# Public-Private Partnerships (PPPs) in the Real Estate Industry in Kenya, & Cytonn Weekly #19/2021

## Focus of the Week

Kenya's Vision 2030 Agenda seeks to make the country an industrialized middle income economy by 2030. The government and the private sector have therefore been working on providing the right environment for implementation of Public Private Partnerships (PPPs) since 1996, to deliver projects in sectors such as infrastructure, housing and student hostels, health care facilities, and agriculture. Additionally, there has been some effort in establishing sound legal and regulatory framework to promote and encourage PPPs. This week, we shall therefore cover PPPs in the real estate sector in Kenya with the aim of giving recommendations on what can be done to make them more efficient, and therefore accelerate the government Big Four Housing Agenda. The report will cover the following:

I. Overview of Public-Private Partnerships (PPPs)
II. Public- Private Partnerships (PPPs) in Kenya
III. Benefits of PPPs and Challenges facing PPPs
IV. Case Study: United Kingdom(UK) Real Estate PPPs
V. Recommendations for Successful PPPs for Housing
VI. Conclusion

**Section I: Overview of Public-Private Partnerships (PPPs)**

A Public Private Partnership is an agreement between the public sector and the private sector for the purpose of designing, planning, financing, constructing, and/or operating projects that would traditionally be regarded as falling within the remit of the public sector. PPP projects can either be solicited or unsolicited (Privately Initiated Investment Proposals). Solicited PPPs involves a private party making a proposal to undertake a PPP project in response to a request from the government while an unsolicited PPP is where the private party makes a proposal to undertake a PPP project at their own initiative by submitting the proposal to the government. PPP contracts are usually long-term and legally binding with the private sector taking up the financial burden and risks involved in development and operation of the project. There are different types of PPP arrangements which include:

- **Build Operate Transfer (BOT):** the private sector institution finances, builds, maintains and operates a facility for a given period of time and recoups its investment by collecting tolls during the concession period,
- **Build Own Operate (BOO): the private entity will finance, build and operate the project but there will be no transfer back to the government,**
- **Build Own Operate Transfer (BOOT):** the private sector builds, owns, operates and eventually transfers the PPP project to the public sector after an agreed period of time,

- **Build Transfer Operate (BTO):** the private organization finances, builds and upon completion, transfers the ownership to the public sector agency. The public sector agency then leases the facility back to the private developer under a long term lease. During the lease, the private developer operates the facility and earns a return from user charges, and,
- **Design Build Finance Operate (DBFO):** the private sector is responsible for financing, designing, construction and operation of the project and is compensated by service payments from the government during the life of the project.

**Section II: Public Private Partnerships (PPPs) in Kenya**

a. **The Structure and Framework of PPPs**

PPPs in Kenya were established under PPP policy statement, 2011 and later revised in Act. 15 of 2013 of the Kenya Constitution titled as the Public Private Partnership Act, which stipulates that**;** i) the government retains total strategic control on the service, ii) the government is mandated to secure new infrastructure which will become the government's assets at the end of the contract period, and, iii) allocation of project and performance risks is to the party best able to manage or mitigate.

The Act was passed to enable the participation of the private sector in financing, construction, development, operation and maintenance of infrastructure projects of the government through concessions or other contractual arrangements. The Act also establishes institutions that will regulate, monitor and supervise the implementation of project agreements, i.e;

- **Public Private Partnership Committee:** its functions include; i) to formulate and oversee the implementation of policies, ii) monitor development and progress of projects, and, iii) take custody of a project agreements made under this Act by monitoring compliance with the terms and conditions of the agreement,
- **Public Private Partnership Unit**: the unit serves as a secretariat and technical arm of the committee and its roles are; i) to provide technical, financial and legal expertise to the committee and any node established under this Act, ii) to serve as a resource centre on matters relating to PPPs in Kenya by maintaining a record of all project documentation, and, iii) to provide other government departments with assistance during procurement processes
- **Public Private Partnership Nodes:** they carry out their functions on behalf of the contracting authorities which include; i)to identify, screen and prioritize projects based on guidelines issued by the Committee, ii) ensure compliance with provisions of the Act by the parties of a project agreement, iii) liaise with all key project stakeholders during the project cycle, and, iv) ensure transfer of assets at the expiry of early termination of project agreement is consistent with the terms and conditions of the agreement.

Recently the government came up with the Public Private Partnership Bill 2021 intended to present a solution to current institutional and governance hurdles that have plagued the successful implementation of PPPs in Kenya over the last 8 years, however the Bill is yet to be enacted.

b. **Projects in the Pipeline in Kenya**

Owing to the substantial framework which is supportive of PPP projects in Kenya, the government of Kenya through Kenya PPP Platform has reported a total of 64 PPP projects currently in the pipeline. In the housing sector, the Kenyan government has PPP projects in affordable housing and student housing, i.e;

**Housing Public-Private Partnership  Projects in Kenya**

| Theme | Project | Partnership | Project Start Date | Project Status | Expected Date of Completion |
|---|---|---|---|---|---|
| **Affordable Housing** | River Estate, Ngara (2,720 units) | National Government and Edderman Property Limited | March 2019 | Ongoing | December 2021 |
| | Pangani Housing Project (1,562 units) | National Government and Tecnofin Kenya Limited | May 2020 | Ongoing | May 2022 |
| | Hydro City, Kamiti (30,489 units) | National Government and Hydro Developers Limited | | | |
| **Student Housing** | Kenyatta University Hostels (10,000 beds) | Africa Integras (Kenya LLC), EPCO Contractors, Triad Architects and Broll Kenya Facility Managers | 2015 | 2035 | Ongoing |
| | University of Embu Hostels (4,000 beds) | Meridiam, JV Unicamp and PDM-Roko-CBA Capital and JV Unicamp | 2018 | 2038 | Pre-Qualification |
| | Moi University Hostels (15,000 beds) | Kesa, Meridiam, JV Unicamp and PDM-Roko-CBA Capital and Chinese Overseas | 2018 | 2038 | Pre-Qualification |
| | South Eastern Kenya University Hostels (5,400 beds) | Kesa and PDM Roko-CBA Capital | 2018 | 2038 | Pre-Qualification |

**Section III: Benefits and Challenges facing Real Estate PPPs in Kenya**

a. **Benefits**

The Kenyan government's consideration to use PPPs to deliver development projects has proven to be beneficial as they capitalize on the private sector's capacities and the public sector's ability to incentivise private sector investments. Some of the major benefits experienced by the government include;

i. **Access to Finance for Projects:  PPPs have granted the government access to private capital to carry out various development projects that would otherwise have taken a long time to implement. Ideally financing for national projects in Kenya comes from debt and this sets back economic development by diverting funds to debt servicing at the expense of economic development. The private financing therefore allows public resources to be used for other projects and enables the government concentrate on important matters such as regulation, policy and planning,**

ii. **Risk Transfer to Private Sector**: PPPs have allowed a substantial transfer of risk to the private sector, for example construction risks such as budget overruns, project completion times and other risks such as operational and maintenance risk. These are risks that are best mitigated by professionals contracted in the PPPs thus reducing inefficiencies in completion and delivery of projects, contrary to which the cost is fully borne by the private sector,

iv. **Government Access to Private Sector Efficiencies**: The government has been able to acquire new and improved technology as well as skilled labour through PPPs as a result of undertaking projects by contracting foreign expatriates from countries such as China and Japan who have vast experience and are more organised as they have worked on similar construction projects in their countries,
v. **Large Scale Investment and/or Development**: PPPs have facilitated large scale development projects that would cause financial strain to taxpayers if implemented by the government. The aim of these large scale developments is to make Kenya an industrialized middle-income country in order to provide a high quality of life to its citizens hence the government has provided incentives such as coming up with the Public Private Partnership Bill to address hurdles since the government's vision cannot be achieved without private sector engagement, and,
vi. **Enhancement in Ease of Doing Business:** PPPs have promoted passing of regulations that have improved the ease of doing business in Kenya due to the establishment of regulatory guidelines that despite having gaps have given a roadmap on procedures to be followed thus boosting foreign investor confidence in undertaking Kenyan projects.

b. **Challenges**

Despite the benefits PPPs have fallen short in achievement of development initiatives attributed to:

i. **Inadequate Planning for PPP Projects: There is a challenge in identifying suitable projects and gauging the risks involved, as well as testing the likelihood of success. In addition, selecting the most qualified project developer for a specific project has always been a tricky task when the pool of investors with capacity for PPPs is limited. PPP projects without sound plans have therefore led to lack of value for money due to ineffective implementation,**
ii. **Insufficient Regulatory Framework to Handle Complex PPP Transactions:** Kenya's laws and regulations set up to conduct business with the private sector are severely lacking and some entirely absent or requiring change. Such gaps in the regulatory framework include;

- **lack of a clear guideline on what happens if the timelines required for evaluation of technical bids, normally 7 days is exceeded.**

- no timelines at all for the evaluation of a Privately Initiated Investment Proposal (PIIP) which is a stumbling block for potential investors who may opt to withdraw when their patience runs out,
- no law on concessional element of PPPs, i.e, where a franchise has been granted the right to finance, build, own, operate and maintain public infrastructure for a given period while charging users for that service

iii. **Irregular Procurement Processes due to Corruption: The public sector has been marred with a myriad of accusations of irregular procurement such as irregular awarding of tenders through corruption, raising speculation with some even being raised in parliamentary debates, hence causing loss of public confidence in the contracted parties thus delayed delivery of PPP projects,**

iv. Insufficient Bulk Infrastructure Required to Support Development: Kenya has limited supporting bulk infrastructure, e.g, the insufficient sewer lines and drainage systems and poor road networks in areas the development projects are being undertaken, meaning that developers often have to incur costs to develop the infrastructure themselves and this discourages the private sector due to the huge amount required,

v. Differing Goals Between the Private and Public Sector: While the private sector mainly focuses on obtaining a return on investment, the public sector's main interest is on protecting the interests of its citizens by enacting regulations and engaging in projects that benefit the public such as affordable housing PPPs, for example, the price ceilings on affordable housing units discourage the private sector from investing as total returns  may be relatively too low compared to the normal market rates for residential units,

vi. Bureaucracy and Lengthy Approval Processes: Bureaucracy in government systems has led to delays in approvals as applications require to go through different channels, some taking up to 6 months, in order to be granted a green light. Furthermore, some delays in responding to bidders are blamed on the failure to achieve quorum at the various levels required to provide approval, which hampers expeditious decision making,

vii. Inadequate Risk Mitigation Strategies: There is no specific project implementation team tasked with handling PPP projects from start to finish hence the ineffective monitoring and auditing of finances in PPP projects in Kenya has led to lack of accountability for allocated funds and imprudent utilization of finances as funds end up being spent without consideration of the budgetary allocations, and,

viii. High Transaction Costs: In the case of unsolicited PPPs, there are high costs involved in retaining consultants to assess the environmental, social and financial implications of a project given the time, data and analytical expertise required for this, with there being no guarantee that the proposal shall be approved and this can discourage them.

**Section IV: Case Study; United Kingdom (UK) Real Estate PPPs**

The UK came up with the first systematic program aimed at encouraging implementing projects through PPPs which was introduced in 1992 through the Private Finance Initiative (PFI), a procurement policy where private firms were contracted to complete and manage public projects. Since then PPPs have been increasingly used to deliver real estate projects in housing and infrastructure as a key way to transforming the country in an efficient and cost effective way. Moreover, UK's PPP model has been used as a benchmark by other countries such as Japan, Sweden, Australia and Canada in enhancing their PPP models.

a. **Success Factors for PPPs in the UK**

i. **Effective Procurement Processes**

There is substantial legislation on procurement policies and contract management. Selection criteria for private firms is strictly based on the company's suitability to pursue a professional activity, economic and financial standing, technical ability and certain mandatory exclusions to ensure that only suitable parties participate, with the government required by law to publish successful bidders, tender amounts and the reasons against other bidders in order to augment transparency and accountability of the process. This ensures that successful bidders' ability to implement a project is unquestionable and that there is an enabling environment for conclusion of projects. Contractual challenges occurring through the life of the project are pursued through an arbiter to ensure continuity of the projects as conflict resolution is on going

ii. **Incentives to the Private Sector**

The UK government is committed to use public-private partnerships to deliver value for the tax payer by emphasizing no shortage of finances for well-structured projects, through offering incentives to the private sector to encourage their engagement, i.e;

- The UK Guarantee Scheme which operates on a commercial basis but allows private projects to benefit from Government's support at lower rates when they experience funding shortfall,

- Housing Guarantees to support development of residential housing in target areas, and
- Co-investment Funds, which deals with charging fees for use of developed infrastructure then co-invests in other projects to accelerate roll out of such projects while gaining commercial return as an investor.

iii. **Diverse Market of Project Finance:**

There exists a diversified pool of finance for PPP projects in the UK with key among them being;

- Through banks and Non-Banking Financial Institutions where repayment is based on projects cash flows on completion with projects assets, rights and interests held as collateral,
- Co-Financing with the Government where the government decides to provide part of the project financing through equity, contingent products such as guarantees, indemnities and hedging, investments and/or debt. Most UK PPPs have utilized government support to ensure that government bears some risks which it can manage better than private investors as well as supporting projects financially, and
- Joint Ventures where the private company enters into a joint venture partnership especially in the cases involving land where land owners receive pre agreed rates of returns.

iv. **Separate PPP Policy and PPP Project Development Agencies**

The UK has separate PPP policy and project development agencies. The project development agency, Partnerships UK, advises government agencies on PPP projects and finances itself by charging fees to the public sector while the policy taskforce sits within treasury and sets guidance on procurement, deal structuring, and evaluation. Individual line ministries also typically have their own project development teams. These distinctions help eliminate conflicts of interests in projects as well as ensuring that development agencies work independently in execution of their mandate.

v. **Flexibility in Undertaking PPP Projects**

The UK has no specific PPP legislation but there is sufficient flexibility and certainty in the common law framework to permit and govern PPPs. For instance, local authorities can enter into a contract with another person for the provision of assets and services in connection with the projects and there are provisions to ensure PPPs are not adversely affected by general changes in the law, for instance subcontractors being paid immediately after a project is certified, to avoid bankrupting the project-financed Special Purpose vehicle (SPV) that would undermine the PPP.

b. **Barriers to PPP Projects in the UK**

i. **High Project Costs**

Infrastructural developments in the UK have always been faced with challenges of inflated costs from the initial bid budget estimates to the developmental costs of the projects. The use of bonds from the private sector as opposed to the government borrowing increases interest payments that could otherwise have been lowered, thus increasing overrun costs and the subsequent total project costs with more debts attracting more interest payments. High returns by the private firms undertaking these PPP projects has also increased costs to the government which are then shouldered by the taxpayer.

ii. **Poor Risk Evaluations**

Public-Private Partnerships have been shown to be over optimistic and underestimating risks at inception of the projects with shareholders retaining an economic interest in the projects while avoiding the full financial consequences of their failure, necessitating the public sector to chip in despite the private sector getting a return to take risks, hence leaving financial burden on the taxpayer.

**Section V: Recommendations for PPPs Success in Kenya**

Public Private Partnerships have enabled the United Kingdom to deliver numerous development projects that have industrialized the country, and Kenya can emulate UK's success in delivery of PPP projects in the following ways:

1. **Regulatory Framework:** The government still has a long way to go in improving gaps in regulation. Despite the efforts in coming up with the Public-Private Partnership Bill 2021 which aims to address the matters regarding implementation of PPPs by the County governments, institutional framework and Unsolicited Proposals, the element of concessional agreements is still lacking**.** The government should provide a clear framework on issues relating to them such as risks, approval processes and mechanisms for servicing long term debt to avoid losing investor confidence,
2. **Procurement Policy:** The government should consider establishing a specific procurement framework just like UK's that is open, restricted and competitive with negotiation and competitive dialogue done with prior publication, and once publicized there is need to come up with ways to visibly track approvals digitally, as well as information displayed to the general public, to ensure competent and capable contractors who have been thoroughly scrutinized are chosen to procure and manage PPPs efficiently,
3. **Incentives for Private Sector Engagement:** The government should strive to provide incentives to the private sector that will encourage uptake of projects, for example,

i. Tax incentives including; exemption from registration tax on acquisition of real estate, reduction of exemption from various appropriation charges, and recognition of a certain percentage of investment as a reserve for servicing corporation tax and protection against reduction of tariffs,
ii. PPP laws harmonized to provide for acquisition of private land by the contracting authority on behalf of the investor
iii. Encouraging of Swiss challenge in the bidding process, where an unsolicited bid for a public project is published to invite third parties to match or better it thus fostering public-private sector trust, support and confidence in the PPP projects thus gain significant traction.

4. **Financing for Projects:** The government should incorporate provisions for enabling other forms of financial support to make projects commercially viable for private investors for example joint ventures by private companies to finance PPP projects as is the case for UK. Additionally, they can offer operational and maintenance support grants to the private entities to show their commitment to the projects,
5. **Institutional framework:** The government should institute bodies tasked with specific urgent responsibilities and directly answerable to the different arms of the government, for example a dispute resolution body that can listen to PPP cases to hasten dispute resolution as opposed to going directly through the court, and separate Project Policy Implementation and Project Development Agencies to ensure there in sufficiency in carrying out duties under their mandate for proper implementation of PPP projects, and
6. **Housing Related Recommendation:** Given Housing as a Big Four Agenda item, we have the following recommendations

i. The government should focus on enabling the private sector to build houses rather than government getting involved in the construction; since announcing the Big Four agenda about 4 years ago, the government has delivered less than 1000 houses so far thus falling short of the annual 500,000 target. Private sector players with the right incentive will accelerate delivery,
ii. There is no shortage of land, as there is a lot of private land looking for Joint Venture partners, hence the government should not look at land as an important ingredient but focus on financing and infrastructure incentives for private developers,
iii. Focus on financing incentives for developers and incentives for end users, primarily through tax incentives,

iv. Provide housing infrastructure incentives in areas such as roads, sewer, water and power, either through delivering them or some rebates for developers who put them up, and,
v. Expedited statutory approvals for developments that registered as part of the Housing Agenda.

**Section VI: Conclusion**

Public-Private Partnerships (PPPs) in the real estate industry in Kenya have not been promising owing to the numerous challenges in regulatory framework involving procurement, private sector engagement, financing and institutional framework. However, with the government's effort to revitalizing the PPP Program, there is hope for sustainable development through them to fast track achievement of industrialization. The real estate sector stands to benefit from developments through the PPPs Initiative, if the recommendations aforementioned are taken into consideration, for the government to facilitate timely and successful implementation and delivery of PPP projects thus improving the country's economy through this model.



---