business practices, promoting the long-term interests of shareholders. To guide the Board on responsible conduct, a Board Charter was prepared and adopted. Further, the Board lays emphasis on the need to build a reputable institution, responsible use of resources, taking care of the environment and having employees who take pride in their work.

Strategic Plan

The Board has developed the Company's first strategic plan to guide the company's operations. The KMRC Strategic Plan 2020-24 outlines the Company's priorities in the short to medium term with specific focus on its core mandate of providing long term funds in order to catalyze the growth of mortgages in Kenya.

Environmental and Social Risk Management Policy

Environmental and social sustainability is a core part of KMRC's commitment to responsible finance. The world grapples with current and potential environmental impacts of climate change, which has resulted to increased resource scarcity, erratic rainfall and drought due to economic development activities implemented in an unsustainable manner. These challenges have put pressure on society and present a threat to global prosperity if not prudently managed. KMRC Board understands these sustainability concerns and acknowledges the responsibility to carry out core operations in an acceptable manner that protects and respects the environment. In this regard, the Board has established an Environmental and Social Risk Management (E&S) policy to guide the organization in this respect. The E&S policy has been placed on the Company's website.

Conclusion

In conclusion, inclusive and equitable economic growth is a policy goal in the *Kenya Vision 2030* and access to decent and affordable housing is one of the pillars under the Government of Kenya's Big 4 Agenda. Meeting the demands of would-be homeowners, especially first-time buyers, will evidence KMRC's success in meeting its primary objective. The Government has provided a number of incentives aimed at stimulating housing delivery. Some of the incentives include review of VAT on low cost housing building material, reduction of corporate taxes to 15% where at least 100 units are built, adoption of low-cost housing technologies and support in development of housing related off site-infrastructure. Other efforts being undertaken include streamlining the title registration processes and digitization of land records for enhanced efficiency, and reduction of stamp duty for first time home buyers. These interventions coupled with KMRC long term funds will provide the much needed assistance to positively impact delivery of affordable housing in our country.

> ***"The Board lays emphasis on the need to build a reputable institution, responsible use of resources, taking care of the environment and having employees who take pride in their work."***

On behalf of the Board of Directors, I congratulate the KMRC management on the impressive work done so far in operationalizing the Company. We express our recognition of their dedication and hard work. I also thank my fellow Board members for their leadership and commitment. We fully appreciate the continuing commitment and support of our shareholders.

Dr. Haron Sirima, OGW
Ag. Chairman

Statement from the Ag. CEO

This first annual report serves as a fitting commemoration of the 1st anniversary of the formation of the Kenya Mortgage Refinance Company (KMRC). Those of us who have the privilege of being part of KMRC at inception are grateful for the opportunity to pave the way and lay the groundwork for what would be a great company; potentially a leading provider of liquidity in the financial system in Kenya. Established in April 2018 with a mission to provide long term funding to primary mortgage lenders in order to increase availability and affordability of mortgage loans to Kenyans, KMRC will offer the housing finance market in Kenya a credible, medium- to long-term finance. This type of institution has proven to be an important factor in the growth and success of mortgage finance markets in other emerging countries. KMRC would therefore serve as a secure source of long-term funding at attractive rates and this would improve mortgage affordability, increase the number of qualifying borrowers and result in the expansion of the primary mortgage market and home ownership in Kenya.

The acute demand for housing in Kenya has not been adequately met by the supply side of the market. The demand-supply gap is mostly noticeable at the lower end of the housing market as the lower income households do not have access to decent housing.

KMRC was established as part of the broader government intervention in the housing market, to make it more responsive to demand especially at the lower income segment. This intervention is based on recognition that reaching the goal of adequate, safe and affordable housing especially for the lower income group, requires a systemic approach to establishing the right legal, regulatory, and market environment for the efficient deployment of private and public capital as well as improved infrastructure and urban planning.

A strong foundation

KMRC has started with a firm footing. The Company is now fully operational with the Board of Directors fully constituted, recruitment of key staff finalized, and internal operational frameworks established. The Company has strong shareholder mix ranging from the Government of Kenya, top tier banks that have the largest stake in mortgage loans in the country, the leading Saccos in Kenya as well as International development finance institutions. The diverse shareholder mix which is reflected in the Board would bring a wider array of ideas, new ways of thinking, insights and different perspectives needed by such a novel institution. With a strong capital base and

firm commitment from its shareholders, KMRC is well positioned for its journey.

Performance

As at 31 December 2019, KMRC had an asset base of KES 2.27 billion. Although the company is yet to start its core business, this strong balance sheet will support the institutions' business goals and maximize financial performance going forward.

Business Model

KMRC will start operations by offering to refinance housing loans with recourse. This means the Company will have full recourse against its borrowers in the event that any of the mortgages in the collateral pool is defective, or there is breach of representation or warranty as may be stipulated in the Refinancing Agreements.There would be an obligation for a borrower to replace the defective collateral with one that is performing. Participating financial institutions will therefore finance home loans the usual way they do, having regard to the KMRC eligibility criteria and submit a portfolio of mortgages for refinancing by

Statement from the Ag. CEO (Continued)

KMRC. This liquidity model suites our local conditions at this time as it will lower the risk exposure to KMRC. The strength and quality of KMRC assets (i.e. mortgage loans assigned to KMRC as security) is crucial to obtaining a higher credit rating for KMRC, which in turn is important for raising funds from the capital markets through the issuance of bonds.

Initially, KMRC may refinance existing mortgage loans with the primary mortgage lenders required to provide alternative collateral which could be in form of Government Securities, Cash or deposits. However, this will be for a very short duration of about one year after which the financial institution is required to replace the alternative collateral with portfolio of mortgages. It is envisioned that in the medium term, only perfected mortgages will be refinanced as KMRC leads the industry in standardization of mortgage finance products.

Its important to note that 80% of World Bank credit line is earmarked for affordable housing which is a loan of up to KES. 4million in Nairobi metropolitan area (Nairobi, Kiambu, Machakos & Kajiado) and up to KES. 3 million elsewhere. The difference, 20% will be available for upper middle income housing. On the other hand, 40% of AfDB funds will be used to refinance mortgages of up to KES. 5million and 60% will go into refinancing mortgages of up to 8million. For purposes of affordable housing, the borrower's income threshold is KES. 150,000 per month.

Commencement of Lending Operations

In preparation for commencement of lending operations, management has been putting in place the necessary structures to ensure KMRC is ready to start its core business. The Company's policies and internal control structures were developed and are already in use. Additionally, key staff have been onboarded and are currently going through fit & proper assessment by the CBK. Further, the following other critical milestones have been achieved:

Portfolio review

In October 2019, KMRC conducted a portfolio review of its 20 participating financial institutions to determine existence of portfolio that meets KMRC eligibility criteria. The review identified a potential aggregate housing loan portfolio of KES 50.3 billion that could be potentially refinanced by KMRC. However, in view of the effect of Covid-19 pandemic in the financial markets, KMRC will review the portfolio afresh in order to ascertain actual portfolio that could be refinanced once a license is granted.

Further, KMRC with the support of the World Bank commissioned a consultant to review participating institutions' mortgage underwriting processes and facilitate capacity building on KMRC requirements.

> ***"In the short term, KMRC is well positioned to support emergency interventions aimed at stabilising the housing market post Covid-19 pandemic"***

This will enable the financial institutions that are not currently offering mortgages to develop a roadmap for building mortgage loan portfolios that meet KMRC's threshold. Capacity building support was also provided to the Sacco Societies Regulatory Authority (SASRA) in order to ensure the regulators mortgage lending guideline and approvals are aligned with KMRC requirements.

License from CBK

KMRC applied for a license from the CBK in September 2019. The Company met the substantial licensing requirements and the CBK granted an approval in principle in March 2020. However, the Regulator imposed additional requirements that the Company is required to fulfil before grant of full license. This included finalization of fit & proper assessment for all Directors and key staff, deployment of an ICT system and risk management framework and availability of KMRC's own office premises for inspection by the Regulator. The Company has submitted all fit & proper requirements for the Directors and key staff to the Regulator and has moved into its own office premises. At the same time, deployment of an ICT system is ongoing, thus all the additional requirements have been met save for the ongoing implementation of the ICT system. It is important to note that grant of an operational license by the CBK is a condition precedent for disbursement of funds by World Bank, AfDB and IFC.

Looking forward

KMRC is starting operations during unprecedented times.

Kenya, like other countries globally is expected to have

Statement from the Ag. CEO (Continued)

a significant reduction in economic activity in 2020 as a result of the Covid-19 pandemic. The pandemic has already caused substantial reductions in key foreign exchange earnings and high GDP contributing sectors such as Agriculture, Manufacturing, Tourism and hospitality, and Transportation. The reported job losses and business closures are expected to limit household expenditures to necessities and limit business expansions (save for those in healthcare and digital financial services). This is likely to delay completion and starting of new property developments. In the short term, reduction in household incomes will most likely limit households' ability to service their existing mortgages and reduce demand for new housing.

Nevertheless, KMRC is expected to play a significant role in contributing towards the achievement of *Affordable housing* objective in Kenya. In the short term, KMRC is well positioned to support emergency interventions aimed at stabilising the housing market post Covid-19 pandemic. As a liquidity provider, KMRC will support mortgage lenders by providing secure long term funds against eligible portfolio of mortgages. This will offer a transition path back to growth and profitability for lenders and for delinquent borrowers to become performing again. KMRC will also support the housing developers by linking them with the participating mortgage lenders in order to effectively link supply and demand. When developers have clear visibility of offtake, they will be more encouraged to commit to affordable housing developments.

I am therefore optimistic that notwithstanding the challenges, KMRC is ready to effectively commence its business operations upon receipt of a full license and thereby support Kenyans access affordable housing.

In closing, I wish to thank the KMRC Board of Directors whose steadfast support and guidance has facilitated effective set up and operationalization of the company. I also wish to convey my sincere gratitude to the KMRC management team for their determination and commitment to the organization. I look forward to our shared effort of catalysing growth of affordable housing finance in Kenya.

Johnstone Oltetia
Ag. CEO

Management Team

Front Row (L-R) Geofrey Mwaura - Head of Credit, Ruth Muiruri - Head of Legal, Johnstone Oltetia – Ag. Chief Executive Officer and Florah Muthaura - Head of Risk and Compliance. Back Row (L-R) Erick Wambua - Finance Manager, Deborah Masara - ICT Manager, Irene Kadima – Communications Officer, Daniel Saruni - Head of HR and Administration and Gideon Rutto – Procurement and Logistics Manager

Report of the Directors

The Directors submit their report and the audited financial statements for the year ended 31 December 2019, which show the state of the Company's affairs.

1 Incorporation

The Kenya Mortgage Refinance Company PLC was incorporated on 19th April 2018 under the Companies Act 2015. It is a public limited liability Company domiciled in Kenya. The address of the registered office is as set out on page 8.

2 Directors

The Directors who held office during the year and to the date are listed on page 8.

3 Principal activity

The principal activity of the Company is providing secure long-term funding to primary mortgage lenders (Banks and Saccos) for financing of eligible mortgages.

The Company will be regulated by the Central Bank of Kenya as a non-deposit taking financial institution, with the Capital Markets Authority (CMA) providing oversight over its bond issuance operations.

4 Business review

The Company was purposely established as a public private partnership arrangement with majority private sector owned in order to crowd in private sector funding to support affordable housing. The Company recently closed a successful capital mobilization drive which resulted in the Government of Kenya, eight (8) commercial banks, one (1) micro finance bank, and eleven (11) SACCO's becoming shareholders of the Company. In addition, two development finance institutions (Shelter Afrique and IFC) are keen to invest equity in the Company and are currently finalizing their due diligence processes.

On April 30th, 2019, the World Bank approved a $250 million International Bank for Reconstruction and Development (IBRD) credit to support the Government Affordable Housing program. On May 15, 2019, African Development Bank (AfDB) approved a further $100 million to support the program. These funds will be applied towards enhancing access to affordable housing finance, strengthening the Company balance sheet, and providing requisite credit enhancements to support the Company issuance of bonds.

As a wholesale financial institution, Kenya Mortgage Refinance Company PLC will extend long term loans at fixed rates to financial institutions secured against mortgages so that they can extend the maturity of their housing loans to end borrowers hence increasing affordability. Given Kenya's growth and urbanization rates, there is critical need to deliver housing at the lower end of the income spectrum in order to improve housing conditions for the average Kenyan. Through its re-financing activities, the Company will seek to catalyze growth of the mortgage market in Kenya by targeting households that fall within the mortgage gap and lower middle-income categories which represents about 95% of the formally employed population.

Kenyans will be able to access longer term housing loans and enjoy a wide choice of competitively priced mortgage offering in the market due to increased competition and product innovation amongst Primary mortgage Lenders. This will lead to an increase in home ownership and growth in household assets.

Report of the Directors (Continued)

4 Business review (Continued)

The primary mortgage lenders will also benefit by improving their asset liability risk management by matching long-term mortgage loans with long-term funds, improving their liquidity management by having access to the liquidity facility and reduce barriers that inhibit the small lenders active participation in the growth of the mortgage asset portfolio.

It is envisioned that in the medium term, the Company will contribute to lowering of overall transaction costs by pooling issuance of bonds as compared to financial institutions accessing the market individually and spur development of the mortgage market. The Company will be a regular issuer of long-term, high quality investments needed by institutions with long term liabilities thus crowding in pension funds, social security funds and insurance companies.

5 Dividend

The directors do not recommend the declaration of a dividend for the year.

6 Financial statements

At the date of this report, the Directors were not aware of any circumstances which would have rendered the values attributed to the assets in the financial statements misleading.

7 Directors' benefits

The Company was incorporated on 19th April 2018. There were directors' sitting allowances paid as shown in Note 16.

8 Statement as to disclosure to the Company auditor

Each of the persons, who was a director at the time the report was approved confirms that:

(a) there is, so far as the person is aware, no relevant audit information of which the Company's auditor is unaware;

(b) the person has taken all the steps that the person ought to have taken as a director so as to be aware of any relevant audit information to establish that the Company's auditor is aware of that information.

9 Auditor

The directors approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees. The agreed auditor's remuneration has been charged to profit or loss in the year.

The Company's auditor Mazars, Certified Public Accountants (K) was appointed during the year and has indicated its willingness to continue in office in accordance with Section 717 of the Kenyan Companies Act No 17 of 2015.

By order of the Board

Company Secretary
10th June 2020

Statement of Director's Responsibilities

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Company as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the Company keeps proper accounting records that: (a) show and explain the transactions of the Company; (b) disclose, with reasonable accuracy, the financial position of the Company; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Companies Act, 2015.

The directors accept responsibility for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. They also accept responsibility for:

i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;
ii) selecting suitable accounting policies and applying them consistently; and
iii) making accounting estimates and judgements that are reasonable in the circumstances.

Having made an assessment of the Company's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the Company's ability to continue as a going concern.

The directors acknowledge that the independent audit of the financial statements does not relieve them of their responsibilities.

Approved by the board of directors on 10th June 2020 and signed on its behalf by:

Director
Dr. Haron Sirima, OGW

Director
Johnstone Oltetia

Report of the Independent Auditor

To the Members of Kenya Mortgage Refinance Company PLC

Opinion

We have audited the accompanying financial statements of Kenya Mortgage Refinance Company PLC (the Company), set out on pages 23 to 45, which comprise the statement of financial position as at 31 December 2019, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the company as at 31 December 2019 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act, 2015.

Basis of our opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the *International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

(i) Shareholders funds.

The company is required to annually ensure that the shareholders shall not, whether directly or indirectly, hold more than twenty-five per centum of the shares of the Company unless it is a public entity or a multilateral development bank, as per note 14 and 15. These shareholders funds were significant to our audit because the balance of Kshs. 1,291,000,100 as of 31 December 2019 is material to the financial statements. In addition, management's assessment process is based on their due diligence processes and a successful capital mobilisation drive.

Our audit procedures included, among others, obtaining company search report (CR12) and annual return filed with registrar of companies to assist us in evaluating the shareholders funds capitalised and their ownership fractions. We also focused on the adequacy of the company's disclosures about those shareholders funds.

The Company's disclosures about shareholders funds are included in Note 14 and 15, which specifically explains that the capitalised amounts and the capital mobilisation drive may lead to rise in share capital and dilution of shareholding for some financial institutions and government balance in the future.

Report of the Independent Auditor (Continued)

Key audit matters (Continued)

(ii) Investment on fixed deposit

We focused on this area because the Company's invested amounts received from shareholders in short term bank deposits and interest income earned from the same could be misstated.

How our audit addressed the area of focus

We obtained fixed deposit receipt from respective banks, checked placement period and interest earned periodically. In additional we obtained withholding certificates on interest income deducted.

The direct tests that we carried out gave us sufficient evidence on correct statement of interest earned and investment on short term deposit.

Other information

The directors are responsible for the other information. Other information comprises the information included in the Annual Report, but does not include the financial statements and our auditor's report thereon.
Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Directors for the Financial Statements

The Directors are responsible for the preparation and fair presentation of the financial statements in accordance with the International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015, and for such internal controls as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company's or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Report of the Independent Auditor (Continued)

Auditor's Responsibilities for the Audit of the Financial Statements (Continued)

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the Company financial statements. We are responsible for the direction, supervision and performance of the Company's audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report of the Independent Auditor (Continued)

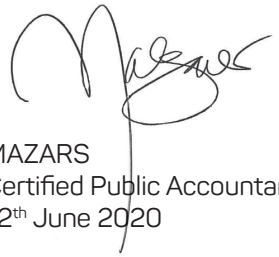
Report on other matters prescribed by the Kenyan Companies Act, 2015

In our opinion the information given in the report of the directors on pages 2 - 3 is consistent with the financial statements.

As required by the Kenyan Companies Act we report to you, based on our audit, that:

i) we have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of the audit;
ii) in our opinion proper books of accounts have been kept by the Company, so far as appears from our examination of those books; and
iii) the Company's statement of financial position and statement of comprehensive income are in agreement with the books of accounts.

The signing partner responsible for the independent audit was FCPA Charles Gathuto, Practising Certificate No. 1231.



MAZARS
Certified Public Accountant (K)
12th June 2020

Financial Statements

Statement of Comprehensive Income

	Note	2019
Revenue		**Kshs**
Interest income	5	125,664,018
Other operating incomes	6	200,000,000
		325,664,018
Expenses		
Administration and operating expenses	7	(32,200,892)
Depreciation on property and equipment	12	(202,901)
		(32,403,793)
Net profit before tax		293,260,225
Income tax expense	8	(28,789,041)
Total comprehensive profit for the year		264,471,184

Statement of Financial Position

	Note	2019 Kshs
Assets		
Cash and Bank	9	2,269,227,540
Other Receivables	10	497,926
Property and Equipment	12	5,129,843
Total Assets		2,274,855,309
Liabilities And Equity		
Liabilities		
Trade and Other Payables	13	25,444,686
Tax Payable	8	8,982,681
Deferred Tax Liability	11	956,758
		35,384,125
Equity		
Share Capital	14	1,291,000,100
Contribution Pending Allotment	15	683,999,900
Revenue Reserves		264,471,184
		2,239,471,184
Total Liabilities And Equity		2,274,855,309

The financial statements on pages 23 to 45 were approved for issue by the board of directors on 10th June 2020 and were signed on its behalf by:

Director
Dr. Haron Sirima, OGW

Director
Johnstone Oltetia

Statement of Changes in Equity

	Notes	Share Capital Kshs	Revenue Reserves Kshs	Contributions Pending Allotment Kshs	Total Kshs
Year ended 31 December 2019					
As at 1 January 2019		-	-	-	-
Profit for the year		-	264,471,184	-	264,471,184
Transactions with owners:					
Issue of Ordinary Share Capital	14	1,291,000,100	-	-	1,291,000,100
Contributions Pending Allotment	15	-	-	683,999,900	683,999,900
At 31 December 2019		1,291,000,100	264,471,184	683,999,900	2,239,471,184

Statement of Cash Flows

	Note	2019 Kshs
Cash flows from operating activities		
Profit before tax		293,260,225
Adjustments for:		
Depreciation on property and equipment	12	202,901
Income tax paid	8	(18,849,602)
Operating profit before working capital changes		274,613,524
Increase in other receivables	10	(497,926)
Increase in other payables	13	25,444,686
Net cash from operating activities		299,560,284
Cash flows used in investing activities		
Purchase of property and equipment	12	(5,332,744)
Net cash used in investing activities		(5,332,744)
Cash flows from financing activities		
Proceeds from issue of ordinary shares	14	1,291,000,100
Proceeds of contribution pending allotment	15	683,999,900
Net cash from financing activities		1,975,000,000
Increase in cash and cash equivalents		2,269,227,540
Cash and cash equivalents at start of year		-
Cash and cash equivalents at end of year	9	2,269,227,540

Notes to the Financial Statements

1 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

These financial statements comply with the requirements of the Kenyan Companies Act, 2015. The statement of comprehensive income represents the profit and loss account referred to in the Act. The statement of financial position represents the balance sheet referred to in the Act.

1.1 Basis of preparation

The financial statements have been prepared under the historical cost convention, except as indicated otherwise below and are in accordance with International Financial Reporting Standards (IFRS). The historical cost convention is generally based on the fair value of the consideration given in exchange of assets. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or liability, the company takes into account the characteristics of the asset or liability if market participants would take those characteristics into when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for measurements that have some similarities to fair value but are not fair value.

In addition, for financial reporting purposes, fair value measurements are categorized into level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

  Transfer between levels of the fair value hierarchy are recognized by the directors at the end of the reporting period during which the change occurred.

Going concern

The financial performance of the company is set out in the report of the directors and in the statement of comprehensive income. The financial position of the company is set out in the statement of financial position. Disclosures in respect of principal risks and uncertainties are included within the Director's Report and disclosures in respect of risk management and capital management are set out in notes 3 and 4 respectively.

Based on the financial performance and position of the company and its risk management policies, the directors are of the opinion that the company is well placed to continue in business for the foreseeable future and as a result the financial statements are prepared on a going concern basis

1.2 New and revised standards

1.2.1 Adoption of new and revised standards

One new Standard, one new Interpretation and a number of Amendments to standards became effective for the first time in the financial year beginning 1st January 2019 and have been adopted by the Company. Neither the new Standard, Amendments nor the Interpretation has had an effect on the Company's financial statements.

1.2.2 New and revised standards that have been issued but are not yet effective

The Company has not applied any of the new or revised Standards and Interpretations that have been published but are not yet effective for the year beginning 1st January 2019, and the Directors do not plan to apply any of them until they become effective. All such new or revised standards and interpretations, with their effective dates, none of which is expected to have a significant impact on the Company's financial statements in the period of initial application.

1.3 Foreign currency translation

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Kenya shillings, which is the Company's presentation currency.

1.4 Revenue recognition

The Company recognises revenue from interest on long term loans to financial institutions secured against mortgages and financial instruments. The Company recognises revenue as and when it satisfies a performance obligation by transferring control of a product or service to a customer. The amount of revenue recognised is the amount the Company expects to receive in accordance with the terms of the contract, and excludes amounts collected on behalf of third parties, such as Value Added Tax.

1.4.1 Interest income and expenses

Interest income and expense for all interest bearing financial instruments are recognised within the statement of comprehensive income on accrual basis using the effective interest method.

The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently. The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Fair value changes on other derivatives held for risk management purposes, and other financial assets and liabilities carried at fair value through profit or loss, are presented in net income on other financial instruments carried at fair value in the profit or loss. Once a financial asset or a portfolio of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest that was used to discount the future cash flows for purposes of measuring the allowance for impairment.

1.4.2 Fees and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as the arrangement of the acquisition of shares or other securities, or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis. Performance-linked fees or fee components are recognised when the performance criteria are fulfilled.

1.5 Financial instruments

Financial assets and liabilities

1.5.1 Measurement methods

a) Amortised cost and effective interest rate

The amortised cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and, for financial assets, adjusted for any loss allowances.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired financial assets – assets that are credit-impaired at initial recognition, the Company calculates the credit- adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Company revises the estimates of future cash flows, the carrying amount of the respective financial asset or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the statement of comprehensive income.

b) Interest income

Interest income and interest expense on interest bearing financial instruments is calculated by applying the effective interest rate to the gross carrying amount, except for:

- Purchased or originated credit impaired (POCI) financial assets, for which the original credit- adjusted effective interest rate is applied to the amortised cost of the financial asset; and
- Financial assets that are not Purchased or originated credit impaired "POCI" but have subsequently become credit-impaired, for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e.net of the expected credit loss provision) in subsequent reporting period

c) Initial recognition and measurement

Financial assets and financial liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on trade-date, the date which the Company commits to purchase or sell the asset.

At initial recognition, the Company measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through the profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such fees and commissions. Transaction costs of financial assets and financial liabilities are carried at fair value through profit or loss are expensed in profit or loss. Immediately after the initial recognition, an expected credit loss allowance (ECL) is recognised for the financial assets measured at amortised cost and investments in debt instruments measured at fair value through other comprehensive income (FVOCI), which results in an accounting loss being recognised in the statement of comprehensive income when an asset is newly originated.

c) Initial recognition and measurement (Continued)

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the entity recognises the difference as follows:

- When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognised as a gain or loss.
- In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

1.5.2 Financial assets

Classification and subsequent measurement

The Company classified its financial assets in the following measurement categories:

- Fair value through profit or loss (FVPL)
- Fair value through other comprehensive income (FVOCI)
- Amortised cost

1.5.2.1 Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse. Classification and subsequent measurement of debt instruments depend on:

- the Company's business model for managing the asset; and
- the cash flow characteristics of the asset

Based on these factors, the Company classifies its debt instruments into one of the following three measurement categories:

i. Amortised cost: assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest (SPPI), and that are not designated at fair value through profit or loss (FVPL), are measured at amortised cost. The carrying amount of these assets are adjusted by any expected credit loss allowance. Interest income from financial assets is included in "interest and similar income" using the effective interest rate method.

ii. Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at fair value through profit or loss (FVPL), are measured through other comprehensive income (FVOCI). Movements in the carrying amounts are; taken through other comprehensive income (OCI), except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income (OCI) is reclassified from equity to profit or loss and recognised in "Net investment income" using the effective interest rate method.

Debt instruments (Continued)

iii. Fair value through the profit or loss: Assets that do not meet the criteria for amortised cost or fair value through other comprehensive income (FVOCI) are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented within "Net trading income" in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in "Net investment income". Interest income from these financial assets is included in "interest income" using the effective interest rate method.

Business model:

The business model reflects how the Company manages the assets in order to generate cash flows. That is, whether the Company's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of "other" business model and measured at fair value through profit or loss (FVPL). Factors considered by the Company in determining the business model for a class of assets include past experience on how cash flows for these assets were collected, how the asset's performance is evaluated and reported by key management personnel, how risks are assessed and managed and how managers are compensated. For example, the liquidity portfolio of assets is held by the Company as part of liquidity management and is generally classified with the hold to collect and sell business model. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These securities are classified in the "other" business model and measured at fair value through profit or loss (FVPL).

Solely payments of principal and interest (SPPI): Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Company assesses whether the financial instruments' cash flows represents solely payments of principal and interest (the "SPPI test"). In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

The Company reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. The changes are expected to be very infrequent and none occurred during the year.

1.5.2.2 Equity Instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

Equity Instruments (Continued)

The Company subsequently measures all equity investments at fair value through profit or loss, except where the Company's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Company's policy is to designate equity investments as fair value through other comprehensive income (FVOCI) when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in other comprehensive income (OCI) and are subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversals of impairment losses) are not reported separately from other changes in fair values. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Company's right to receive payment is established.

Gains and losses on equity investments at fair value through profit or loss (FVPL) are included in the "Net trading income" line in the statement of profit or loss.

- Modification of loans

  The Company sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Company assesses whether or not the new terms are substantially different to the original terms. The Company does this by considering, among others, the following factors:

  - If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
  - Whether any substantial new terms are introduced, such as a profit share/ equity based return that substantially affects the risk profile of the loan.
  - Significant extension of the loan term when the borrower is not in financial difficulty.
  - Significant change is interest rate
  - Change in the currency of the loan
  - Insertion of collateral, other security or credit enhancement that significantly affect the credit risk associated with the loan.

  If the terms are substantially different, the Company derecognises the original financial asset and recognises a "new" asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred.

  However, the Company also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

  If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Company recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate of credit-adjusted effective interest rate for purchased or originated credit impaired (POCI) financial assets.

Equity Instruments (Continued)

- Derecognition other than on a modification

  Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Company transfers substantially all the risks and rewards of ownership, or (ii) the Company neither transfers nor retains substantially all the risks and rewards of ownership and the Company has not retained control.

  The Company enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as "pass through" transfers that result in derecognition if the Company:

  i. Has no obligation to make payments unless it collects equivalent amounts from the assets

  ii. Is prohibited from selling or pledging the assets; and

  iii. Has an obligation to remit any cash it collects from assets without material delays

  Collateral (shares and bonds) furnished by the Company under standard repurchase agreements and securities lending and borrowings transactions are not derecognised because the Company retains substantially all the risks and rewards on the basis of predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Company retains a subordinated residual interest.

1.5.3 Financial liabilities

i. Classification and subsequent measurement

In both the current period and prior period, financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at fair value through profit or loss such as derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair values of the financial liability that is attributable to changes in the credit risk of that liability) and partially profit or loss (the remaining amount of change in the fair value of the liability);

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Company recognises any expense incurred on the financial

- Financial guarantee contracts and loan commitments

ii. Derecognition

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

Derecognition (Continued)

The exchange between the Company and its original lenders of debt instruments with substantially different terms, as well as substantial modification of the terms of the existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If the exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange of modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

1.5.4 Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

- their risks and economic characteristics are not closely related to those of the host contract;
- a separate instrument with the same terms would meet the definition of a derivative; and
- the hybrid contract is not measured at fair value through profit or loss

1.6 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with Banks and other short-term highly liquid investments with original maturities of three months or less. Funds restricted for a period of more than three months on origination and cash reserve deposits with the Central Company of Kenya are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

1.7 Property and equipment

All categories of property, plant and equipment are initially recognised at cost and subsequently carried at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure directly attributable to the acquisition of the assets. Computer software, including the operating system, that is an integral part of the related hardware is capitalised as part of the computer equipment.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that it will increase the future economic benefits associated with the item that will flow to the Company over those originally assessed and the cost of the item can be measured reliably. Repairs and maintenance expenses are charged to the profit and loss account in the year in which they are incurred.

Increases in the carrying amount arising on revaluation are recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. Decreases that offset previous increases of the same asset are recognised in other comprehensive income. All other decreases are charged to the profit and loss account. Annually, the difference between the depreciation charge based on the revalued carrying amount of the asset charged to the statement of comprehensive income and depreciation based on the asset's original cost (excess depreciation) is transferred from the revaluation surplus reserve to retained earnings.

Property and equipment (Continued)

Depreciation is calculated using the straight line method to write down the cost or the revalued amount of each asset to its residual value over its estimated useful life.

Depreciation on property and equipment is calculated on the reducing balance at the following annual rates:

	Rate - %
Motor vehicles	25%
Office equipments	20%
Computer hardwares	25%

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item, is depreciated separately.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposal of property, plant and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. On disposal of revalued assets, amounts in the revaluation surplus reserve relating to that asset are transferred to retained earnings.

1.8 Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Company are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

1.9 Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

1.10 Income tax

The tax expense for the period comprises current and deferred income tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity respectively.

1.10.1 Current income tax

The current income tax charge is calculated on the basis of tax laws enacted or substantively enacted at the reporting date. The directors periodically evaluate positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. They establish provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

1.10.2 Deferred income tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same entity or different taxable entities where there is an intention to settle the balances on a net basis.

2 Significant judgements and key sources of estimation uncertainty

In the process of applying the accounting policies adopted by the Company, the directors make certain judgements and estimates that may affect the amounts recognised in the financial statements. Such judgements and estimates are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the current circumstances. However, actual results may differ from those estimates. The judgements and estimates are reviewed at each financial reporting date to ensure that they are still reasonable under the prevailing circumstances based on the information available, and any revisions to such judgements and estimates are recognised in the year in which the revision is made.

2.1 Significant judgements made in applying the Company's accounting policies

The judgements made by the directors in the process of applying the Company's accounting policies that have the most significant effect on the amounts recognised in the financial statements include:

i. Classification of financial assets: whether the business model in which financial assets are held has as its objective the holding of such assets to collect contractual cash flows or to both collect contractual cash flows and sell the assets; and whether the contractual terms of financial assets give rise on specified dates to cash flows that are solely payments of principal and interest;

ii. whether credit risk on financial assets has increased significantly since initial recognition; and

iii. how to determine the incremental borrowing rate used in the discounting of lease liabilities.

2.2 Key sources of estimation uncertainty

Key assumptions made about the future and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year include:

i. Useful lives and residual values of property and equipment and intangible assets

ii. Management reviews the useful lives and residual values of the items of property and equipment, intangible assets and right-of-use assets on a regular basis. During the financial year, the directors determined no significant changes in the useful lives and residual values.

3 Financial risk management

The company's business involves taking on risks in a targeted manner and managing them professionally. The core functions of the company risk management are to identify all key risks for the company, measure these risks, manage the risk positions and determine capital allocations to each operating entity. The company regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice.

The company's risk management objective is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the company's financial performance.

The company defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors.

Financial risk management is carried out by the management under policies approved by the Board of Directors. The management function identifies and evaluates financial risks in close co-operation with the individual Company's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as interest rate risk, credit risk and nonderivative financial instruments. In addition, internal audit is responsible for the independent review of risk management and the control environment.

3.1 Credit risk and expected credit losses

Credit risk is the risk of suffering financial loss, should any of the Company's' customers, clients or market counterparties fail to fulfil their contractual obligations. Credit risk arises mainly from loans and advances and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, financial guarantees, letters of credit, endorsements and acceptances.

The Company is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its trading activities ('trading exposures'), including non-equity trading portfolio assets.

Credit risk and expected credit losses (Continued)

Credit risk on financial assets with banking institutions is managed by dealing with institutions with good credit ratings and placing limits on deposits that can be held with each institution. The Company carries out its own assessment of credit risk before investing, and updates such assessments at each reporting date.

In assessing whether the credit risk on a financial asset has increased significantly, the Company compares the risk of default occurring on the financial asset as at the reporting date with the risk of default occurring on that financial asset as at the date of initial recognition. In doing so, the Company considers reasonable and supportable information that is indicative of significant increases in credit risk since initial recognition and that is available without undue cost or effort. There is a rebuttable assumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

For these purposes default is defined as having occurred if the debtor is in breach of contractual obligations, or if information is available internally or externally that suggests that the debtor is unlikely to be able to meet its obligations. However, there is a rebuttable assumption that default does not occur later than when a financial asset is 90 days past due.

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Evidence that a financial asset is credit impaired include observable data about the following events:

- significant financial difficulty of the debtor
- a breach of contract
- it is probable that the debtor will enter bankruptcy
- the disappearance of an active market for the financial asset because of financial difficulties.

The gross carrying amount of financial assets with exposure to credit risk at the balance sheet date was as follows:

	Basis for measurement of loss allowance				
	12-month expected credit losses	Lifetime expected credit losses (see note below)			
		(a)	(b)	(c)	Total
	Kshs	Kshs	Kshs	Kshs	Kshs
At 31st December 2019					
Other receivables	497,926	-	-	-	497,926
Cash at bank	2,269,227,540	-	-	-	2,269,227,540
Exposure to credit risk	2,269,725,466	-	-	-	2,269,725,466

3.1 Credit risk and expected credit losses (Continued)

Financial assets for which the loss allowance has been measured at an amount equal to lifetime expected credit losses have been analysed above based on their credit risk ratings as follows:

i. financial assets for which credit risk has increased significantly since initial recognition but that are not credit impaired;

ii. financial assets that are credit impaired at the balance sheet date;

iii. trade receivables, contract assets and lease receivables for which the loss allowance is always measured at an amount equal to lifetime expected credit losses, based, as a practical expedient, on provision matrices.

3.2 Liquidity risk

The company is exposed to the risk that it will encounter difficulty in raising funds to meet commitments associated with customer requirements. Liquidity risk is addressed through the following measures:

i. Management of liquidity risk

The company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the company's reputation. The Risk Committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties meeting financial liabilities as they fall due is encountered.

A portfolio of short-term liquid assets largely made up of short-term liquid investment securities and bank facilities ensure that sufficient liquidity is maintained within the company as a whole.

ii. Source of funding

The Company recently closed a successful capital mobilization drive which resulted in the Government of Kenya, eight (8) commercial banks, one (1) micro finance bank, and eleven (11) SACCO's injecting equity funds. In addition, two development finance institutions (Shelter Afrique & IFC) are keen to invest equity in the Company.

iii. Exposure to liquidity risk

The company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the company's reputation. The Risk Committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties meeting financial liabilities as they fall due is encountered. A portfolio of short-term liquid assets largely made up of short- term liquid investment securities and Company facilities ensure that sufficient liquidity is maintained within the company as a whole. A mortgage refinance company shall maintain such leverage ratio as may be specified by the Central Bank by notice in the Gazette.

Exposure to liquidity risk (Continued)

The table below represents the cash flows payable by the company under non- derivative financial liabilities by remaining contractual maturities at the end of the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Less than one month Kshs	Between 1-3 months Kshs	Between 3-12 months Kshs	Over 1 year Kshs
31st December 2019				
Other payables	-	25,444,686	-	-

The company manages the inherent liquidity risk based on expected undiscounted cash inflows.

3.3 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market price and comprises three types of risks: currency risk, interest rate risk and other price risk.

3.3.1 Currency risk

The company operates wholly within Kenya and its assets and liabilities are reported in the local currency. As at the end of trading period it had no currency risk pertaining to its operations.

3.3.2 Interest rate risk

The Company is not exposed to cash flow interest rate risk as it has no variable rate borrowings resulting from changes in market interest rates.

3.3.3 Other price risk

Other price risk arises on financial instruments because of changes in the price of a financial instrument. The Company is not exposed to other price risk because it has no investments in instruments like quoted shares as at the end of the year.

4 Capital Risk Management

The Company's objectives when managing capital, which is a broader concept than the 'equity' on the face of the statement of financial position, are:

i. To comply with the capital requirements set by the Central Bank of Kenya;

ii. To safeguard the Company's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and

iii. To maintain a strong capital base to support the development of its business.

The institution's aim is to build a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

4 Capital Risk Management (Continued)

In implementing current capital requirements, the Central Bank of Kenya requires each Mortgage Refinance Company's Institution to maintain;

- A core capital of not less than one billion shillings.
- A core capital of not less than 10.5 per centum of total risk weighted assets plus risk weighted assets and off-balance sheet items.
- A total capital of not less than 14.5 per centum of its total risk weighted assets plus risk weighted assets and off-balance sheet items.
- The computation of risk weighted assets and off-balance sheet items shall be computed as may be determined by the Company from time to time.

The Company has complied with all externally imposed capital requirements.

The table below summarises the composition of regulatory capital and the ratios of the Company for the year ended 31 December 2019. During the year, the Company complied with all of the externally imposed capital requirements to which they are subject.

Capital	**2019**
	Kshs
Share capital	1,291,000,100
Retained profit	264,471,184
Net after tax profits, current year to-date	264,471,184
Other reserves	683,999,900
	2,503,942,368
Core capital	2,503,942,368
Total risk - weighted assets	450,667,259
Borrowings	-
Gearing	0%
Capital ratios	
· Total regulatory capital expressed as a percentage of total risk	555.6%
· Minimum total Capital to Risk Weighted Assets Requirement	14.5%
Excess	541.1%

5 Interest income

	2019 (Kes)
	125,664,018

6 Other operating income

Grant	
-National Treasury	200,000,000

7 Administration and operating expenses

	2019 Kshs
Staff costs	10,485,771
Board expenses	3,608,000
Office rent and service charge	220,873
Conferences, Seminars and workshops	2,595,628
Licenses and permits	407,127
Appraisal fees	1,567,500
ICT expenses	191,400
Telephone, postage and internet	35,360
Marketing and advertisement	525,502
Office running expenses	720,116
Consultancy fees	10,874,140
Insurance costs	14,620
Audit fee	700,000
Bank charges	27,459
Subscriptions	227,396
	32,200,892

8 Income tax

a) Income tax expense

Current income tax	27,832,283
Deferred income tax (Note 11)	956,758
	28,789,041

8 Income tax (Continued)

The tax on the company's profit before income tax differs from the theoretical amount that would arise using the statutory income tax rate as follows:

Net profit before tax	293,260,225
Tax calculated at the statutory tax rate of 30%	87,978,068
Tax effect of:	
Expenses not deductible for tax purposes	810,973
Income not subject to tax	(60,000,000)
Income tax credit	28,789,041

(b) Statement of financial position

	2019
	Kshs
At 1 January	-
Current tax charge	27,832,283
Tax paid during the year	(18,849,602)
At 31 December	8,982,681

9 Cash and bank balances

Short-term bank deposits	2,225,197,448
Cash at bank and in hand	44,030,092
	2,269,227,540

For the purpose of the statement of cash flows, cash and cash equivalents comprise the following:

Fixed deposits	
- KCB Bank Kenya Limited	2,067,075,360
-Co-operative Bank of Kenya Limited	158,122,088
	2,225,197,448

10 Other receivables

Prepayments	497,926

11 Deferred income tax

Deferred income tax is calculated using the enacted tax rate of 30% except for capital gains, for which the enacted tax rate of 5% is used.

Deferred tax assets/(liabilities), and the deferred tax charge/(credit) in the profit and loss account and in other comprehensive income are attributable to the following items:

Year ended 31st December 2019	At 1st January Kshs	Credited/ (charged) to profit or loss Kshs	At 31st December Kshs
Property, plant and equipment			
- on historical cost basis	-	(956,758)	(956,758)

12 Property and equipment

	Computer Kshs	Motor vehicles Kshs	Total Kshs
Cost			
At 1 January 2019	-	-	-
Additions	629,500	4,703,244	5,332,744
At 31 December 2019	629,500	4,703,244	5,332,744
At 1 January 2019	-	-	-
Charge for the year	104,917	97,984	202,901
At 31 December 2019	104,917	97,984	202,901
Net book value			
At 31 December 2019	524,583	4,605,260	5,129,843

13 Trade and other payables

Accruals	25,444,686

14 Share capital

	Number of ordinary shares	Issued and fully paid up capital Kshs
At 1 January		
Issue for cash	12,910,001	1,291,000,100
At 31 December		1,291,000,100

The total number of authorised ordinary shares is 50,000,000 with a par value of Kshs. 100 each.

15 Contribution pending allotment

	2019 (Kes)
At 1 January	
Movements during the year	683,999,900
At 1 January and 31 December 2019	683,999,900

After the recent capital mobilisation drive, the company received a total of Kshs. 1,975,000,000 out of which Kshs. 1,291,000,100 was capitalised. The balance of Kshs. 683,999,900 was held as contribution pending allotment awaiting investment in equity from two development finance institutions (Shelter Afrique and IFC). Any excess funds not capitalised may be refunded to the shareholders.

16 Related party transactions

The company recently closed a successful capital mobilization drive which resulted in the Government of Kenya, eight (8) commercial banks, one (1) micro finance bank, and eleven (11) SACCO's becoming shareholders of Kenya Mortgage Refinance Company PLC. In addition, two development finance institutions (Shelter Afrique & IFC) are keen to invest equity in the Company and are currently finalizing their due diligence processes. The Company is related to other companies which are related through common shareholding or common directorships.

The following transactions were carried out with related parties.

i. Key management compensation	
Salaries and other employment benefits	10,069,715
ii. Board expenses	
• fees	2,150,000
• allowances	1,458,000
	3,608,000

Notes

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