Kenya Mortgage Refinance Company (KMRC) Recap, & Cytonn Weekly #45/2020

Focus of the Week

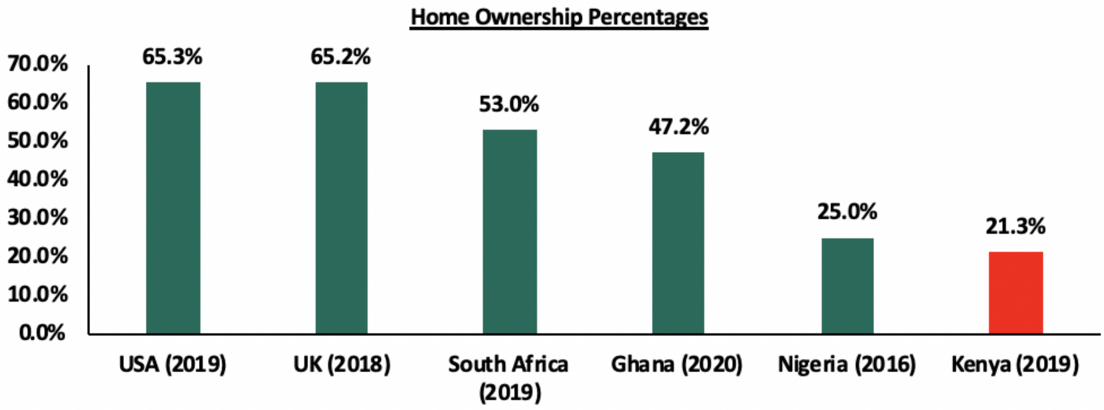
Kenya Mortgage Refinance Company (KMRC), a treasury backed lender, began lending in September 2020, following approval to operate by the Central Bank of Kenya. The facility was established in 2018 and we have since written two topical on the same before it became operational, the Kenya Mortgage Refinancing Company Note and the Kenya Mortgage Refinancing Company Update. In this week's topical, we do a recap on the facility by covering the following;

i. Overview of Housing Sector in Kenya,
ii. Home Financing in Kenya,
iii. Introduction to KMRC,
iv. The KMRC Objectives,
v. Benefits and Challenges of KMRC,
vi. Case Study of Saudi Real Estate Refinance Company,
vii. Lessons Learnt from The Case Study, and,
viii. Conclusion.

i. **Overview of Housing Sector in Kenya**

Kenya currently has a housing deficit of approximately 2.0 mn units which grows by 200,000 units per year according to the National Housing Corporation. This is mainly attributed to the rapid urbanization and population growth rates of around 4.0% and 2.2%, respectively against a global average of 1.9% and 1.1%. The current housing deficit is attributed to factors such as; inadequate supply due the fragmented nature of the real estate sector, high development and land costs, focus on high end markets due to lack of profitability at the lower end of the market, and occasional delays in issuing building approvals in major towns such as Nairobi, Kisumu and Mombasa counties.

Home ownership in urban areas in Kenya has remained low at approximately 21.3% implying that more than 78.7% of the urban population are renters, compared to more developed countries such as South Africa which has more than 53.0% of its urban population owning homes. The relatively low rate of home ownership in Kenya is attributed to: i) high property prices, (ii) high initial transaction cost e.g. the initial deposit required to access mortgage, (iii) lack of credit risk information for those in the informal sector leading to their exclusion, (iv) high interest rates for mortgage loans, (v) lack of real estate finance to fund large scale developments, and, (vi) low income levels which has made it hard to service loans. The graph below shows the home ownership percentage of Kenya in comparison to other countries;



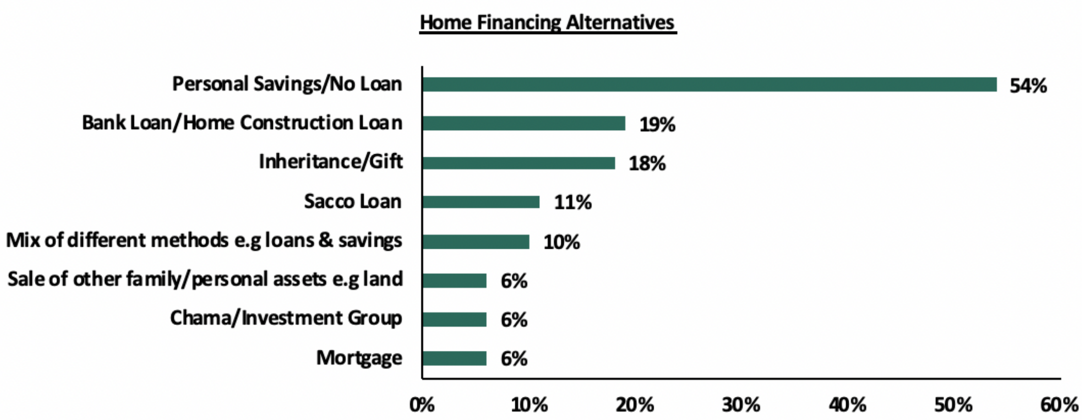
Source: Center for Affordable Housing Africa, Federal Reserve Bank

With the aim of addressing the housing deficit and improving home ownership, the Kenyan Government established the Affordable Housing Initiative (AHI) as one of its Big Four Development Agenda. Through the initiative, the government targets to deliver 500,000 housing units to the lower and middle income population segments by 2022. Some key projects under the initiative include; the Park Road, Ngara project, the Mavoko Sustainable Housing project, Kibera Soweto East Zone B project, NHC Stoni Athi View, Starehe Affordable Housing, and, Mariguini Informal Settlement.

The government has established several incentives and initiatives aimed at increasing home ownership in the country such as; (i) waiver on stamp duty for first time home buyers of affordable housing units, (ii) the affordable housing relief of 15.0% of gross emoluments up to Kshs 108,000 per annum or Kshs 9,000 per month for Kenyans buying houses under the Affordable Housing Scheme, (iii) exemption from tax for interest on mortgage repayments of up to Kshs 300,000 per annum provided that the taxpayer occupies the property, (iv) establishment of the National Housing Development Fund and the Kenya Mortgage Refinance Company.

ii. **Home Financing in Kenya**

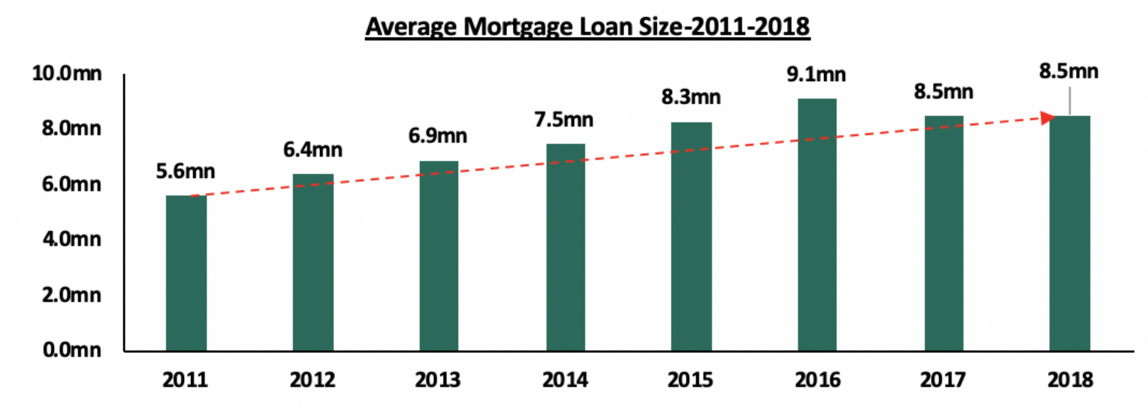
Availability of affordable housing finance continues to be the key challenge towards home ownership in Kenya. According to the Kenya Bankers Association, the main home financing option in Kenya is personal savings, as shown below;



Source: Kenya Bankers Association

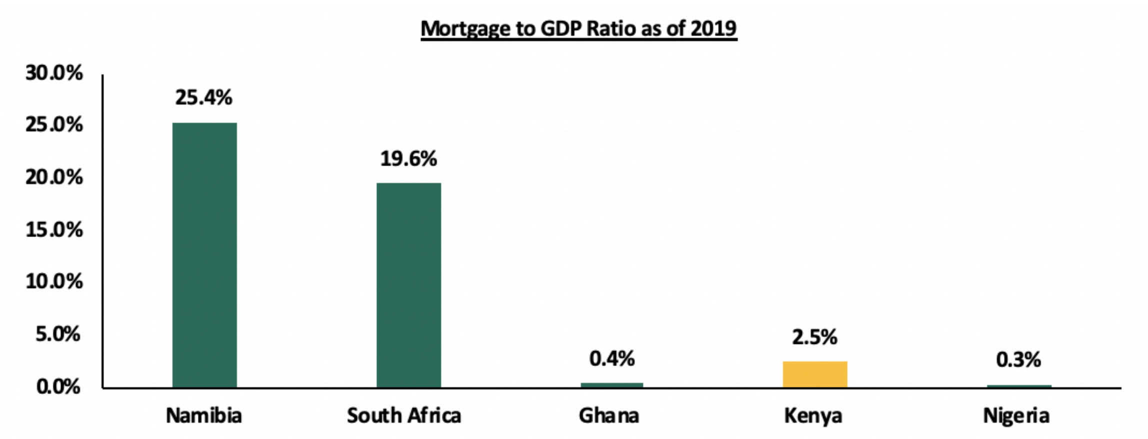
Mortgage is the least popular alternative for home financing evidenced by the low uptake with approximately 26,504 accounts as at 2018 out of an adult population of more than 24 million. This is mainly attributed to; relatively high interest rates averaging 12.0% as at 2020. Additionally, the average mortgage loan size decreased from Kshs 8.52 mn in 2017 to Kshs 8.48 mn in 2018 as banks tightened credit standards to the mortgage market.

The graph below shows the average mortgage loan size from 2011 to 2018.



Source: Central Bank of Kenya (CBK)

With an average mortgage size of Kshs 8.5 mn and interest rates at 12.0% and an average tenor of 12 years, one is required to make monthly repayments of approximately Kshs 111,640 per month which is unaffordable assuming a gross salary of Kshs 50,000 per month. Given the above, the Kenya mortgage to GDP ratio has continued to lag behind at 2.5% as of 2019 compared to countries such as Namibia at 25.4% as shown in the graph below;



Source: Center for Affordable Housing Africa

In Kenya, currently banks are the main providers of mortgage financing, according to the Central Bank of Kenya, Banking Sector Annual Reports, 2018, about 76.1% of lending to the mortgage market was by 6 institutions similar to 2017. Most financial institutions are reluctant to expand their mortgage portfolio attributed to; low supply of long-term capital due to limited access to capital markets funding, asset-liability mismatch by tenor due to the relatively long-term nature of mortgage loans and short-term nature of bank deposits, limited credit risk information especially for those in the informal sector, and, complex legal and regulatory framework as well as collateral requirements making mortgages exceedingly expensive. This shows that there has been the need to bridge the funding gaps by proving long term funding to the primary lenders to enhance their lending capabilities. This prompted the birth of the Kenya Mortgage Refinance company which is aimed at addressing liquidity issues affecting financial institutions through; (i) using the capital markets to raise funds to support the lending activities of Primary Mortgage Lenders (PMLs) at relatively low rates to enable onward lending to borrowers, and, (ii) increasing liquidity thus reducing risk premiums on mortgages for borrowers.

iii. **Introduction to KMRC**

The KMRC is an initiative of the National Treasury and World Bank aimed at supporting the affordable housing initiative, through providing secure, long-term funding to mortgage lenders thus increasing the availability and affordability of mortgage loans in Kenya. KMRC as a financial services company has specialized in lending to Primary Mortgage Lenders (PMLs) such as banks, Sacco's and other microfinancing institutions within the country for onward lending to potential home owners. The facility is supervised and regulated by the Central Bank of Kenya. KMRC has so far raised funds in form of loans and equity, and also plans to issue a green bond next year. The World Bank extended approximately Kshs 25 bn to KMRC in the form of a concessional loan through the National Treasury, while the African Development Bank (AfDB) injected Kshs 10 bn. KMRC has also received additional funding from 19 undisclosed financial institutions comprising of seven commercial banks, 11 Sacco's and one micro financer (Kenya Women Microfinance Bank) which bought shares through a participating programme amounting to Kshs 2.0 bn. As at September 2020, KMRC had raised funds worth Kshs 37.3 bn. The facility lends to PMLs at an annual interest rate of 5.0%, thus enabling them to write home loans at 7.0% lower than the market average rate of 12.0%. The facility has revealed that so far, it has eight lenders who participated in the first phase of the refinancing programme. These institutions submitted a pool of mortgages application amounting to Kshs 21.0 bn but only Kshs 4.5 bn qualified.

KMRC has two main types of products, they include;

a. **Affordable Housing Loans**: These are loans that are extended to Primary Mortgage Lenders (PML) to refinance mortgage loans capped at Kshs 4.0 mn for Nairobi Metropolitan Area (Nairobi, Kiambu, and Machakos & Kajiado) and Kshs 3.0 mn elsewhere, at a 7.0% interest rate to individual borrowers whose monthly income is not more than Kshs 150,000.
b. **Market Housing Loans**: These are loans that are extended to Primary Mortgage Lenders to re-finance mortgage loans above the affordable housing loans threshold. The market housing loans have a limit of above Kshs 4.0 mn, and will be issued at interests determined by the average market rates.

The applicable terms and conditions for the above loans include;

i. The properties eligible must be a residential unit meant for occupation by the owners or immediate family of the occupants,
ii. The loans are eligible for both self-employed individuals and the employed,
iii. The loan to value (LTV) ratio of all the eligible properties is up to 90.0% of the value of the properties, and this implies that a minimum deposit rate of 10.0% is required to be eligible for the loans,
iv. The payment terms of the mortgage loans are fixed for 25 years for both the salaried and the non-salaried applicants, and,
v. The properties that qualify for financing needs to be valued for purposes of giving a quotation before the loan is approved.

iv. **The KMRC Objectives**

Some of the key objectives of KMRC include:

a. **Assisting in the standardization of mortgage practices in Kenya through capacity building to member institutions.** - This will be achieved through training individuals in member institutions, since the training will be from a centralized institution, the member institutions will be in a position to adopt uniform practices when it comes to mortgages, these includes the terms of repayments and interest rates,
b. **Contributing to the growth of Kenyan capital markets through the issuance of KMRC bonds as a source of sustainable long-term fund**-So far, KMRC has announced that it plans to issue a green bond towards the end of next year,
c. **Contributing to the growth of the mortgage market in Kenya through support to PMLs**-KMRC lends money to PMLs who in turn lends the funds to individuals seeking for home financing, this has the potential of increasing mortgage uptake as the facility offers mortgages at relatively affordable rates both to the PMLs and applicants,
d. **Facilitating member institutions to extend the mortgage maturity in line with the**

objective of long-term finance- One of the main factors that has limited uptake of mortgages is unfavorable payment terms, facilitating institutions to offer longer mortgage tenors will provide mortgage applicants with favorable terms as the repayment periods will be longer, and,

e. **Facilitating the entry of new mortgage lenders in the market in order to broaden the scope of mortgage issuance and increase competition**- As at 2018, according to the Central Bank of Kenya about 76.1% of lending to the mortgage market was by only 6 institutions. With the facility providing long term funding to financial institutions, we expect an increase in the number of firms lending funds to mortgage borrowers. Additionally, this will most likely result in increased competition among various institutions thus the possibility of providing relatively attractive terms and conditions for competitive advantage.

v. **Benefits and Challenges of KMRC**

a. **Benefits**

i. **Increased Home Ownership**: One of the key objectives of KMRC is to increase home ownership among Kenyans through offering mortgages at affordable rates. Home ownership has remained relatively low at 21.3% in urban areas and the lending by KMRC will thus enable potential home buyers access affordable mortgages enabling them acquire homes,
ii. **Increased Mortgage Uptake**: The KMRC is expected to promote the growth of the Kenyan mortgage market with a targeted mortgage account of 50,000 homes within 5 years,
iii. **Increased Liquidity to Mortgage Lending Institutions:** KMRC provides long term funding to banks and other mortgage lending institutions like Sacco's hence creating liquidity for the institutions, and,
iv. **Spur Competition in the Mortgage Market**: KMRC lending at low rates will create competition especially with other lending institutions offering higher interest rates. The low interest rates will attract borrowers giving the institution a competitive advantage over other financial institutions thus prompting the lenders to revise their terms of lending to remain competitive in the market. In addition, the higher number of PMLs in the market, the higher the competition, thus institutions will resort to revising their terms amid the competition.

b. **Challenges**

Key challenges likely to face by KMRC;

i. **Limited Housing Options**: Given the relatively low loan size provided by KMRC, potential homeowners will have few or no options of housing units within the NMA due to the relatively high property prices and low supply of affordable housing units thus forcing them to focus on housing units within satellite towns which are relatively affordable. The current NMA residential unit prices ranges from Kshs 6.3 mn to Kshs 16.6 mn for detached units, and Kshs 7.4 mn to Kshs 10.4 mn for apartments. This is significantly higher than the KMRC range of Kshs 3.0 mn to Kshs 4.0 mn.

The table below shows the residential market average price of units within the NMA;

All values in Kshs unless stated otherwise

NMA Residential Market Rates and Performance 2020

Segment	Unit Size (SQM)	Average Price per SQM	Price	Average Y/Y Price Appreciation	Average Total Returns
Detached units					
High-End	90	184,843	16.6 mn	0.0%	4.2%
Upper Mid-End	90	140,642	12.7 mn	0.9%	5.6%

NMA Residential Market Rates and Performance 2020

Segment	Unit Size (SQM)	Average Price per SQM	Price	Average Y/Y Price Appreciation	Average Total Returns
Lower Mid-End	90	69,484	6.3 mn	(0.5%)	4.1%
Apartments					
Upper Mid-End	90	116,093	10.4 mn	(0.7%)	4.6%
Lower Mid-End	90	90,939	8.2 mn	0.1%	5.9%
Satellite Towns	90	81,833	7.4 mn	(0.1%)	5.3%
Residential Market Average		113,972	10.3 mn	(0.1%)	5.0%

Source: NMA Residential Report 2020

ii. **Lack of clarity on how to Maintain the Low Lending Rates:** The lending rates by the facility are at 5.0% to 7.0% significantly lower than the market rate and KMRC is yet to clarify how it will sustain the rates,

iii. **Default Rates Likely to be High:** This is attributable to the high level of job losses and tough economic times. According the Central Bank of Kenya, Banking Sector Annual Reports, mortgage defaults increased by Kshs 10.8 billion to Kshs 38.1 billion in December 2018 from Sh27.3 billion in December 2017,

iv. **Competition from Government Instruments**: KMRC is likely to face challenges raising funds through bonds as a result of competition from government instruments as they are offering much higher rates than the 5.0%. In addition, to be able to lend at 5.0%, the green bond will have to be issued at a relatively low rate which is likely to make it unattractive to investors noting that Acorn's green bond was issued at 12.3% and attracted 85.0% subscription,

v. **Failure by Borrowers to Meet Mortgage Loan Eligibility Criteria thus Limiting Uptake:** After the KMRC started its operations, more than three quarter of loans that were submitted by PMLs in the first phase of refinancing did not meet the stringent requirements that have been set by World Bank. The criteria for selection for approval for financial institutions requires that lenders applying for concessional funding from KMRC have at least 80.0% of the loans within the affordable housing threshold to create a balance between the affordable and non-affordable housing loans, and

vi. **Bureaucracy and Inefficiencies from State Departments:** The prolonged processes in government departments due to high levels of bureaucracy and delays in processes such as approvals, registration of properties and title deeds are likely to slow down the operations of KMRC.

vi. **Case Study of Saudi Real Estate Refinance Company**

Saudi Real Estate Refinance Company (SRC) was formed in 2017 with the primary goal of developing the housing finance market in Saudi Arabia. SRC is owned by the Public Investment Fund (PIF) and is licensed to operate in the secondary real estate market by the Saudi Arabian Monetary Authority. It was established to enable the originators offer long term and short term financing solutions to home buyers, SRC does not offer direct loans to buyers, it uses intermediaries mainly the financial institutions and lends to them at a rate of 6.0%. The company has two main products which include; i) the short-term funding, these are bridging loans for finance companies during a warehousing period, borrowers get immediate access to short-term loans of less than five years to leverage the balance sheet capacities for financial institutions enabling them to offer more loans, and, ii) the portfolio acquisitions and long term fixed rate mortgage, for this, SRC acquires residential mortgage portfolios from banks and mortgage finance companies with the aim of freeing up their balance sheet, improving their capital utilization, the loans have a fixed term of 25 years. The activities by the facility are in support of Saudi Arabia's government vision of increasing the level of home ownership to 60.0% by the end of 2020, with a goal of 70.0% by the end of 2030. SRC is uniquely positioned to become the partner of choice for lenders helping them finance the primary mortgage market. So far, SRC has contributed to increasing the homeownership rates to 62.0% in 2020 from 47.0% in 2017 through indirectly availing mortgages to potential home owners. The facility raises finances through issuing bonds, loans from both local and international institutions, and, equity funding.

Some of the key functions of the Saudi Real Estate Refinance Company Include:

i. **Providing Financial Support to Money Lending Institutions:** Banks and other financial institutions get financing directly from SRC, this enables them to provide mortgage loans to prospective home owners within the country,
ii. **Offering Lenders Funding in the Form of Short or Long-Term Loans or Portfolio Acquisitions:** SRC provides fundamental liquidity and capital to support the housing mortgage market development,
iii. **Participating in the Securities Market:** SRC accumulates portfolios of loans into mortgage backed securities to generate more funds for investments,
iv. **Improving the Housing Market of Saudi Arabia:** SRC facilitates the growth of the housing market and enhances increased home ownership in Saudi Arabia, and,
v. **SRC works by Creating an Effective Secondary Market**: From these secondary markets home loans and servicing rights are bought from lenders (the mortgage originators) and sold to investors, to generate higher returns.

Key Challenges

i. **The high cost of properties including land and already built properties**- Currently, the average price of land in Saudi Arabia within the capital is approximately Kshs 100,000 per SQM according to Riyadh Market Study Report by KPMG. The amount is regarded as significantly high and may exceed the loan limit that SRC can offer. This has impacted mortgage uptake mainly because the value of some properties may surpass the limit of the amount for financing, in such a situation, it becomes hard to fully finance a property through mortgage, and,
ii. **Insufficient quality housing units which can qualify for loans as a result, most loan applicants end up being disqualified for the home loans.**

Achievements

i. **SRC has attracted foreign banking institutions to participate in the real estate sector in Saudi Arabia through providing funding**- An example of is the Saudi British Bank (SABB), which is 40.0% owned by the Hong Kong and Shanghai Banking Corporation (HSBC) holdings, a financial investments company,
ii. **Boosted the growth in the number of financial institutions offering loans which has generally contributed to the growth of mortgage accounts in Saudi Arabia**- According to Saudi Arabian Monetary Authority (SAMA), the total number of individual mortgage contracts until August 2019 stood at 96,787 compared to approximately 27,000 contracts during the same period in 2018,
iii. **Following its inception, SRC has contributed to increased home ownership in Saudi Arabia which was at 47% in 2017 to 62% in 2020**- This is primarily attributed to the fact that it is able to provide financing to potential home owners to construct or buy houses,
iv. **The SRC has increased access to home financing**- This grew significantly between 2018 and 2019 after its inception by 168.0% to reach approximately Kshs 72 trillion (USD 7.2 bn), as mortgage financing companies and commercial banks benefitted from subsidized financing designed to increase home ownership, and,
v. **The company has been able to increase its visibility and awareness of its existence in the**

market- This has enabled it to attract more mortgage applicants over time including educating borrowers on the existence of favorable mortgage rates in the market.

vii. **Lessons Learnt from the Case Study**

The SRC has been successful in improving the mortgage market in Saudi-Arabia which has resulted in the growth of home ownership in the country. Some key takes for Kenya from the case study are:

- **KMRC must vigorously raise funds for sustainability**- So far SRC has successfully attracted foreign banking institutions, issued bonds and secured loans to raise funds. This has helped to improve the capacity of the institution to channel funds for mortgage purposes. The KMRC can embrace this through approaching foreign investors to increase their pool of funds,
- **Increasing awareness of its existence to potential home owner through awareness campaigns**- This is likely help in increasing mortgage uptake in Kenya which has remained relatively low partially due to limited knowledge of affordable home financing options,
- **SRC has successfully raised funds through bonds, KMRC on the other hand is planning to issue a green bond in the coming year, and if successful this could be a step in the right direction for KMRC, and**,
- SRC has been lending to financing institutions, SRC has two main products, that is the short term loans with a tenor of 5 years and the long term loans with a fixed term of 25 years, **in the long run KMRC can adopt the strategy by SRC to incorporate short term loans which most likely will help promote flexibility for those willing to pay back within shorter repayment periods**, and with this, the company will be in a position to earn from interests paid from short repayment windows.

viii. **Conclusion**

KMRC is expected to; i) provide secure long-term funding at affordable interest rates, ii) contribute to the growth of the Kenyan capital markets, iii) facilitate entry of mortgage lenders, and, iv) improve home ownership in Kenya. To enhance sustainability of the lending terms, KMRC must ensure that the loan applications comply with the eligibility criteria provided. In addition, the facility will need to aggressively fund raise to ensure sustainability of relatively low lending rates.

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