Joint Venture Agreements (JVs) in Real Estate, & Cytonn Weekly #20/2024

Real Estate

I. **Statutory Review**

The National Treasury tabled the Finance Bill 2024, which addresses several key areas impacting taxation, housing, and infrastructure financing. The aim of the bill is to introduce amendments and proposals aimed at refining the taxation system, several of which tie in enhancing infrastructure financing and advancing housing initiatives in Kenya.

Key highlights from the bill include:

i. **Taxation on Infrastructure Bonds:** One notable proposal is the introduction of withholding tax on interest earned from infrastructure bonds (IFBs) with tenures of at least 3 years. Currently, interest income from IFBs is tax-free, making them an attractive investment option. However, if the bill passes through Parliament, future infrastructure bonds will attract a withholding tax rate of 5% on interest income. While the proposed tax rate remains relatively lower compared to regular bonds, the introduction of withholding tax could reduce the attractiveness of IFBs to investors. Additionally, the government's delay in issuing sovereign green bonds, coupled with the potential taxation of IFBs, may lead investors to shift their focus to green bonds once they are launched. Currently, the only listed issuer of green bonds on the Nairobi Securities Exchange (NSE) has been Acorn Holdings, which issued a 5-year green bond in 2019 with a coupon of 25%. Despite these challenges, recent IFB issuances by the Central Bank of Kenya (CBK) have seen significant oversubscription, indicating continued investor interest in these instruments. However, the imposition of withholding tax may impact investor sentiment and demand for IFBs in the future,

ii. **Housing Levy Contributions Relief:** The bill suggests a relief of 15% on housing levy contributions, expanding the number of rebates available to employees. The relief is entitled to those saving for a purchase under an approved affordable housing scheme. Employees earning a gross salary will benefit from the relief, which will marginally reduce their taxable pay. For instance, an employee contributing to the housing levy stands to earn a relief of up to Ksh 108,000 p.a, depending on their salary bracket. The table below illustrates how the relief on housing levy contributions is calculated based on different gross monthly salaries, showcasing the impact of the proposed 15% relief on employees' taxable income;

Gross Monthly Salary (Ksh)	Housing Levy Contribution (1.5%)	Annual Contribution (Ksh)	Relief (15% of Contribution)
50,000	750	9,000	**1,350**
75,000	1,125	13,500	**2,025**

Gross Monthly Salary (Ksh)	Housing Levy Contribution (1.5%)	Annual Contribution (Ksh)	Relief (15% of Contribution)
100,000	1,500	18,000	**2,700**
500,000	7,500	90,000	**13,500**
1,000,000	15,000	180,000	**27,000**
2,000,000	30,000	360,000	**54,000**
3,000,000	45,000	540,000	**81,000**
4,000,000	60,000	720,000	**108,000**
5,000,000	75,000	900,000	**108,000**

The affordable housing levy, legislated through the 2024 Affordable Housing Act, aims to provide resources for the development and access to affordable housing. The levy, which is set at 1.5% of the employee's total gross monthly salary, is expected to generate significant revenue for the affordable housing program,

iii. **Deletion of Section 54 of the Affordable Housing Act 2024:** The bill also proposes amendments to section 54 of the Affordable Housing Act 2024 by deleting it. This section currently states that, "Except with the prior written consent of the Board, a purchaser of an affordable housing unit under this Act shall not by contract, agreement or otherwise, sell or agree to sell his or her unit or any interest therein to any other person." The proposed deletion aims to clean up the provision following the advisory given by the Attorney General, abd,

iv. **Family Trust:** The Finance Bill of 2024 outlines tax regulations concerning the income or principal sum of a registered family trust. Previously, there existed an exemption for capital gains arising from the transfer of title of immovable property to a family trust, but this exemption has been removed from the bill. Additionally, the bill includes provisions regarding the withdrawal of funds from the National Housing Development Fund for the purchase of a house by a first-time homeowner who is a contributor to the fund, aligning it with family trust regulations.

II. **Commercial Office Sector**

During the week, Gateway Real Estate Africa, a subsidiary of London-listed Grit Real Estate Income Group, unveiled a significant development in Kenya's real estate landscape. The project, named Eneo, is a state-of-the-art Business Process Outsourcing (BPO) facility located within the Tatu City Special Economic Zone (SEZ). Comprising 2 towers with a combined gross lettable area of approximately 26,000 SQM, Eneo boasts modern amenities and interconnected retail spaces, including a grocer, restaurants, pharmacy, and convenience retail shops. Additionally, Eneo is designed to offer green design principles. Incorporating sustainability elements such as eco-conscious designs and natural lighting ensures environmental responsibility while enhancing the quality of life for occupants.

This development is poised to have a transformative impact on the local economy and job market. With more than 1,300 employment opportunities created during the construction phase alone, Eneo is expected to generate additional employment opportunities in the BPO sector upon its completion. Moreover, the facility is custom-designed for CCI Global, Africa's largest international contact center specializing in Business Process Outsourcing, further solidifying Kenya's position as a hub for BPO operations in the region.

We expect the unveiling of Eneo at Tatu City to catalyze further growth and investment in Kenya's commercial office real estate sector. As Kenya's Special Economic Zones continue to attract new entrants and drive investor confidence, the Eneo facility stands as a testament to the country's growing potential as a hub for global business services.

III. **Real Estate Investments Trusts (REITs)**

On the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 24.5 and Kshs 22.0 per unit, respectively, as of 9th May 2024. The performance represented a 22.5% and 10.0% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at 12.3 mn and 30.7 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 633.8 mn, respectively, since inception in February 2021.

REITs provide various benefits like tax exemptions, diversified portfolios, and stable long-term profits. However, the continuous deterioration in the performance of Kenyan REITs and the restructuring of their business portfolios is hampering major investments that had previously been made. The other general challenges include; i) inadequate comprehension of the investment instrument among investors, ii) prolonged approval processes for REIT creation, iii) high minimum capital requirements of Kshs 100.0 mn for trustees, and, iv) minimum investment amounts set at Kshs 5.0 mn, continue to limit the performance of the Kenyan REITs market.

We expect the performance of Kenya's real estate sector to be supported by: i) increased investment by local and international players, ii) Nairobi's recognized position as a regional hub, which will spur growth, especially in the commercial office sector, iii) relatively positive demographics in the country necessitating demand for housing and real estate, and iv) continued infrastructural improvements opening up new areas for investments. However, factors such as rising construction costs, strain on infrastructure development like drainage systems, limited investor knowledge in REITs, and existing oversupply in select real estate sectors will continue to hinder the optimal performance of the sector by limiting developments and investments.