UNIVERSITY OF NAIROBI

THE EFFECTIVENESS OF FINANCING REAL ESTATE DEVELOPMENT THROUGH OFF-PLAN SALES: CASE STUDY OF SELECTED RESIDENTIAL DEVELOPMENTS WITHIN NAIROBI COUNTY

BY

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RESEARCH PROJECT SUBMITED TO THE UNIVERSITY OF NAIROBI, DEPARTMENT OF REAL ESTATE AND CONSTRUCTION MANAGEMENT, IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR AWARD OF DEGREE IN MASTER OF ARTS IN VALUATION AND PROPERTY MANAGEMENT

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DECLARATION

Student's Declaration

I, **Kirk Kimaru Katwa**, hereby declare that this research project is my original work and has not been presented in another university for award of a degree.

Signed: ………………………………… Date: ………………………………….

Kirk Kimaru Katwa

Supervisor's Declaration

This research project has been submitted for examination with my approval as a university supervisor.

Signed: ………………………………… Date: ………………………………….

Dr. Luke Obala

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DEDICATION

I dedicate this work to my parents Joseph and Salina Katwa for their unending love, care and support throughout my life.

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May God bless and watch over you!

ABSTRACT

Developing real estate is a high risk activity which requires commitment of large sums of capital. Unfortunately, most investors and developers do not have such funds and would therefore resort to borrowing, whereby they would pay interest to financial institutions thereby increasing the cost of real estate development. Off-plan property sales emerges as an alternative source of finance, presenting developers with a chance to obtain funds from would-be buyers of the units in their proposed development. In spite of the huge significance of off-plan property sales and its growing popularity in the global platform, there is limited knowledge in this strategy as a financing option. The study sought to determine the effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers; its challenges; and recommending appropriate mechanisms of enhancing it.

The researcher identified five case study areas (Loresho Ridge; Ramata Greens Apartments; Kings Millennium Estate; Muthaiga Valley Apartments; and Pearl Heights Apartments) within Nairobi City County, which are recent real estate developments that incorporated off-plan sales as a financing strategy. Key-informant interviews were conducted on developers and estate agents in the case study areas while questionnaires were administered to randomly sampled real estate developers and estate agents.

The study established off-plan sales is an effective mode of financing real estate development since it generates significant savings on the cost of development, mainly through savings on interest, to the tune of between 4% - 8.5% of the total cost of development. It is also beneficial to buyers since off-plan units are sold at lower prices compared to completed developments.

The challenges faced by developers in using off-plan sales as a strategy of financing real estate development include: difficulty in achieving the target amount through off plan sales; penalties due to project delays; failure by off-plan property buyers to complete payment of the purchase price; and lower prices of the off-plan sales relative to sale prices of the units upon completion of the developments. Challenges faced by buyers of off-plan property include potential fraud by unscrupulous developers; probability of distressed sale due to inability to complete purchase price; poor quality of construction; and delays in project delivery. The study recommends that developers need to establish an optimum mix in their financing options; careful time planning for real estate development; early and vigorous marketing of the development; pre-qualification of potential off-plan buyers; the need for due diligence by buyers prior to purchase of the off-plan units; and the need for legal framework regulating off-plan sales.

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LIST OF ACRONYMS

JV	-	Joint Venture
3D	-	Three Dimensional
ACL	-	Australian Consumer Law
NHBC	-	National House Building Council
UK	-	United Kingdom
AAK	-	Architects Association of Kenya
SPV	-	Special Purpose Vehicle
MPC	-	Monetary Policy Committee
KNBS	-	Kenya National Bureau of Statistics
Kshs.	-	Kenya Shillings

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CHAPTER ONE

INTRODUCTION

1.1 Introduction

Real estate in the form of commercial, residential or industrial developments play a major role in the socio-economic advancement of any country. It plays the key role of providing space and facilities for people to carry out their activities as well as return on investment for property owners.

Okal (2011) asserts that developing real estate is a high risk activity which requires commitment of large sums of capital in the construction process. The entire process and returns thereof are affected directly by the economic performance of both the local area and the nation at large. Unfortunately, most investors and developers do not have such large amounts of capital at hand and would therefore resort to borrowing or a combination of equity and debt to finance their real estate investments. Off-plan property sales therefore comes in as an alternative source of finance to developers presenting them a chance to obtain funds from would-be buyers of the units in their proposed development.

According to Isthmus (2010), off-plan property is a property before a structure has been constructed upon it. Pre-constructions are usually marketed to real estate developers and to early adopters as developments so that the purchaser can secure much better finance terms from their lenders. Government of Western Australia (2014) notes that buying "off-the-plan" can mean many things but generally involves signing a contract with a developer to buy a property before the developer has obtained final approval to subdivide land that is being purchased or, in the case of a building, before building has commenced or been completed.

In off-plan sales contracts or agreements, a developer promises to deliver a parcel of land, a house and land package or a strata property to a buyer at an agreed price at a future date, subject to the developer obtaining all necessary approvals in respect of the development from the relevant authorities and satisfying any conditions necessary to finalise the development. In the case of land subdivisions, for example, this would include the construction of roads, and connection to services such as power, water and sewerage.

Mugendi (2012) notes that this kind of arrangement has become popular because home owners are looking for an arrangement where they can get a cheaper deal than other similar units by the time the construction is complete. The grace period allowed to arrange for financing is also key to popularization of this mode of property acquisition as investors and home buyers seek to get a smooth experience to property ownership. Developers in this form of arrangement also get the opportunity to avoid using their own internal financing or debt financing from lending institutions. For a world driven towards maximization on returns, in this case for the developer and the buyer, it's clear that off plan buying and selling of property is geared to be used as a risk management tool.

1.2 Problem Statement

Africa's population boom is creating demand for residential property, ranging from basic housing to high-end luxury properties. In an attempt to address this, numerous announcements have been made in recent years of ambitious large-scale satellite city projects across Africa, mostly by private developers. However, many of these projects have experienced significant delays due to financing problems as well as restrictive property development policies.

Kenya had an economic growth rate of 5.8% in the year 2016 (KNBS, 2016) and a population growth rate of 2.6% for the same year (World Bank, 2016). With a growing economy and equally dynamic population, rapid urbanization is one of the phenomena characterizing Kenya's economic and social landscape today. The current housing supply, pegged at about 50,000 units per year against a demand of 250,000 units (Ministry of Land, Housing and Urban Development, 2016), does not sufficiently meet the demand pressures emanating from population growth, increased numbers of single family households, inward migration and the growing student and elderly populations (Knight Frank, 2016). This has prompted developers to carry out residential real estate development, especially apartments/flats, terraced maisonettes and stand-alone houses in various urban centres in Kenya.

The housing supply deficit is largely attributed to the high cost of development compared to capital available to developers as well as the challenge of fluctuating high interest rates, thereby pushing developers to find innovative ways of financing their developments. For instance, the Monetary Policy Committee (MPC) in June 2015 increased the base rate by 150 basis points to 10% and by a further 150 basis points to 11.5% in July 2015. The increments were meant to tame the persistent volatility in the global foreign exchange markets coupled with the projected recovery in international oil prices that have implications on inflationary expectations. Consequently, the Kenya Banks Reference Rate was increased by 133 basis points, from 8.54% to 9.87%, the highest since its inception in July 2014 (Central Bank of Kenya, 2015). Such fluctuations lead to unpredictability in cost of finance for property development thereby prompting developers to resort to creative ways of financing real estate development. However, there has been an attempt to lower and stabilize interest rates through the enactment of *The Banking Amendment Act 2016,* which curbs interest rates at not more than 4% above the base rate set and published by the Central Bank of Kenya. The Kenya Bankers Association has however noted that this has increased the lender's scepticism and generally reduced credit uptake into the market (Kenya Bankers Association, 2017). Therefore, offering potential buyers an opportunity to purchase the off-plan property units emerges as an innovative way for developers to source for funds for property development.

Most residents of urban centres in Kenya desire to own their own properties for investment purposes through rental earnings or for owner occupation purposes. However, high purchase cost for most properties is unaffordable. An opportunity to buy properties off plan is viewed favourably as most off-plan prices are significantly discounted compared to the market price.

Off-plan sales has been used by developers in Kenya to finance projects in the past such as Loresho Ridge in Loresho Area; Ramata Greens in Baba Dogo Area; Kings Millennium Development in Imara Daima; Muthaiga Valley Apartments in Parklands Area; and Pearl Heights in Kileleshwa among others. It is ideal due to minimal risks involved, but not necessarily the easiest to achieve. Funds raised through off-plan sales form part of the developers' equity hence the developer avoids paying interest to the financiers, which has an effect of increasing returns on investment. According to Business Daily on Thursday, July 5, 2018:

> *"Skyrocketing housing prices and unpredictable rent regimes have witnessed emergence of 'smart' investors in Nairobi who buy apartments off-plan at discounted prices. Real estate property developers now prefer off-plan products that provide them with upfront sales enabling them to evade costly bank loans."*

It is common to find many projects in Nairobi, both commercial and residential being sold off-plan and the developers are not willing to break ground until they reach a certain percentage of sales.

Cytonn (2017) points out that this method is advantageous because off-plan property purchase allows buyers to acquire a future asset at today's price and hence in a rising or a peaking market, the buyer achieves capital gains, and on completion they have a significant margin.

They are also able to pay in instalments over the construction period therefore lessening the financial burden of making one-off payments.

In spite of the huge significance of off-plan property sales and its growing popularity in the global platform, there is limited knowledge in this strategy as a financing option. Most of the studies on financing of property development have concentrated on conventional financing options such as pooling of funds or construction loans. Okal (2011) conducted a study to investigate the strategies for financing commercial real estate developments in Kenya. The study just mentioned pre-sales (same as off-plan sales) as one of the innovative strategies but did not look into the details of the strategy. Rather, it broadly focused on the analysis of traditional versus emerging financing strategies for commercial properties. Mugendi (2012) also carried out a study to investigate the challenges of off-plan property purchase in Kenya. It mainly focused on evaluating the process and procedures of buying off-plan property, but did not look at its effectiveness as a financing strategy.

Research on the use of off-plan sales in financing real estate development has therefore been long overdue. This study aims at extending the existing knowledge and literature on off-plan property sales. It seeks to provide an in-depth assessment of the off-plan property sales in Kenya, specifically analysing its effectiveness to developers as a source of finance for property development as well as its effectiveness to the buyers as an investment avenue. The study also investigated the challenges facing developers and buyers in off-plan sales and proposes appropriate recommendations on how the sector can be enhanced in the country.

1.3 Purpose and Objectives of the study

1.3.1 Purpose

The overall drive of the research is investigating the effectiveness of financing of real estate development through off-plan sales in Kenya.

1.3.2 Objectives

The following are the specific objectives of the study;

a) Determining the level of use of off-plan property sales as a strategy of financing property development in Kenya.

b) To determine the effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers.

c) To establish the challenges and constraints of off-plan property sales in Kenya.

d) To recommend appropriate mechanisms of enhancing off-plan property sales in Kenya.

1.4 Research questions

The following research questions will guide this study:

a) How prevalent is the use of off-plan property sales as a strategy of financing property development in Kenya?

b) How effective is off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers?

c) What are the challenges and constraints of off-plan property sales in Kenya?

d) What are the appropriate mechanisms of enhancing off-plan property sales in Kenya?

1.5 Propositions

The formulation of propositions for this research is guided by the study's research questions and aims to facilitate easier understanding of the issues being studied.

The main propositions for the study are:

i) Off-plan sales is a financing strategy that is widely used by real estate developers in Kenya.
ii) Off-plan sales is an effective strategy of financing real estate development in Kenya.

1.6 Justification of the study

Reviewing the available studies further unveiled existence of a huge deficiency of information on off-plan property sales as a method of financing property development. Most of the studies in the property development and investments have concentrated on conventional methods of financing real estate development, such as pooling of funds and construction loans. Little has been done on off-plan property sales as a strategy of financing real estate development. Therefore, this research enhances the knowledge on using off-plan sales as a strategy of financing real estate development.

1.7 Significance of the study

This research goes a long way in reviewing and widening the existing literature on off-plan sales, particularly as a method of financing real estate development. It carries out an in-depth assessment of the off-plan property sales in Kenya, specifically analysing its effectiveness to developers as a source of finance for property development as well as its effectiveness to the buyers as an investment avenue. The study also investigated the challenges facing developers and buyers in off-plan sales and proposes appropriate recommendations on how the sector can be enhanced in the country. Most of these aspects have not yet been adequately addressed.

The end results are of great benefit to various parties especially the real estate developers as they provide knowledge on the effectiveness of off-plan sales as a method of financing development of real estate, clearly illustrated by analysis of data in case study real estate developments. It therefore increases the body of knowledge on property development financing strategies. It also informs the potential investors about the benefits likely to be enjoyed as well as the challenges likely to be experienced when one buys an off-plan property. The study also serves to add knowledge to the various target groups involved with off-plan property sales such as real estate professionals, policy makers, general public, private sector and foreign investors who are part of real estate development.

1.8 Scope of the study

As a result of envisaged financial and time constraints, the researcher formulated a manageable geographical and conceptual scope. This study was limited to Nairobi owing to availability of numerous real estate development projects being undertaken in various areas within Nairobi and its environs. It focused on selected residential development projects which offered the 'off-plan purchase option' to potential buyers and used the funds to finance development. The researcher specifically analysed the effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers. The study also investigated the challenges facing developers and buyers in off-plan sales and proposes appropriate recommendations on how the sector can be enhanced in the country.

1.9 Organization of the study

This research report is systematized in five chapters discussed as follows:

Chapter one which is an introductory chapter incorporates background of the study, statement of the problem, research questions, study objectives, research hypothesis, justification of the study, significance of the study, scope of the study and research project structure.

Chapter two constitutes a review of published and unpublished literature concerning off-plan property sales. A conceptual framework has been developed towards the end of the chapter.

Chapter three constitutes details on the research design and methodology including a description of the study area, study population, sampling techniques and sample size, data categories, research instruments, data analysis and presentation techniques, ethical issues and limitations of the study.

Chapter four incorporates the data presentation and analysis section.

Chapter five highlights the summary, conclusions and the recommendations of the study. It also tests the hypothesis and gives areas of further research.

CHAPTER TWO

LITERATURE REVIEW

2.0. Introduction

This section will provide a review of current works relevant to the topic. This chapter begins with a general definition of key concepts, then proceeds to describing the real estate development process along with the strategies of financing real estate development. A summary of literature is presented from various sources on the process of real estate development, actors in the development process, stages of real estate development, financing options for real estate development, off-plan property sales with insight to off-plan sales contracts and challenges of off-plan sales, off-plan sales in Kenya, off-plan sales in other markets around the world, laws regulating off-plan developments and pattern of finance requirement for a speculative development. The chapter ends with a summary and conceptual framework on off-plan sales.

2.1. Definition of Vital Concepts

2.1.1 Real Estate

Appraisal Institute (2002) defines real estate as land and anything that is for all time fastened to it. Fixtures include buildings, fences, and things attached to buildings, such as plumbing, heating, and light fixtures. Essentially Real Estate is an interest in land, which can either be freehold interest (otherwise called a fee-simple interest) or a leasehold interest. In freehold interest, the investor is entitled to the full ownership rights including use and exchange of title and should likewise accept the responsibilities of a landowner such as potential losses from catastrophic events and the commitment to pay property taxes. A leasehold interest exists when a landowner consents to pass a portion of his rights on to an occupant in return for a payment of rent. For example, renting an apartment comprises a leasehold interest in land while owning a home achieves possession interest. Other interests are recognized in some jurisdictions such as life estate, however, those interests are less regular in the investment field.

Buying property is a decision that needs not to be taken lightly as it involves normally a large financial outlay. Investment in real estate constitute a class of real property that has a capability to produce income or profit to the homeowner or the property owner, such income or profit to being measurable either in monetary terms or in the form of non-monetary satisfaction. The primary criterion of such property is its income producing characteristics (North, 1976).

Landlords in fulfilling their aim of generating the highest income attainable from their property investment can either increase the lettable space of the property by repairs, renovations, alterations and modification or harness new creative concepts in real estate industry which supplement the rental income (Kimani, 2008).

2.1.2 Real Estate Development Process

Peca (2009) defines real estate development as the enhancement of raw land through the advancement procedure in which physical ingredients like land and structures are adequately joined with finances and marketing assets with the aim of making an environment in which people live, work and plan. Real estate developer carries out improvements either by beginning at the ground up or by reconditioning a prevailing property. Bulloch and Sullivan (2004) also describe real estate development as the procedure of making value by ensuring palpable enhancements to real property. Peca (2009) further describes development process as a creative process which occurs in the context of complex relationships between the participants and the economic, political, financial, and social institutions of the environment in which they operate. Real estate development process includes the following components: the plan, financial, costs, physical, design and market.

2.1.3 Main actors in development process

There are various players in the development process, key amongst them being landowners; developers; public sector and government agencies; planners; financial institutions; building contractors; agents; professional teams; and occupiers. The table below summarizes their roles in real estate development.

Table 2.1: Role of various actors in the development process

Actor	**Role in Real Estate Development**
Landowners	They are the owners of the sites where real estate development is carried out. They actively or passively participate in the initiation of development through their wish to sell and or improve the value of their land.

Actor	**Role in Real Estate Development**
Developers	Organize the development concept, source for finance and rally the various development players together to carry out real estate development.
Public sector and government agencies	They form the regulatory authorities over property development. Their role is to provide the various licenses and approvals relevant in the development stages. They are also development partners in the case of public – private partnerships.
Planners	The fundamental motivation behind planning is to urge advancement and to avert unwanted improvements. The basis of deciding planning applications is set around the statute and a variety of central government policy guiding notes. Planners assist developers to understand what use as construction materials, what density, what design standards are required in order to obtain permission.
Financial institutions	Financial institutions play an important role of financing the development process. They offer the short term and long term finances needed for development. Short term funding covers the costs during the development process while long term funding covers the costs of holding the completed project as an investment.
Building contractors	Building contractors are employed by the developer to carry out specialist activities within the development process such as structural works, electrical works, plumbing and mechanical installations. A prudent developer will seek the right balance between the lowest tender and the quality performance.
Agents	Agents possess detailed knowledge of property markets and are contributory in beginning the process of development by either locating land suitable for a developer or advising the landowner to sell a particular site due to development potential. They also assist the developer to sell or let the developed units.

Actor	Role in Real Estate Development
Professional teams	Due to complexity and the skills required in the development process developers employ professionals to carry out the tasks during the development stages. They comprise: planning consultants, economic consultants, architects, quantity surveyors, engineers, project managers, solicitors and accountants. Each of the professionals offer a specialized skill in the development stage.
Occupiers/Buyers/ Tenants	This is the final consumer of the output of real estate development. Their tastes and preferences should be carefully considered by the developer prior to development.

Source: David and Topping, (2001)

2.1.4 Stages in development process

David and Topping, (2001) and John et al (2009) argue that real estate development process starts from an inception of an idea by the developer and this idea is subjected to the next stages of development. These stages are discussed below:

a) Idea inception

Development process is usually long and complex but it just starts by idea generation. This is the first step in property development process whereby the developer engage his or her brain into actions and conceptualize an idea which will result into a built up structure. Bulloch and Sullivan (2004) notes that in this phase of the development scheme, the developer hopes to give a product that takes care of a specific demand seen in the marketplace. In conceptualizing, the developer considers in mind the size and scope of the anticipated idea formulation. It is this idea which is presented to the designer architect who comes up with a translation from mind to a piece of paper in form of drawing. At this level the developer is in a position to conceptualize cash inflows and outflows and thus able to determine the viability of the idea at this stage (John et.al 2009).

b) Idea refinement

David and Topping, (2001) points out that this stage is a pre-feasibility stage where a feasibility checklist is designed to screen out ideas that are likely to fail before an intensive investment of time, money and effort. It goes to identifying the necessary location attributes and economics in attempts to gain control of the site, it involves the application of the principles of highest and best use of land where the developer determines whether the idea is legally permissible, physically possible, financially feasible and socially acceptable.

c) Feasibility Study

David and Topping, (2001) notes that feasibility study is an extremely vital stage of the development process because it directs the making of decisions by the developer throughout. It involves the assessment of market investigation both in overall and in precise terms, and the financial appraisal of the proposal. The procedure of financial assessment needs to guarantee that the expense of development is sensible and on account of private area development this will set up the potential for profit in connection to risk conceived while in public sector it will endeavor to guarantee that expenses are recouped. Bulloch and Sullivan (2004) further explains that in this stage, the developer works to ensure that the highest and best use for the location within the restraints identified in the phase of Idea Inception.

d) Acquisition

This is the stage that involves an assessment of all legal issues regarding the land ranging from possession, prevailing planning regulations and any rights of way. Determination of the existing proprietors is critical in this stage failure to which development viability will be adversely affected.

Acquisition stage is not limited to legal investigation but also involves ground investigation. This investigation encompasses a valuation of the location’s load bearing capacity, admission and drainage. A survey of current services like water and electricity ought to be done to determine their capacity to contribute to the proposed development. The absence or inadequacy of the services poses a cost to developers and their cost of provision must be catered for.

Finance acquisition also occurs at this level of development whereby not except when applying the internal resources; the developer needs to obtain suitable finance for the development project on the most favorable terms, before the commitment to a scheme (John et.al 2009).

e) Design and costing

David and Topping, (2001) notes that design is an almost continuous process running parallel with the various stages, getting progressively more detailed as the development proposal increases in certainty. It involves scaled layout plans showing the position of proposed building(s) on the site, together with simple floor plans showing the internal arrangement of building on each floor. At this level the quantity surveyor must be able to make a detailed estimate of the building costs to enable negotiations to commence with building contractors.

Design and costing stage involves all members of the professional team and continues throughout the construction of the scheme. To reduce delays during property development developer has to ensure that at each appropriate stage design and costing are complete.

f) Permission

David and Topping, (2001) notes that this entails the application for approval of the building plans as per the law. Any development which by statutory definition involves a change of use or building operations requires planning permission from the local planning authority prior to its commencement. A detailed application will involve the submission to the planning authority of detailed drawings and information on siting, means of access, design, external appearance and landscaping.

There are a variety of other regulations that may be necessary before a development commences such as listed building consent which is the right to alter or demolish a protected building. The prudent developer must clear all legal permission hurdles before commitment to the development (John et.al 2009).

g) Commitment

At this stage, all the appropriate inputs of land, finance, labour, materials and the statutory permissions must be satisfactorily negotiated before any agreement is signed making the developer liable for any major outlay of money. The project must be evaluated again at this stage due to changes in economic circumstances from when the preliminary work was undertaken. At some time, all contracts to acquire the land, secure finance and appoint professional contractor will be signed. In the case of non-profit development commitment stage should be held back to ensure all resources are in place to minimize costs and risks (David and Topping, 2001).

h) Implementation

John et.al (2009) note that the aim of the implementation stage is to ensure that development takes place as per the projected time, quality and budget. It commences once all the raw materials of the development process are in place. Depending on the developers experience and complexity of the scheme the budgeted parameters could be well achieved by a project manager who will coordinate the design and building process. Bulloch and Sullivan (2004) points out that during the construction phase, the contractor and subcontractors are responsible for constructing the building based on the design and specifications which were finalized in preconstruction. The project manager and or developer must anticipate problems during the project period and make prompt informed decisions to minimize delays.

i) Let/manage/dispose

This is the last stage of the development process but it's planned during the early states in that an occupier may have been secured during the development process. John et.al (2009) point out that the success of the development depends on the ability to secure a willing occupier at the estimated rent or price. Bulloch and Sullivan (2004) note that at some point after the project has become financially stabilized, the developer will be faced with a decision on what to do with the property. Disposal may take place in the form of letting or outright sale of the freehold interest. Management of the property needs to be considered as part of the design process at an early stage if the final product is to benefit the occupier and the developer. All aspects of managing the capital improvements over their economic lifecycle are initiated. These include maintenance, releasing and refinancing. The financial success of the development cannot be assessed until the building is complete, let and, where appropriate sold.

2.2 Financing Real Estate Development: The Theoretical Concept of Finance

A review of literature on finance reveals that there are only two types of finance available: debt and equity finance. Using either as a source of financing a project depends on the characteristics of assets being financed and transaction cost. Atati (2014) suggests that debts are used if the ability to exploit potentially profitable investment opportunities is limited by the resources of the owner (equity).

Cheong, (2015) defines debt financing as the borrowing of loans from other companies, banks, or financial institutions in order to support a business's operations. The loan principal is repaid at a later point in time, with some interest expenses being paid before the debt's maturity. Debt finance can be obtained from formal financial institutions like banks, micro-finance arrangements, indigenous moneylenders, family members, employers and government. Bank lending as a form of debt can be categorized into two: either as asset specific or corporate loans. Again, the debt can be either secured by collateral or unsecured.

Creamer et al (1960) defines equity as funds obtained by corporations or companies from external sources (through capital stock flotations) and from internal sources (through income retention). Equity finance gives the developer total control over the decisions when undertaking the project if the developer completely funds the project using equity. Heffernan (2003) and Tirole (2006) assert that financial instruments vary widely according to the characteristic of term to maturity. Equity has no redemption date and therefore possesses an infinite term to maturity.

2.2.1 Debt Finance for Real Estate Development

The gap between aggregate task costs and the measure of value contributed is compensated for through debt. Debt finance can be arranged into short-term and long-term. There are distinctive sorts of debt yet the most widely recognized in real-estate development are construction and home loan financing. Construction financing, as a rule, is given in single amounts, alluded to as advances, as segments of the undertaking are finished. Interest on the remarkable parity is added to the aggregate collected credit sum, repayable on inhabitance of the completed building (Guzman, 2000). Home loans are utilized for long-term financing. Mortgage lenders commonly include banks; trust and life insurance organizations; pension funds; and cooperatives.

The most famous subsidizing instrument for mortgage holders is the term loan, whereby a predefined maturity date sets the time for reimbursement of the loan amount and interest. Van Order (2007) distinguishes models for subsidizing advances to be either portfolio lender model or securitization model. While the portfolio lender model includes financial intermediaries originating and holding advances which are financed with obligation or stores, the securitization display includes raising assets through the security markets.

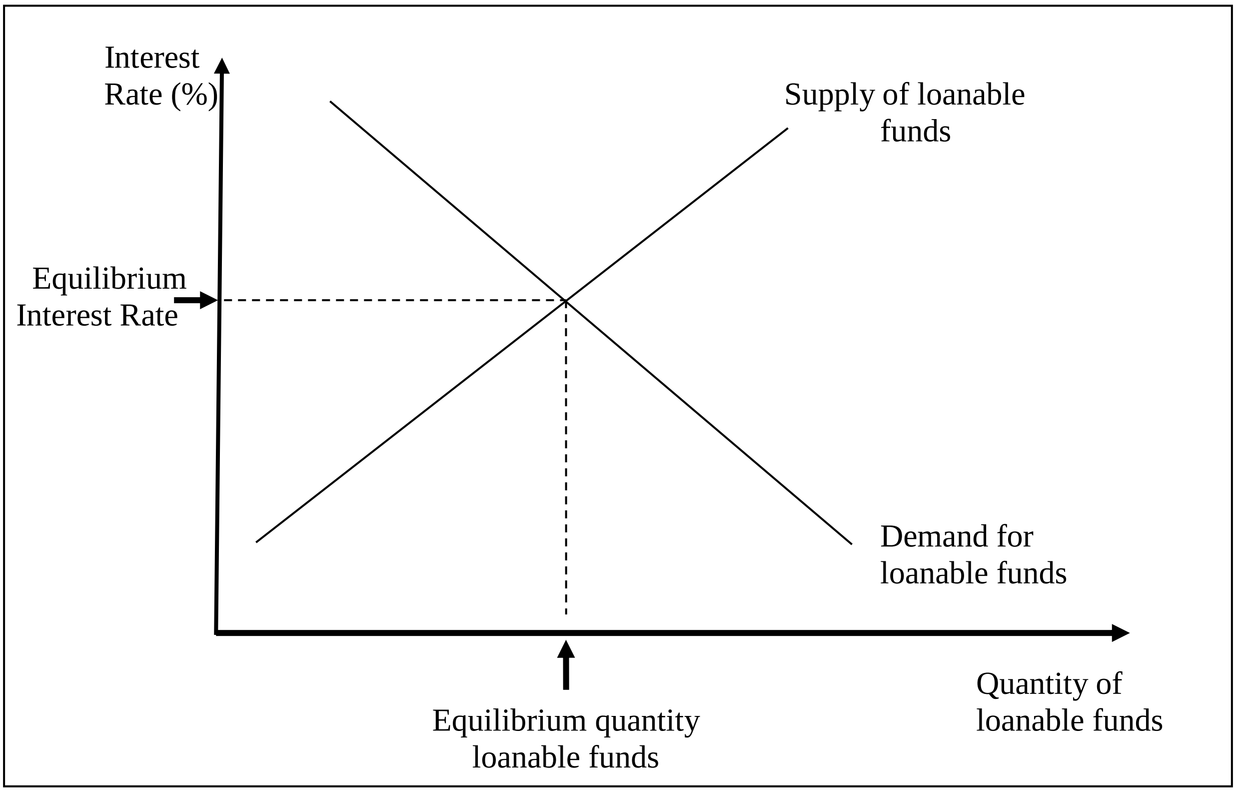
Long-term loans differ from short-term through the medium term to long-term (project finance, capital expenditure) - which may have tenure of somewhere in the range of 10 and 30 years. Loaning for commercial purposes is short-tenured while the average mortgage loan varies between 10 years and might be up to 30 years.

Demand and Supply of Loanable Funds

Grimsley (2014) defines Loanable Funds as the aggregate of all the cash individuals and substances in an economy have chosen to save and loan out to borrowers as an investment as opposed to using it for personal utilization. The theory of loanable funds utilizes a classical market examination to depict the supply, demand, and interest rates for loans in the market for loanable funds.

The supply of loanable funds is derived from individuals and organizations, such as government and organizations that have chosen not to spend a portion of their cash but rather spare it for investment purposes. The demand of loanable funds arise from individuals and organizations seeking loans. Kimball and Agarwal (2015) noted that the loanable funds theory is a structure used to decide interest rate in the short-run. As indicated by this, the interest rate is determined by the demand for and supply of direct and indirect finances on the primary and auxiliary markets during a given period.

Figure 2.1 Demand and Supply of Loanable Funds



Source: Kimball and Agarwal (2015)

As noted in Chapter One, high and fluctuating interest rates has been a challenge to property developers as they seek to use debt in financing real estate development in Kenya. Such fluctuations lead to unpredictability in cost of finance for property development thereby prompting developers to resort to creative ways of financing real estate development. However, there has been an attempt to lower and stabilize interest rates through the enactment of *The*

Banking Amendment Act 2016, which curbs interest rates at non more than 4% above the base rate set and published by the Central Bank of Kenya.

2.2.2 Equity Finance for Real Estate Development

It constitutes of all monies obtained from various actors: business entities, friends and relatives, who have interest to maintain interest in the proposed development with the funds raised. Appraisal Institute (2002) defines equity as any material input that a funding group panels and that decreases the quantity of mortgage financing and/or government grants required. Examples of equity include:

a) Land and/or buildings that the sponsor group owns or that is being donated by the local government, another non-profit organization or a faith group;
b) Cash that the sponsor has saved, or raised in a fundraising campaign; and
c) Pooling of funds by investors to develop a common property.

According to *Business Daily* on Wednesday, January 3, 2018:

> *"Real Estate Investment Trusts (Reits) prices have remained depressed due to lack of clarity on exact returns from underlying assets, investment analysts have said. In 2017 Stanlib's Fahari i-Reit, the only listed Reit in Kenya, saw its price decline by 13.4 per cent closing at Sh10.30 down from Sh11.90 at the beginning of the year and shedding 50.5 per cent from its listing price of Sh20.80 in November 2015."*

Muigai (2016) points out that Shared Equity Products is another type of equity finance model, which involves a range of financial products that enable the division of the value of the dwelling between two or more legal entities. These products therefore enable the main buyer to reduce their outgoings by giving up rights to that part of the equity in their homes. These shared equity products may be taken out by first time buyers to reduce the costs of entering the housing market, by more mature owners who wish to diversify their housing equity risks especially older households who are looking to release equity.

Crowd funding is another way of pooling funds from investors for real estate development. Maarbani (2015) defines Real Estate Crowd funding as the offering of traditional real estate assets or ventures through differing types of financial products and distributed to investors through technology. It allows a broader range of investors (the crowd) to make smaller investments in real estate assets and ventures in a more efficient manner. The aggregation of smaller amounts of capital from a broad group of investors results in the creation of a significantly larger pool of new capital, allowing the crowd to collectively buy properties, lend money to home owners and property developers, and potentially take equity stakes in new development projects as joint venture partners.

In my view, proceeds from off-plan sales form part of equity for the real estate development since it comprises of funds pulled from individuals or entities seeking ownership of the property just as companies are owned through shares.

2.3 Off-plan Sales

According to Isthmus (2010), off plan purchase is defined as the buying of property before works have begun or before the actual works have been completed. The buyer has the option of either making judgement on what to purchase from the unfinished house or from plans, maps and computer generated images of proposed development project of housing. This form of acquisition applies both to plots and houses. The buyer gets to buy the house by paying a deposit or providing the developer with a letter of credit before the project starts and signs a contract with the developer binding him to pay the remaining balance as a lump sum or in instalments according to the terms and condition of the contract.

In off plan purchase usually the subdivision of land has not occurred and the certificates of title have not yet been issued by the Ministry of Lands. The issuance of certificate of title to the buyer occurs upon settlement of outstanding monies owed to the developer.

Mugendi (2012) noted that the contrast between an off-the-plan and a customary property buy is that individuals purchasing an established property can review the property before signing an agreement to purchase. This implies they can get a 'feel' of the property and check whether it is reasonable for their requirements. Individuals who purchase off-the-plan are some of the time restricted to survey promoting material or a longing idea given by the developer. In these cases, the purchaser needs to depend on the demonstrable skill, competency and trustworthiness of the developer, and the terms of the agreement, to guarantee the task is finished on time, and to an adequate quality.

Mugendi (2012) further notes that purchasing property off-the-plan can have some benefits over purchasing an established property. Usually, the greatest advantage is the chance to purchase a property at 'the present cost' yet just pay most of the purchase price numerous months down the track. Profit is a major motivation for the developer and on the part of the home buyer he/she seeks to get quality at the best price in the market. Risk mitigation by both parties is key to choosing off plan method as way of acquiring a home (Boussabaine and Khirkhan, 2004). Through influence diagrams they describe a way through which investment decisions can be reached while at the same time considering risk issues.

Impact outlines are an ongoing advancement in decision analysis and have turned out to be profoundly helpful for risk analysis, risk management, and risk communication. An impact outline can give an instinctive technique for recognizing and recording the fundamental components, including decisions, vulnerabilities, and objectives and how these impacts each other inside a project situation. They are likewise used to create cognitive maps of how specialists see a given risk management decision and how different stakeholders may view a similar choice.

2.3.1 Off-plan Contracts

According to Saleemi (2006), a contract is an agreement entered into by two parties or more with the intention of creating a legal obligation, which may have elements in writing. Contracts can be made orally. The remedy for breach of contract can be "damages" or compensation of money.

Cytonn (2017) notes that the process of purchasing an off-plan property commences with the signing of three documents:

i) The Reservation Form – This is to reserve or book the unit as the buyer and effectively notify the developer not to sell the unit.
ii) The Letter of Offer – This indicates the amount of money that the developer is willing to accept in exchange of granting ownership of the off-plan property to the buyer.
iii) Sale Agreement – This is the final and binding document once the developer and the buyer have agreed on the property to be sold, the price, deposit to be paid, payment period and the mode of payment.

In the sale agreement for an off-plan property, the developer promises to deliver a development/housing unit together with all the stipulated amenities to a buyer at an agreed price at a future date, subject to the developer obtaining all necessary approvals in respect of the development from the relevant authorities and satisfying any conditions necessary to finalize the development. In most cases, the sale agreement stipulates the amount of deposit payable by the buyer to the developer upon signing of the sale agreement, with the balance of the purchase price due at the settlement date, or via a specific payment plan.

2.3.2 Challenges of Off-plan sales Developments

Property investment through off plan method is advantageous predominantly for the fact that gains are made on speculation of the market. The property market is however subject to boom /bust cycles which provide many lessons about the management of the economy and the banking system, in particular about the dangers and unforeseeable consequences of financial regulation and deregulation. Some of the challenges that come about as a result of off plan sales include:

a) The property market is inherently cyclical

This arises from the cyclical nature of both tenant demand and development activity due to differential movement in property values and development cost (Fraser, 1993), property's short run supply inelasticity and the time lags involved in property development. There is the possibility that a surge in development activity induced by an upturn in demand will result in a majority in completions coinciding in a downturn in demand a few years later. This possibility cannot be ignored in Kenya where majority of developments focus on the middle and high income earners. At some point in the future the demand for this type of property may reduce leading to the developer having houses that are not bought.

b) Relaxation of planning controls destabilizes real estate market

When the authorities that are in charge of urban planning are not strict on enforcing the policies in place, instability creeps into the real estate market due to legal incompliance. According to Mugendi (2012), this is the case in Kenya where planning approvals can be fast tracked or circumvented through exchange of money. This may result in unforeseen rise in housing supply at the expense of quality housing. Market prices, which in most cases are based on previous supply constraints, give a false indication of future values and development profitability in the context if decontrol. This may result in the investors loosing much of the anticipated profits.

c) Probability of distressed sale

Some investors do not budget or develop a financial plan when committing to buy an off-plan unit and end up in a difficult position where they do not have adequate funds to complete the purchase. A traded off financial specialist in this circumstance regularly results to offering on the agreement for almost no benefit to different speculators. Anyway when the other financial specialist completes a home loan valuation, properties ordinarily esteem 10-30% higher than their deal price tag, demonstrating the off arrangement venture worked, yet shockingly the primary speculator was not in the situation to profit by it (Mugendi, 2012).

d) Cost overrun

This is an unexpected cost incurred in excess of a budgeted amount due to under estimation of the actual cost during budgeting. Sometimes it is anticipated in such cases as inflation. When this happens the investor ends up digging deeper into his/her pocket or abandoning the project in whole.

Joint Building Council (1999) allows the architect to vary contract terms up to 15% of the builders work. However, variations above 15% of the builders work can only be done with the consent of the employer and the contractor. This increase is there on passed to the buyer of the property and in this case end up hurting the financial position of the investor.

e) Time overruns

Mugendi (2012) notes that in off plan investments, there is the chance of the project extending beyond the anticipated completion date. This may be due to regulatory challenges such as inability of the developer to acquire final subdivision of land or approval of the building plans, thus stalling the project. This is also due to poor site management and supervision, low speed of decision making by the project team, client initiated variations and unforeseen ground conditions. This time delays result in held up money meaning the investor may be losing in investing in other opportunities. Time overruns may also be caused by death of the developer, court cases and even illness of the developer.

f) Finance

Developers rarely fund their projects alone and mostly rely on financial institutions through construction loans. There might be some significant delay between the date of signing the loan contract and the disbursement date. Okal (2011) notes that most lending bodies give a formal finance approval with a specific time frame but end up extending the time frame when conducting background checks on the borrower. In addition, the developer’s financial circumstances may change between the date of contract and the completion date thereby leading to financial setback for the real estate development.

2.4 Off-plan sales in Kenya

Kioleoglou (2015) did an analysis on whether purchasing off Plan was the most efficient way of investing in real estate. It was noted that during the last decades, markets around the globe have been attempting elective approaches to back tasks. In real estate development, there have been a few alternatives to raise adequate funds for such ventures. Bank Loans, value reserves, are probably the most well-known among others. The choice however that most developers appear to incline toward is "off plan sales".

Plate 2.1 Photographs of Recent Residential Real Estate Developments

Garden City Apartments – Thika Road

Sohail Gardens - Westlands

(Source: Field Survey, 2017)

Several projects have been undertaken in Kenya, particularly in Nairobi, which were partly financed through off-plan sales. They include: Garden City residential development (apartments and maisonettes) along Thika Super Highway, Rosslyn Gardens and Rosslyn Heights located off Redhill Road, Pearl Heights apartments in Kileleshwa, Sohail Gardens in Westlands, Ramata Greens in Baba Dogo just to mention a few. Property financial specialists or property theorists prefer to buy property in as such in the expectation of making generous capital additions. This normally happens in light of the fact that engineers, who offer property available to be purchased off-plan, frequently offer money related motivators to early adopters. Typically, this comes as a markdown in light of the deal plan. Moreover, there might be plentiful open door for capital development in a rising business sector and with an advancement cycle of normally 12– 24 months.

Off-plan purchasing is a pattern that has seen many hopeful property holders secure their fantasy homes by putting their funds on artistic impressions of developments and building plans. It is a way to home possession that some are not happy with, but rather one which has served others well. Purchasing a property off-plan, regardless of whether to use as a home or as a speculation, causes a larger number of dangers than purchasing a property that has just been assembled.

Kioleoglou (2015) further notes that other than the apparent dangers of a developer who might discontinue from business before the construction of the development is completed and the purchaser being unable to recuperate the deposit progressive, the option of decline in property values before completion of the construction is an issue to be considered.

There is need for the developers to understand that the market trends. If the real estate market and the economy in general is depressed, prices tend to go down, sales are difficult and achieving sales of off-plan units would be a daunting task.

In most cases developers go this route due to limited options since most of them set up projects without having the required financial muscle to complete the project. Banks are not willing to finance 100% of any project. Usually, developers decide to start a project where they involve the land owner on a Joint Venture basis (whereby they do not have to pay for the land and the land owner would be compensated with proceeds of the project). They then raise funds to commence the construction work and when need arises they sell the off-plan units. Through creating appealing artistic 3D plans, they offer amazing concept of real estate developments which appeal to potential buyers. The developers also present projections for possible returns on investment for potential buyers intending to let the properties (Kioleoglou, 2015).

Off plan sales have been boosting land advertises throughout the years however they have likewise caused genuine loses to financial specialists. Several projects have come up whereby potential investors have bought into the concept and sunk their funds only for them to turn into a scam. A good example is Simple Homes Housing Co-operative which failed to deliver their proposed development and disappeared with buyers' deposit.

According to *The Standard on Sunday* on 13th March 2017:

> *"The disappearance into thin air of property development firm Simple Homes is turning out to be a modern-day mega pyramid scheme in which thousands of Kenyans have lost hundreds of millions of shillings. From interviews with multiple sources, it emerged that victims of the scam lost at least Sh500 million to the con artists. The company marketed itself as a Special Purpose Vehicle (SPV), which purported to aid Kenyans purchase homes using a 'pay rent, own home' model but suddenly closed shop and erased its Internet footprint, leaving those who had invested their money bewildered."*

If one resolves to continue with an off-plan investment, they would need to conduct due diligence on the developer by analyzing their previous developments and whether they were delivered to the expected standards and quality. Professionals should be engaged before committing funds through a deposit. A lawyer would be essential in drafting a contract between the parties and offering legal advice on the procedures to follow until the development is complete. A valuer would also be important to give advice on whether the investment is worth undertaking based on projected potential of the development.

Cytonn (2017) further noted that:

> *"if a developer offers a house or off-plan property at a price that is very low by market standards and not achievable under normal circumstances, and it is the only company offering such, then one should be cautious and evaluate them fully as it is probably a scam to lure unsuspecting buyers desperate to acquire a home."*

2.5 Off-plan sales in other Markets

2.5.1 Australia

Government of Western Australia (2014) notes that Australia is one of the countries that has successfully practiced off plan developments. The off plan buying and selling of property is guided by policies formulated by the department of consumer and employment protection. The policies mostly focus on safeguarding the progress payments of purchasers before completion is complete. The policies include:

a) Developer's right to utilize progress payments: - Developers do not have the right to utilize any payments by purchasers for any activity, rather they safeguard the money as down payment for the units upon completion. Usually only 10% is paid as deposit and no further progress payments are permitted. The balance of 90% is only paid by Buyers at completion of the development. The Developer is required to fund the construction either from its own funds or through debt funding.

b) Buyer's right to prevent further dealings by the developer: - The Buyer does not have any rights to prevent further dealings by the Developer of the property other than preventing the Developer from selling the property to another person. The Developer has the right to provide securities on the property (such as a mortgage) to financiers for the construction loan as well as proceed to arrange subdivision and sectional titles.

c) Buyer's right to deal with the property: - While any upside or downside of property value belongs to the Buyer upon signing of the Sale purchase Agreement, this is conditional upon the Buyer completing the purchase with the Developer upon completion of the construction/development. The Buyer's rights to deal with the property are also extremely limited. It is also prudent practice in Australia by Developers to prevent the Buyer's right to caveat the land as this will delay subdivision and sectional titling.

d) Termination of the Sale Purchase Agreement: - Both parties have the right to terminate the Sale Purchase Agreement if certain acts are not done by the Developer by a sunset date. As such, the risks lies with the Developer to ensure these acts are undertaken within the specified time. These acts include;

    i) completion of construction to enable Occupancy Permit to be issued

    ii) registration of subdivision plan at Land Registry with new titles issued In the event of termination, the 10% deposit is fully refundable to the Buyer

e) Ownership of property in the case of liquidation of the developer: - In event of liquidation of Developer, the Buyer has very limited rights to the property. If the development doesn't proceed and as such, the receiver of the developer cannot complete the Contract for failure to carry out certain acts, then the Contracts are terminated and the deposit of 10% fully refundable to the Buyer.

2.5.2 Dubai in the United Arab Emirates

According to Isthmus (2010), the sale of off-plan properties was immensely affected by the 2008 real estate bubble. During the times of advantage bubbles, the costs of properties rose to abnormal states with no monetary defense. The conventional valuation approaches were disposed of and advertise members defended these new high costs with later similar deals and expansion.

Before this, the market of off-plan properties was vibrant with many investors sinking their money to proposed concepts before actual ground breaking. The spread in pricing is important to cover the construction risks for the investors. The price for the off-plan property should be lower than the price of a similar or typical development that has already been constructed. However, the market stabilized in the years 2012 – 2013 and investors cautiously regained confidence in off-plan sales.

2.5.3 United Kingdom

According to Isthmus (2010), property developers in the United Kingdom sell off-plan properties at a discount to potential buyers in a bid to attract financing for their developments and to compensate the investors for potential construction risks. Further, buyers have alternative to insurance funds in case the developers fail to complete their projects or be bankrupt.

2.6 Laws regulating off-the-plan developments

Isthmus (2010) notes that 'caveat emptor' (meaning let the buyer beware) is the market doctrine for buyers of units in off-plan developments. Though, participants in the market are aware of the risks intrinsic to in purchasing and vending off-plan, and the regulations laid for property development.

Developers keep track records of finished developments, that can be observed to indicate their ability to complete a development as well as the quality of their work. In most markets, novel developers are anticipated to offer better discounts because they lack experience. With a vibrant real estate market, legal costs are lower and thereby legal advice is standardized and widely accessible hence enhancing the buyers' knowledge on legal procedures regarding property investments.

a) The Sectional Properties Act, 1987, No. 21 of 1987 – Laws of Kenya

In Kenya, there is no clear legal provisions on sale of off-plan developments. The Land laws have provisions for registration of properties, but no clause or article or clause on registration of a property purchased off the plan. Most residential properties that are sold off-plan in Kenya include apartments, terraced and stand-alone maisonettes, town houses and villas.

Section 4 of The Sectional Properties Act, 1987, No. 21 of 1987 Laws of Kenya provides for the subdivision of buildings into units which can then be registered by the Lands Registrar. It is on this basis that sections of buildings such as apartments, pent-houses and office suites can be registered separately and each unit issued with an individual Title.

Section 5 of the same Act provides for the registration of sectional plans. This thereby enables developers to come up with a concept, generate a sectional plan from an existing plan of the site and sell the concept to potential investors in the form of off-plan sales. The registration of such sectional plans gives the investors enough confidence that the developer actually intends to undertake the proposed development.

b) Australian Consumer Law (ACL) - Australia

In Australia, the ACL applies to contracts among business and buyers for the supply of products and enterprises. The statutory buyer ensures accommodated in the ACL apply to off-the-plan deals where products or administrations frame part the buy.

The ACL gives a purchaser guarantee that requires products or services to be supplied inside a reasonable time, where an agreement fails to stipulate a period for the supply of those goods or services. In the event that a trader fails to agree to this consumer guarantee, the purchaser might have the capacity to end the agreement, seeing that it applies to those products or services, and recoup damages for any loss or damage endured due to the trader's inability to comply. These consumer guarantees are relevant to off-the-plan sales. It is always important for off-plan property sales contract to have stipulated completion date, as that may be useful if action is required against the developer for potential delays.

c) Dubai in the United Arab Emirates

According to Safai et al (2018), in Dubai, off-plan real estate investment is overseen by a combination of real estate laws and regulations whose major aim is to protect buyers' interests. They include:

i) Interim registration law -Law 13 of 2008

Safai et al (2018) notes that this law stipulates that all sales and clearances of off-plan units need to be registered on the provisional real estate register that is sustained by the Dubai Land Department. Any sale that is not recorded is as such null and void. Equally, the law administrates the right of developers to end a sale agreement for an off-plan unit if the buyer evades the payment and provides for: the termination procedure to be followed; and the monies that may be retained by the developer in the event of termination which is linked to the percentage of completion of the off-plan unit as follows:

a) Where the percentage of completion of the unit exceeds 80%, the developer may retain up to 40% of the price of the unit specified in the off-plan sale contract;
b) Where the percentage of completion of the unit is between 60% and 80%, the developer may retain up to 40% of the price of the unit specified in the off-plan sale contract;

c) Where the developer has commenced construction work on the project as per the designs approved by the competent authorities and the percentage of completion of the real estate unit is less than 60%, the developer may retain up to 25% of the price of the real estate unit specified in the off-plan sale contract; and
d) Where the developer has not commenced the execution of the project for reasons beyond his control and without negligence on his part, the developer may deduct not more than 30% of the amounts paid by the buyer.

ii) The trust account law - Law 8 of 2007

Safai et al (2018) notes that this law protects buyers by setting a requirement for developers selling off-plan units to be registered with the Real Estate Regulatory Agency (RERA), and to deposit all amounts paid by purchasers into an escrow account with an escrow agent accredited by the Dubai Land Department. The amounts deposited in the escrow account are exclusively allocated for the purposes of construction of the particular real estate project and any other directly related activities.

iii) The jointly owned property law (Law 27 of 2007)

According to Safai et al (2018), this law directs developers to unveiling all pertinent information regarding to their off-plan development in a “Disclosure Statement” to potential purchasers.

2.8 Summary and Conceptual Framework

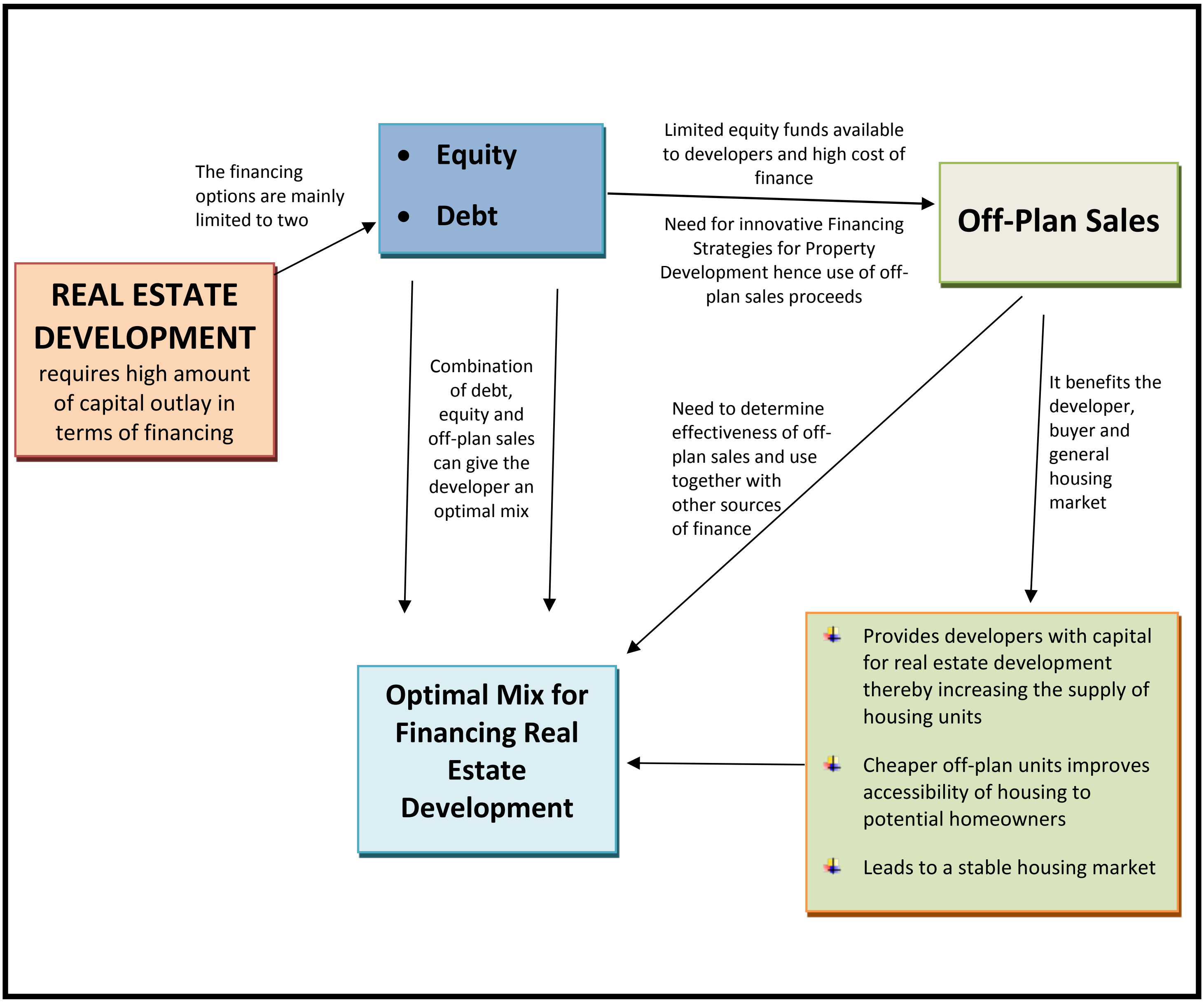
Developing real estate is a high risk activity which requires commitment of large sums of capital whose sources are mainly limited to equity or debt. Unfortunately, most investors and developers do not have enough equity to finance real estate development and the alternative debt financing is costly due to high interest rates.

Developers thereby explore other innovative ways of financing real estate development other than the traditional debt and equity. Off-plan property sales emerges as an alternative source of finance, presenting developers with a chance to obtain funds from would-be buyers of the units in their proposed development.

In using off-plan sales, the developer considers various aspects such as: off-plan sales contracts to be used to ensure smooth transfer of property rights to the buyers; legal framework around off-plan sales; benefits of off-plan sales to the buyer to enable effective marketing of the off-plan units; and challenges faced in selling off-plan units.

Analysis of the effectiveness of off-plan sales enables the developer to establish an optimum mix of equity, debt and off-plan sales to effectively finance the real estate development.

The conceptual framework is illustrated in the diagram below.



Source: Own Construction, (2017)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter generally presents in detail the case study areas, and highlights the research design and methodology used in conducting the study as well as the procedures for collecting data. It also describes the study population, sampling techniques and sample size, case study areas, data collection instruments, data analysis and presentation techniques, ethical issues and limitations of the study.

3.2 Research Design

This is a descriptive cross-sectional study design; the reason for choosing cross-sectional is that the research period is short. Hinton (2010) opines that cross-sectional studies provide a snapshot of the outcome and characteristics associated with it. This kind of design captures the desired characteristics of this research.

3.3 Research Methodology

Bryman (2004) defines a research method as a technique for collecting data. Kothari (2004) noted that research methods are all those methods/techniques that are used for conducting research, underscoring that research methodology is a way to systematically solve the research problem. The techniques to be employed in the acquisition of data are determined by the type of data that the researcher wishes to collect. Patton (1990) further asserts that given the multiplicity of approaches available to accomplish research, the method-selection process demands due consideration to the nature of questions posed, the type of data required to address the study's objectives, the characteristics of the respective respondents, and the field conditions.

The aim of this research study was to investigate the financing of real estate development through off-plan sales and the researcher used mixed method to carry out an in-depth investigation into this phenomenon. According to Cameron (2015), mixed methods represents research that involves collecting, analysing and interpreting quantitative and qualitative data in a single study or in a series of studies that investigate the same underlying phenomenon. It provides strengths that offset the weaknesses of both quantitative and qualitative research.

3.3.1 Population

Mugenda and Mugenda (1999) define population as an entire group of individuals, events or objects having a common observable characteristic. It's however not possible to obtain all the relevant information pertaining to the research from the whole population due to limited finances, time and resources. A researcher therefore has to identify a working population, which is defined by Rea and Parker (2007) as that part of the general population which possesses the characteristics that the research aims to study therefore fulfilling the requirements of the research.

The main actors in real estate development with information on off-plan sales are the developers and real estate agents, therefore the researcher chose them as respondents for this research. The working population included the real estate developers and estate agents within Nairobi City County since the study was limited to Nairobi City County. The *Kenya Property Developers Association* website indicated that there were 69 members (developers) operating in Nairobi as at 12th July, 2017 while a *Kenya Gazette* notice on 31st March, 2017 indicated that the total registered estate agents allowed to practice Kenya in 2017 was 359. Out of this, 312 registered estate agents have listed their postal addresses in Nairobi indicating they operate from Nairobi County.

3.3.2 Sampling

Sampling is defined by Kothari (1990) as the process of selecting a few individuals (a sample) from a bigger group (the sampling population) to form the basis for estimating or predicting the prevalence of an unknown piece of information, situation or outcome regarding the bigger group. A sample is therefore a set of elements selected in some way from a population. Mella (2012) noted that if the reliability and validity of a piece of research is to be achieved, selecting a sample from the larger population is mandatory. This is because of time and financial constraints that make the consideration of the whole population impossible. Sampling therefore allows for more accurate measurement within a reasonable time and budget.

3.3.3 Sampling Procedure

a) Case Study Areas

This research has basically used purposive sampling, also known as judgmental, selective or subjective sampling in the selection of case study areas within Nairobi City County. lker Etikan et al.(2016) defines purposive sampling technique as the deliberate choice of a participant due to the qualities the participant possesses, further noting that it is a non-random technique that does not need underlying theories or a set number of participants. It is a type of non-probability sampling technique based on the characteristics of a population and the objectives of the study

The researcher obtained a list from the *Kenya Property Developers Association* of 16 recent real estate development projects within Nairobi City County which incorporated off-plan sales as a financing strategy with a view to identify case study areas. The table below briefly describes the developments.

Table 3.1: List of Recent Real Estate Developments within Nairobi City County which incorporated off-plan sales as a financing strategy

Real Estate Development	Location	Nature of Development	Number of Units	Amenities
Kings Millenium Estate	Imara Daima	Apartments and Town Houses	220	Swimming Pool, Community Hall, Club House and Children's Play Area.
Airview Apartments	Embakasi	Apartments	120	None
Nine Sisters Apartments	Dagoretti	Apartments	70	None
Ramata Greens Apartments	Baba Dogo-Ruaraka	Apartments	70	Commercial Block, Gym, Sauna and Club House

Real Estate Development	Location	Nature of Development	Number of Units	Amenities
Pearl Heights Apartments	Kileleshwa	Apartments	32	Swimming Pool and Club House
Nantie Gardens	Lavington	Apartments	60	Club House.
Loresho Ridge	Loresho Estate	Apartments, Villas and Townhouses	164	Swimming Pool and Children's Play Area.
Jacaranda Gardens	Along Kamiti Road	Apartments	840 (in phases)	Club House, Swimming Pool, Shopping Mall And Kindergarten
Casa Ozone Apartments	Kilimani	Apartments	48	Swimming Pool and Club House
Muthaiga Valley	Parklands	Apartments	50	None
Bloom Field Apartments	Kilimani	Apartments	68	Swimming Pool and Club House
Sohail Regency	Westlands	Apartments	42	A Common Resident's Lounge
Sepal Garnet	Westlands	Apartments	29	Club House
Peony Estate	Lavington	Apartments	108	Swimming Pool, Gym and Children's Play Area
Young Garden	Lavington	Apartments	25	None
Azumi Heights	Westlands	Apartments	20	None

Source: Kenya Property Developers Association (2017)

The researcher identified five case study areas from the list, to include: Loresho Ridge in Loresho Area; Ramata Greens in Baba Dogo Area; Kings Millennium Development in Imara Daima; Muthaiga Valley Apartments in Parklands Area; and Pearl Heights in Kileleshwa. These case study areas were chosen on the basis of their distribution across Nairobi City County, variety in terms of nature of development, variation in the number of units developed, amenities provided and the fact that they had the information required by the researcher. The researcher conducted key-informant interviews on the developers of the real estate developments in each of the selected case study areas as well as the estate agents who participated in off-plan sales of the units prior to their development.

b) Other Developers and Estate Agents

The study also used questionnaires sought and capture the views of other developers and estate agents outside the identified case study real estate developments. The researcher used random sampling to narrow down on the number of developers and registered estate agents to be administered with questionnaires.

Marczyk et al (2005) argues that the minimum sample size that a researcher can use in a field study is 10% of a population. Alreck and Settle (1995) point out that there are maximum and minimum practical survey sample sizes that apply to all surveys, arguing that a sample size of less than 30 respondents provides too little certainty to be practical. Alreck and Settle (1995) put forward the formulae below for determining a sample population with a confidence level of 95% and a margin of error of positive or negative 5%.

$$n = \frac{\mathrm{Z}^2\mathrm{pqN}}{\mathrm{e}^2(\mathrm{N}-1)+\ \mathrm{Z}^2 pq}$$

Where **N**=population size

n= sample population estimated to have characteristics being measured, assuming a 95% confidence level.

p=the proportion in the target population estimated to have the characteristics being measured (confidence level)

q= 1-**p**

e= acceptable error (e=0.05, since the estimated error of this research is ± 5% of the true value.

Z= the standard normal deviate at the required confidence level of **1.96**

i) Developers

The population of the developers was drawn from the Kenya Property Developers Association, whose website indicates that there were 69 members as at 12th July, 2017. The researcher applied the above formula by Alreck and Settle (1995) to determine the sample size since it is more accurate than the general 10% apportionment proposed by Marczyk et al (2005).

The determined sample size was:

$$n = \frac{1.96^2 * 0.95(1 - 0.95) * 69}{0.05^2(69 - 1) + 1.96^2 * 0.95(1 - 0.95)}$$

n = 35.72

Say 36 developers (Sample Frame used is 36 developers)

ii) Registered Estate Agents

The population of the registered estate agents is obtained from the Kenya Gazette notice on 31st March, 2017 which indicates that the total registered estate agents allowed to practice in 2017 is 359. Out of this, 312 registered estate agents have listed their postal addresses in Nairobi indicating they operate from Nairobi County and therefore constitute the target population. The researcher applied the above formula by Alreck and Settle (1995) to determine the sample size since it is more accurate than the general 10% apportionment proposed by Marczyk et al (2005).

The determined sample size was:

$$n = \frac{1.96^2 * 0.95(1 - 0.95) * 312}{0.05^2(312 - 1) + 1.96^2 * 0.95(1 - 0.95)}$$

n = 69.32

Say 69 registered estate agents (Sample Frame used is 69 registered estate agents)

Table 3.2: Target respondents for the research

Target Respondents		Number
Developers:	Interviews (in case study areas)	5
	Questionnaires (randomly sampled)	36
Estate Agents:	Interviews (in case study areas)	5
	Questionnaires (randomly sampled)	69
Total		**115**

3.4 Background Information of the Study Areas

This study is limited to a sample of five case study areas within Nairobi City County which are recent real estate developments that incorporated off-plan sales as a strategy for financing the development.

Figure 3.1 Satellite Image of Nairobi showing location of Case Study Areas

Source: Google Earth, 2017

3.4.1: Loresho Ridge

Loresho Ridge is a serene modern estate located off Waiyaki Way, within Loresho Estate, approximately 11kms from the city centre of Nairobi. It is set on approximately 16.894 acres of land, comprising a total of 164 units of various types as follows: 67 three bedrooms apartments (Johari Apartments); 12 four bedrooms villas (Fahari Villas); 15 type A townhouses (Kilele Ridges); 54 type B townhouses (Makao Ridges); 13 type C townhouses (Watani Ridges) and a kindergarten. Common amenities include a commercial centre, a kindergarten, swimming pool with changing rooms, a children's play area and gate house.

The developer of Loresho Ridge is associated with a pension scheme with investments in various sectors of the economy and is experienced in real estate development having successfully completed projects such as Runda Park Estate in Runda and Bogani Park in Karen. The development was financed partly through equity, partly by loans and partly through proceeds of off-plan sales. Construction commenced in 2012 and was was completed in 2015.

Figure 3.2 Location of Loresho Ridge

Source: Google Earth, 2017

Plate3.1 Photographs of Loresho Ridge Estate

Source: Field Survey, 2017

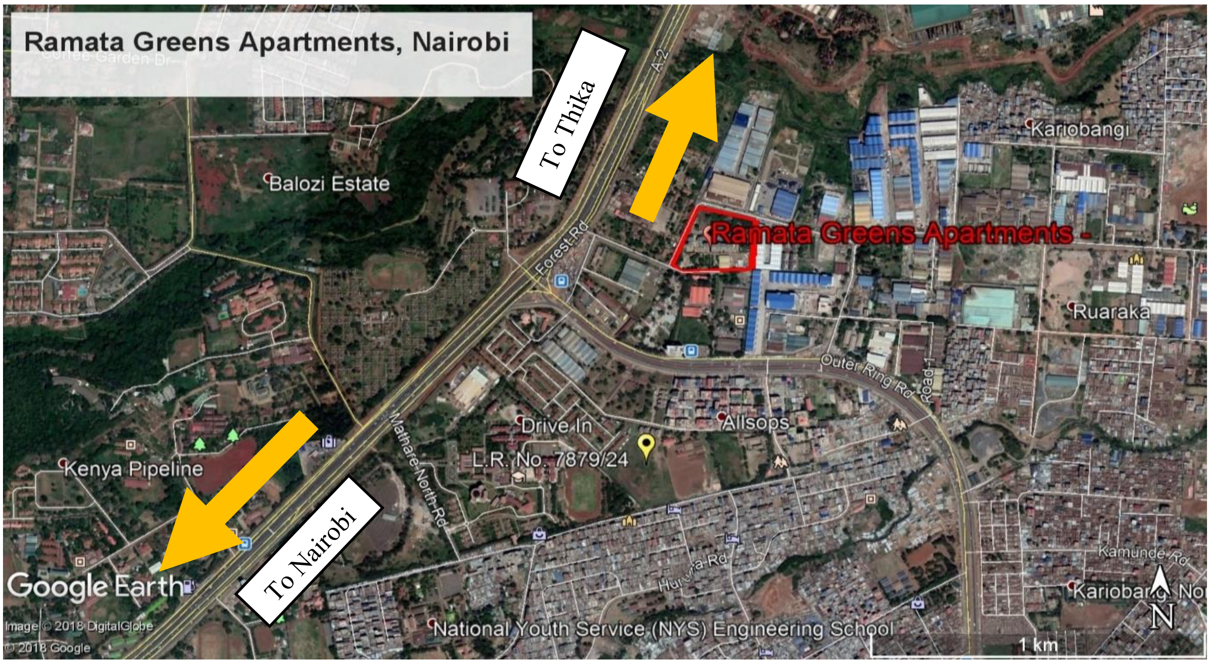
3.4.2: Ramata Greens Apartments

Ramata Greens is a modern apartment complex set on approximately 9.14 acres of land ,located an unnamed road, approximately 200 metres off Thika Super Highway at Allsops Junction in Ruaraka, about 7kilometres from the city centre of Nairobi.

The development is designed and developed in 3 phases, all in a secure gated community. The first phase is complete has a total of 70 units comprising of 20 two bedrooms apartments and 50 three bedrooms apartments set in seven blocks. A separate commercial block with a supermarket, gym, sauna, entertainment areas and a club house is provided. The remaining two phases have not yet been constructed.

The developer is registered by the National Construction Authority as a building works contractor and is fairly new to real estate development since this was the first project undertaken. Construction of the development commenced in 2013 and was completed in 2016 being financed partly through equity, partly by loans and partly through proceeds of off-plan sales.

Figure 3.3 Location of Ramata Greens Apartments



Source: Google Earth, 2017

Plate3.2 Photographs of Ramata Greens Apartments

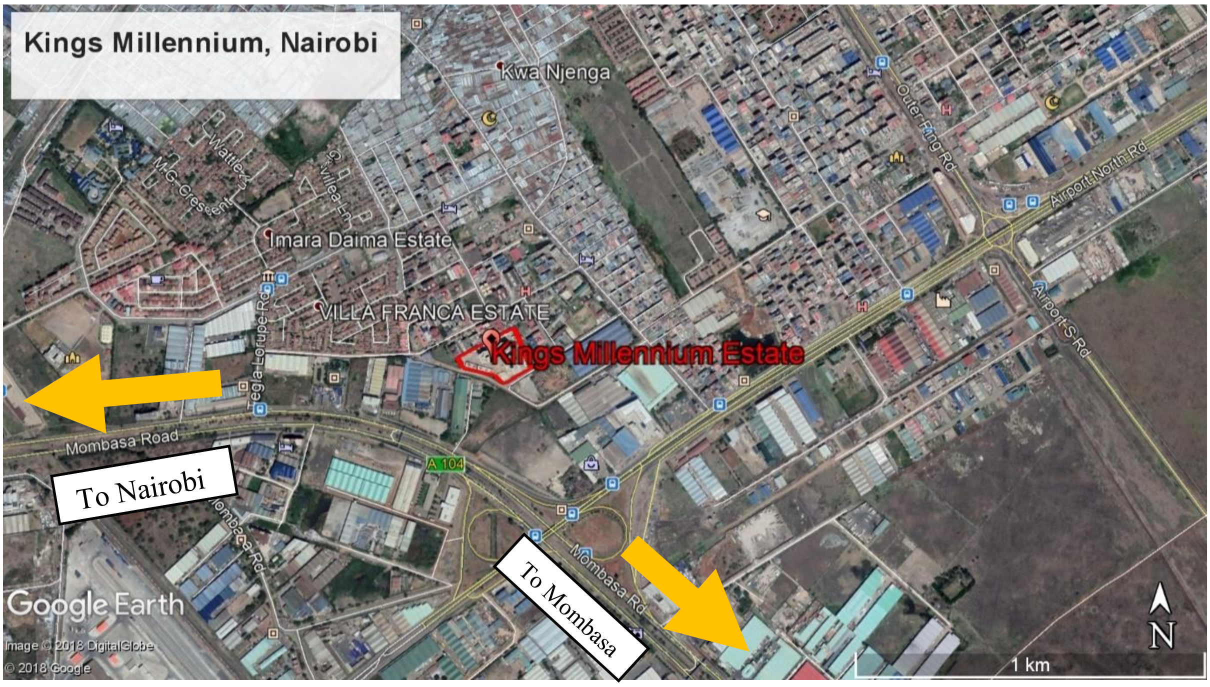
Source: Field Survey, 2017

3.4.3: Kings Millennium Development

It is located off Imara Daima Road in Imara Daima, approximately 10 Kms from the Nairobi City Centre, Nairobi City County. The development, which is set on approximately 4.94 acres, comprises a total of 180 three-bedrooms apartments set in 3 Blocks and 40 four bedrooms town houses each with a self–contained domestic staff room. Common amenities include a swimming pool with changing rooms, a children's play area, community hall and a club house.

Kings Millenium was constructed over a three years period, between 2013 and 2016, by a seasoned developer with vast experience in real estate development. The company is a fully Kenyan-owned real estate development company founded in 2009 that has become synonymous with the development of ultra-high commercial, residential, retail, hospitality and mixed-use properties. Some of the successfully completed projects include:360 court apartments in Syokimau, Rivera Towers in Kilimani, Muthama Heights in Syokimau, Bogani Palms in Karen, Skyrock Apartments in Hurlingham, Sifa Towers office block in Kilimani and Westland Business Park in Westlands. Ongoing projects include: Square Aprtments in Eldoret, The Prism office block in Upperhill and Pearl Regency Apartments in Lavington. The main mode of financing for the projects is through equity, debt, joint ventures and off-plan sales.

Figure 3.4 Location of Kings Millennium Development



Source: Google Earth, 2017

Plate3.3 Photographs of Kings Millennium Development

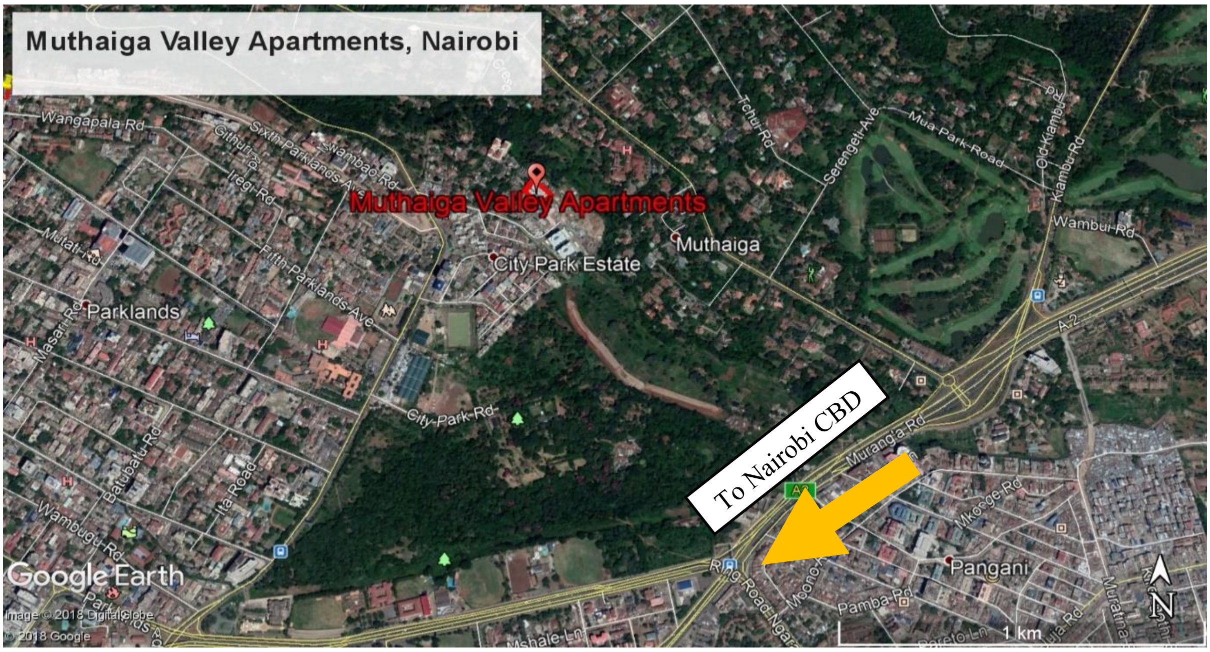
Source: Field Survey, 2017

3.4.4: Muthaiga Valley Apartments

Muthaiga Valley Apartments are designed as luxury multi-storey apartments located off City Park Drive in City Park Estate, approximately 4 Kilometres from the City Centre of Nairobi. The development, which is set on approximately half an acre of land comprises a total of 50 three bedrooms apartments set in two inter-connected thirteen storey blocks.

The developer is registered by the National Construction Authority as a building works contractor and is fairly new to real estate development since this is the first project undertaken. Construction of the development commenced mid 2015 and completed in December 2017 being financed partly through equity, partly by loans and partly through proceeds of off-plan sales.

Figure 3.5 Location of Muthaiga Valley Apartments



Source: Google Earth, 2017

Plate3.4 Photographs of Muthaiga Valley Apartments

Source: Field Survey, 2017

3.4.5: Pearl Heights Apartments

Pearl Heights is a modern design 8 storey apartment complex is located along Gatundu Road in Kileleshwa Estate, approximately 5 Kilometres from the City Centre of Nairobi. The development, which is set on approximately 0.7129 of an acre, comprises a total of 32 three bedrooms apartments each with a servants quarter, set in two inter-connected blocks. A common gate house, swimming pool, steam room, sauna, jacuzzi, changing rooms and club house will be provided. Construction commenced in 2013 and was completed in 2016.

The development company was established in 2001 and works with registered contractors deliver their projects. It is experienced in real estate development having successfully completed developments in prime parts of Nairobi many of which can be easily identified under the name of '*Pearl'*. Completed projects include: Pearl Garden and Pearl Court Apartments in Kileleshwa and Five Pearl Apartments in Parklands. Pearl Towers in Kileleshwa is an ongoing project.

Figure 3.6 Location of Pearl Heights Apartments

Source: Google Earth, 2017

Plate3.5 Photographs of Pearl Heights Apartments

Source: Field Survey, 2017

3.5 Data Collection

3.5.1 Data Acquisition

To acquire the data, the researcher mainly utilized interviews and questionnaires. Interviews were carried out intensively on key-informants in the study areas to get comprehensive information from them. This method is important as it enables the collection of first-hand data from those who understand exactly what goes around off-plan property sales and its efficiency in financing real estate development.

Questionnaires were administered to the property developers and estate agents as representatives of property buyers and sellers. Information sought from them by the researcher was mainly be their opinions on various aspects of off plan sales and particularly its effectiveness, both as a financing strategy to the developer and as an investment to the buyer as well as its challenges.

3.5.2 Data Collection Instruments

Direct Interviews were conducted by the researcher on the developers and estate agents in the case study areas whereby off-plan sales had been adopted as a strategy to finance real estate development. These interviews offered an opportunity for explanations and clarifications and were supplemented by the information collected through questionnaires to various developers and estate agents outside the case study areas.

Field Observation involved the researcher visiting the case study areas, making observations on the nature, size and quality of the real estate developments.

Photography, which is an indirect mode of data collection, was also used to capture the state of developments in the study areas.

Secondary data was obtained through library research, reviewing existing and available literature from text books, dissertations, Acts of Parliament, journals, newspapers and other documents.

3.6 Ethical Issues

The researcher committed to ensure that the information provided by the respondents was voluntary and would be used as it is without any form of manipulation and that it would only be used for the purpose of this research.

3.7 Data Processing, Analysis and Presentation

The purpose of data analysis is to approve or disapprove the hypothesis and to establish the study's findings in line with the study objectives. The data analysis and presentation is on the next chapter.

3.8 Data Needs Matrix

The data needs for the research were informed by the research objectives. The data needs matrix on Table 3.2 below presents a general picture of the structure used by the researcher in collecting analysing and presenting data. It summarises: the data required per objective; the sources of data; the data collection methods employed by the researcher; the method used in analysis of collected data; and the output or presentation of the analysed data.

Table 3.3 Data Needs Matrix

Objectives	Data Needs	Data Sources	Collection Methods	Methods of Analysis	Data Output
To determine the level of use of off-plan property sales as a strategy of financing property development	Mode of financing of real estate development and proportion of off-plan sales required by developers; and level of off-plan property purchases.	Developers and estate agents from the selected case study areas and from a random sample.	Oral interviews, questionnaires, industry analysis, journals, newspapers and books.	Text analytics, Computation of figures and percentages	Text analytics, Tables, bar graphs and pie charts
To determine the effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers.	Motivations of developers and property buyers in off-plan sales.	Developers and estate agents from the selected case study areas and from a random sample.	Oral interviews, questionnaires , industry analysis, journals, newspapers and books.	Text analytics, Computation of figures and percentages	Text analytics, tables, bar graphs and pie charts
To establish the challenges and constraints of off-plan property sales.	Challenges faced by: developers when using off-plan sales as a strategy to finance real estate development; and buyers investing in off-plan property units.	Developers and estate agents from the selected case study areas and from a random sample.	Oral interviews, questionnaires , industry analysis, journals, research papers, newspapers and books.	Text analytics	Text analytics and bar graphs

Source: Author 2017

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter deals with the analysis, presentation and interpretation of the collected data from various respondents in the field. The responses were analysed in line with the research objectives which were: to determine the level of use of off-plan property sales as a strategy of financing property development in Kenya; to determine the effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment the property buyers; to establish the challenges and constraints of off-plan property sales in Kenya; and to recommend appropriate mechanisms of enhancing off-plan property sales in Kenya.

Mugenda and Mugenda (1999) defined data analysis as the process of bringing order, structure and meaning to a mass of collected information. Qualitative data analysis involves researchers obtaining detailed information about a phenomenon that is the subject of study, and trying to establish patterns, trends and relationships from the gathered information.

Once the analysis was done, quantitative data was presented using the sample descriptive statistics tools such as simple percentages, bar graphs, tables and pie charts. Qualitative data such as responses from interviewees was presented in narrative text form. Primary data was collected through oral interviews and administration of questionnaires while secondary data was obtained through industry analysis, journals, research papers, newspapers and books.

4.2 Response Rate

As indicated in Chapter 3, the researcher identified five case study areas within Nairobi City County which are recent real estate developments that incorporated off-plan sales as a strategy for financing the development. The case study areas are: Loresho Ridge in Loresho Area; Ramata Greens in Baba Dogo Area; Kings Millennium Development in ImaraDaima; Muthaiga Valley Apartments in Parklands Area; and Pearl Heights in Kileleshwa.

The researcher successfully conducted key-informant interviews on all the developers of the real estate developments in the selected case study areas and all the estate agents who participated in off-plan sales of the units prior to development. A total of 10 interviews were conducted as earlier targeted indicating a response rate of 100% as shown in Table 4.1.

Table 4.1 Interviews Response Rate

Target Respondents	**Target Number of Interviewees from the Case Study Areas**	**Number of Interviewees Interviewed from the Case Study Areas**	**Percentage Response**
Real Estate Developers	5	5	100%
Estate Agents:	5	5	100%
Total	**10**	**10**	**100%**

Source: Field Survey 2017

With regard to information collected using questionnaires, Mugenda and Mugenda (1999) pointed out that a response rate of 50% is adequate for analysis and reporting, one of 60% is considered good while one of 70% and above is deemed to be very good. The general response rate was very good.

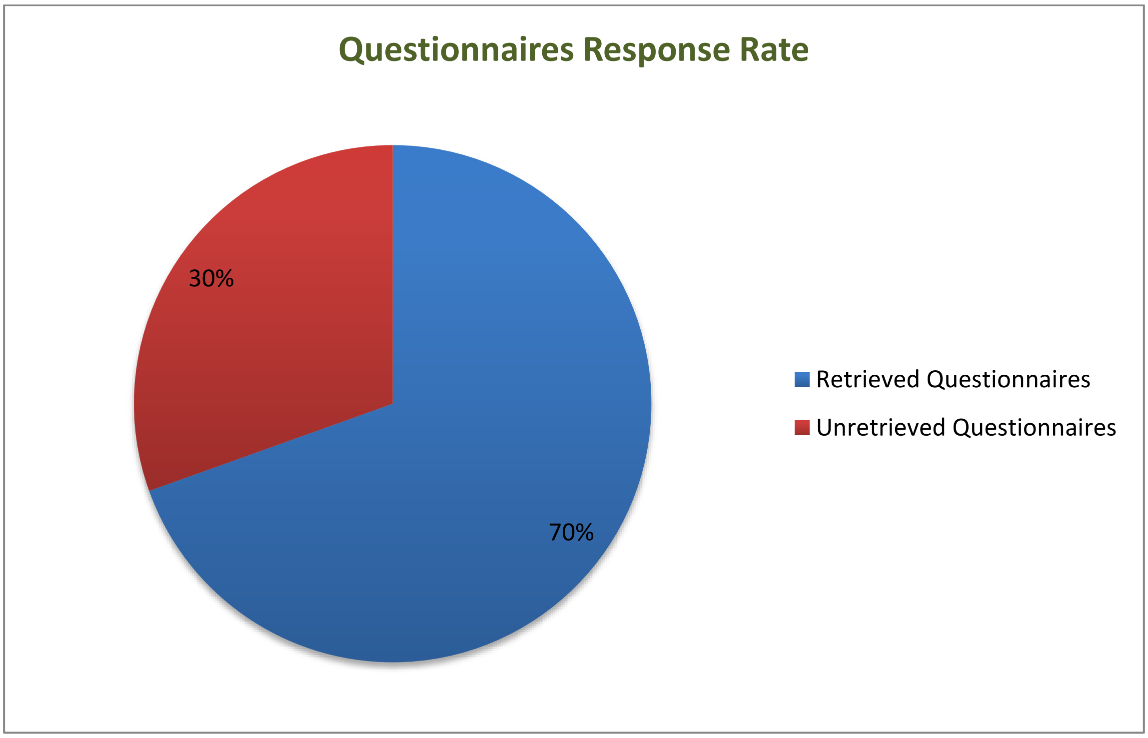
The researcher administered 36 questionnaires to randomly sampled real estate developers as discussed in Chapter 3, of which 26 questionnaires were dully filled and retrieved by the researcher while 10 questionnaires were not returned by the respondents. The researcher also administered 69 questionnaires to randomly sampled registered estate agents as discussed in Chapter 3, of which 47 questionnaires were dully filled and retrieved by the researcher while 22 questionnaires were not returned by the respondents. This indicates a response rate of 72% and 68% for real estate developers and registered estate agents respectively, as shown in Table 4.2 and Pie-Chart 4.1, which by the standards of Mugenda and Mugenda (1999) is generally very good.

Table 4.2 Questionnaires Response Rate

Target Respondents	Number of Questionnaires Administered	Number of Questionnaires Returned	Percentage Response
Real Estate Developers	36	26	72%
Estate Agents:	69	47	68%
Total	**105**	**73**	**70%**

Source: Field Survey 2017

Chart 4.1 Questionnaires Response Rate



Source: Field Survey 2017

4.3 Level of use of off-plan property sales as a strategy of financing property development in Kenya.

The research established that developers use a combination of various modes of finance to facilitate real estate development. The developers in the case study areas indicated that their main sources of finance included: internal company equity; bank loans from financial institutions; joint-venture arrangements (especially between a land owner and a developer - whereby the land owner offers the land for the real estate development while the developer sources for funds and carries out the real estate development and both parties agree on a formula for sharing the developed units); and off-plan sales.

Table 4.3 Summary of proportions of different modes of finance used by developers in the Case Study Areas

Case Study Area (Real Estate Development)	Proportion of Mode of Finance Used				
	Equity	Loan	Off-plan Sales	Joint Venture	Total
Loresho Ridge - Loresho Area	42%	30%	28%	-	100%
Ramata Greens - Baba Dogo Area	47%	22%	31%	-	100%
Kings Millennium Development – Imara Daima	28%	19%	24%	29%	100%
Muthaiga Valley Apartments - Parklands Area	22%	37%	41%	-	100%
Pearl Heights - Kileleshwa	30%	38%	32%	-	100%

Source: Field Survey 2017

The developers in the case study real estate developments noted that they could not use one source of finance due to risks and variations in cost of finance, thereby creating a need to find an optimal mix from various sources. They also noted that equity and debt have always been the traditional modes of finance. The high cost of debt in the local financial institutions as well as unavailability of equity funds necessitated the incorporation of other innovative ways of financing real estate development. According to the developers, this includes real estate investment trusts, crowd funding and off-plan sales. They also noted that off-plan sales is currently gaining popularity by developers and is mostly included as one of the target sources of financing real estate development.

The research established that the developers in the case study areas targeted to have off-plan sales financing between 30% and 40% of the total cost of construction in the real estate developments. They however managed to achieve between 24% and 41% as indicated in table 4.4 and bar graph 4.1.

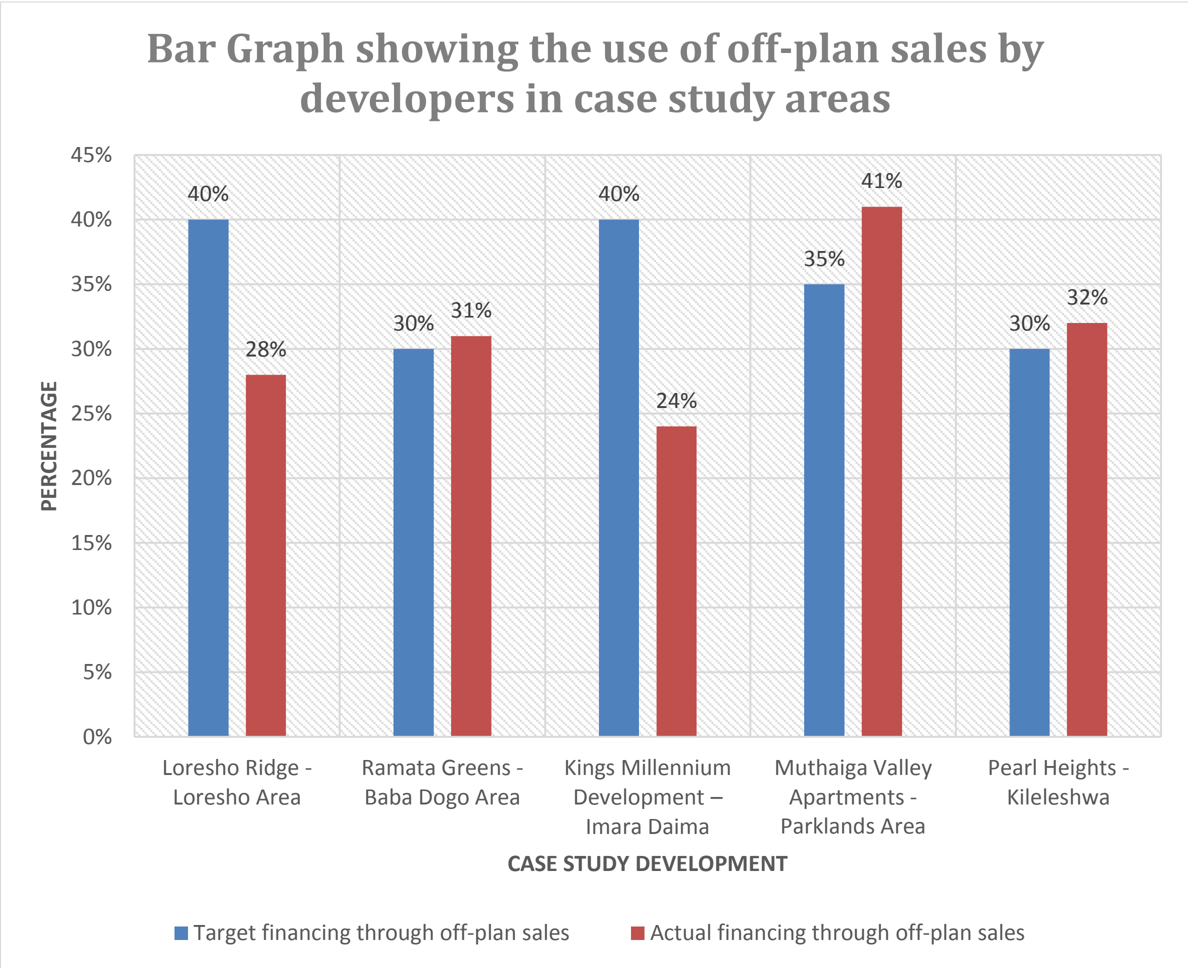
Table 4.4 Use of off-plan sales by Developers in the Case Study Areas

Case Study Area **(Real Estate Development)**	**Nature of Development**	**Target percentage of financing through off-plan sales (percentage)**	**Actual/Achieved percentage of financing through off-plan sales (percentage)**
Loresho Ridge - Loresho Area	Villas, Apartments and Townhouses	40%	28%
Ramata Greens - Baba Dogo Area	Apartments	30%	31%
Kings Millennium Development – Imara Daima	Apartments and Townhouses	40%	24%
Muthaiga Valley Apartments - Parklands Area	Apartments	35%	41%
Pearl Heights - Kileleshwa	Apartments	30%	32%

Source: Field Survey 2017

It emerged from the study that developers who focused in the development of apartments only had success in achieving their target off-plan sales as opposed to those who incorporated villas and town houses in their real estate developments. The estate agents in the case study areas attributed this to affordability of the apartments since they had lower selling prices relative to the villas and townhouses. Ramata Greens in Baba Dogo Area, Muthaiga Valley Apartments in Parklands Area and Pearl Heights in Kileleshwa all achieved their off plan sales target of 30%, 35% and 30% respectively by actually getting 31%, 41% and 32% of the total construction costs through off-plan sales respectively while Loresho Ridge in Loresho Area and Kings Millennium Development in Imara Daima each fell short of their 40% target and actually achieved 28% and 24% respectively.

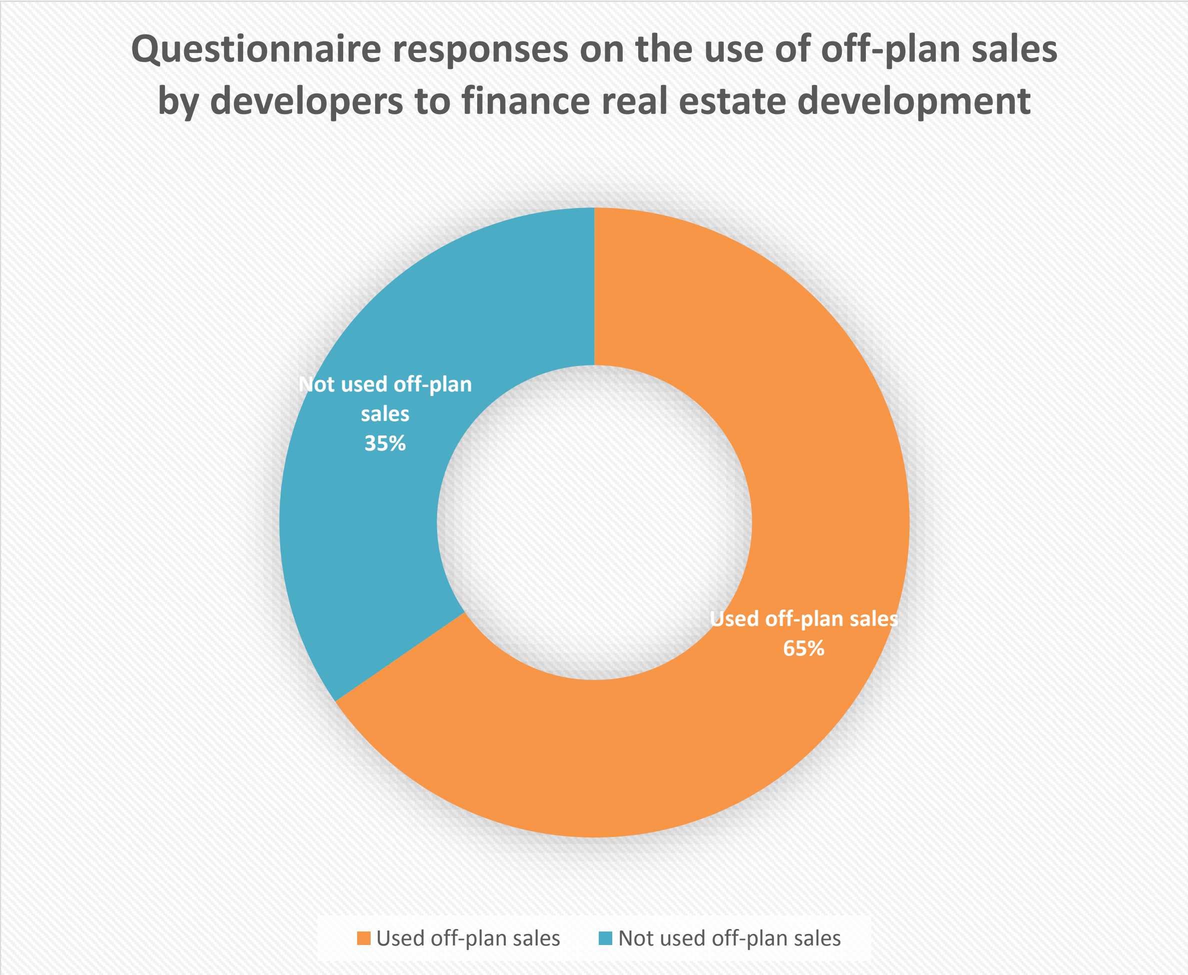
Graph 4.1: Use of off-plan sales by Developers in the Case Study Areas



Source: Field Survey 2017

Questionnaire responses by randomly sampled developers revealed that a majority of them (65%) use or have previously used off-plan sales as a strategy to finance their developments. The chart below illustrates their response.

Chart 4.2 Questionnaire responses on the use of Off-Plan Sales by Developers to Finance Real Estate Development



Source: Field Survey 2017

The research also sought to find out from the randomly sampled developers, who indicated that they had previously used off-plan sales as a strategy of financing real estate development, about their target percentage of financing through off-plan sales versus the actually achieved percentage. It was established that most developers targeted to achieve between 30% and 40% of the total cost of development through off-plan sales of the units to be developed or under development. However, majority of them only managed to finance between 20% and 30% using proceeds of the off-plan sales.

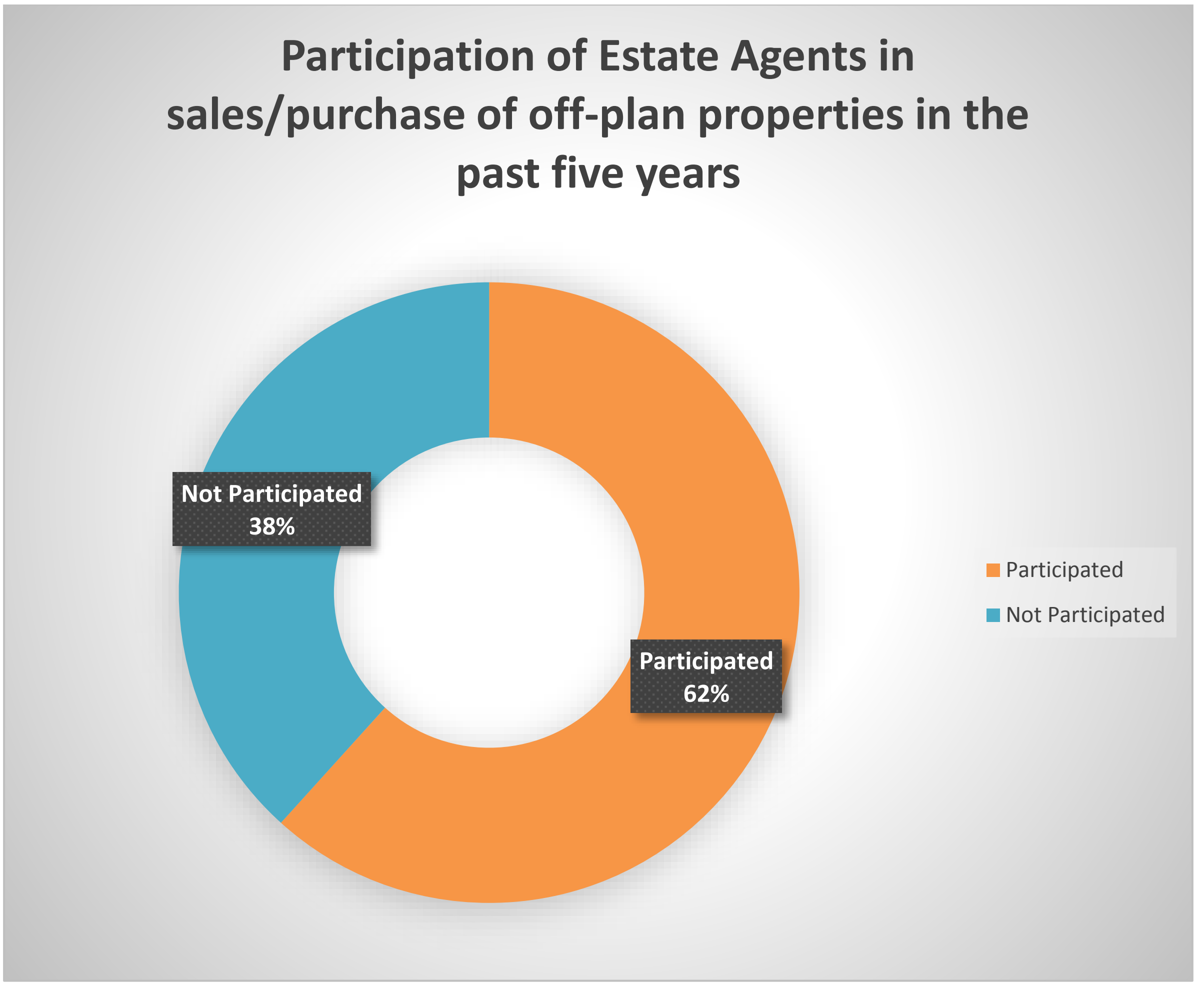
Table 4.5 Percentage of financing through off-plan sales targeted by developers versus percentage achieved

Percentage of financing through off-plan sales	Number of Developers who targeted this range of percentage	Number of Developers who achieved this range of percentage
1% - 10%	0	0
11% - 20%	4	2
21% - 30%	7	18
31% - 40%	12	6
40% - 50%	3	0
Above 50%	0	0
Total	**26**	**26**

Source: Field Survey 2017

On the prevalence of off-plan sales in the real estate market, questionnaire responses from the randomly sampled real estate agents revealed that a majority of them (62%) have participated as selling/purchasing agents of off-plan properties in the last five years. The chart below illustrates their response.

Chart 4.3 Response by Estate Agents on their participation in sales/purchase of off-plan properties in the past five years



Source: Field Survey 2017

4.4 Effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers

The study established that the sale/purchase of off-plan properties in the real estate market involves the developers sourcing for funds to finance the developments and the buyers investing in real estate, both of whom have different motivations based on the effectiveness of the method. The research therefore sought to establish what exactly drives developers to use off-plan sales of properties to finance real estate development as opposed to other sources of finance. It was also keen to establish the motivation of property buyers in purchasing properties off-plan yet there is the option of buying a fully constructed property.

4.4.1 Effectiveness of off-plan property sales as a financing strategy to real estate developers

The study results indicated that the drivers for off-plan sales for real estate developers include the following:

1. **Off-plan sales leads to significant savings on development cost relative to the alternative debt financing**

Interview results revealed that off-plan sales generate significant savings on the cost of development mainly through savings on interest. All the developers noted that they used a mix of off-plan sales and construction loans from financial institutions to finance their developments. They noted that the alternative for off-plan sales would be loans from financial institutions. The construction period for the developments ranged between 2½ years – 3 years and interest was paid on the borrowed funds over this period. Funds raised from off-plan sales does not attract any interest and therefore leads to savings on interest that would have been paid to financial institutions had the funds been borrowed. However, the developers noted that the selling price for off-plan properties was significantly lower compared to prices of these properties upon completion of the construction meaning the developer would generate higher returns in selling the properties upon completion of construction as opposed to off-plan.

They also noted that due to negotiations between the developer and the property buyers, some units were sold at higher prices than the fixed asking price while some were sold at prices lower than the asking prices. Therefore, they gave the researcher the average prices of the units sold off-plan and the average prices for the units sold upon completion of the development.

To determine whether the sale of off-plan property units to finance real estate development leads to net savings on interest, the researcher compared (for each of the case study developments) the cost of borrowing the funds raised through off-plan sales (assuming the developer was to take a construction loan) versus the amount that would have been realized from the units sold off-plan, had they been sold at the prevailing prices upon completion of the development. The data obtained from the developers of the identified five real estate developments which used off-plan sales as part of the financing option was analysed to determine whether it is a cheaper mode relative to debt financing.

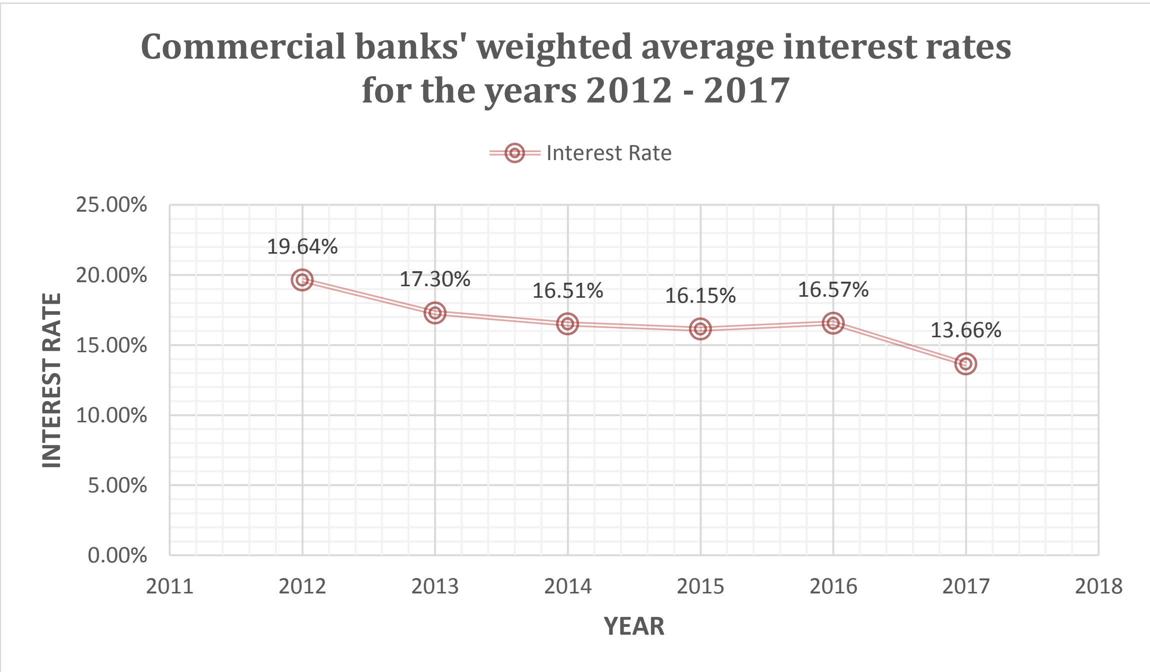
The five case study real estate developments were developed between the years 2012 – 2017. The researcher further obtained data on prevailing lending interest rates in commercial banks between these years from Central Bank of Kenya website to aid in the analysis of the cost of finance.

Table 4.6 Commercial banks' weighted average interest rates

Year	Average lending rate by Commercial Banks {%}
2012	19.64%
2013	17.30%
2014	16.51%
2015	16.15%
2016	16.57%
2017	13.66%

Source: Central Bank of Kenya website

Graph 4.2 Commercial banks' weighted average interest rates



Source: Central Bank of Kenya website

(https://www.centralbank.go.ke/statistics/interest-rates/)

FINDINGS FROM THE CASE STUDY DEVELOPMENTS

a) Loresho Ridge – Loresho Area

Loresho Ridge gated community was developed with the aim of attracting would-be home owners interested in investing in their future. Bearing in mind the different needs and abilities of each potential customer, a range of housing options was provided to appeal to each person's lifestyle and budget. It comprises a total of 164 units of varying accommodation as follows: 70 three bedrooms apartments (*Johari Apartments*); 12 four bedrooms villas (*Fahari Villas*); 15 type A townhouses (*Kilele Ridges*); 54 type B townhouses (*Makao Ridges*); 13 type C townhouses (*Watani Ridges*) and a kindergarten. Common amenities include a swimming pool with changing rooms, a children's play area and gate house. The development commenced in 2012 and was completed in 2015 (3 years construction period). The developer used a mix of equity, loan from financial Institutions and proceeds of off-plan sales to finance the development. Study findings revealed that the selling prices of the units sold off-plan were lower than the selling prices of similar units upon completion of the development. A comparison of these prices indicated that the values of the units developed appreciated significantly over the construction period as illustrated in the table below.

Table 4.7.1 Comparison of off-plan prices of the units under development and prices of the units upon completion of the Loresho Ridge development

Unit Type	Off-plan Sale Price/unit {Kshs} (x)	Price per unit Upon Completion {Kshs} (y)	Price Appreciation over the construction period (y-x)	Percentage Appreciation in price (y-x)/x
3 bedrooms apartments *(Johari Apartments)*	11,500,000	16,500,000	5,000,000	43.48%
4 bedrooms villa *(Fahari Villas)*	28,000,000	38,500,000	10,500,000	37.50%
Type A Townhouse (*Kilele Ridges)*	25,000,000	35,500,000	10,500,000	42.00%
Type B Townhouse *(Makao Ridges)*	22,500,000	31,500,000	9,000,000	40.00%
Type C Townhouse *(Watani Ridges)*	24,000,000	34,500,000	10,500,000	43.75%
			Average Appreciation	**41.35%**

Source: Field Survey 2017

The study findings indicated that the developer targeted to generate 40% of the total cost of development through off-plan sales but only managed to raise 28%. Out of the 70 three bedrooms apartments, 22 were sold off-plan at an average price of Kshs. 12 Million each while the remaining apartments were sold upon completion of construction at an average price of Kshs. 16.5 Million each. Out of the 12 four bedrooms villas, 2 were sold off-plan at an average price of Kshs. 28 Million each while the remaining villas were sold upon completion of construction at an average price of Kshs. 38.5 Million each. Out of the 15 type A townhouses, 4 were sold off-plan at an average price of Kshs. 25 Million each while the remaining type A townhouses were sold upon completion of construction at an average price of Kshs. 35.5 Million each. Out of the 54 type B townhouses, 17 were sold off-plan at an average price of Kshs. 22.5 Million each while the remaining type B townhouses were sold upon completion of construction at an average price of Kshs. 31.5 Million each. Out of the 13 type C townhouses, 3 were sold off-plan at an average price of Kshs. 24 Million each while the remaining type C townhouses were sold upon completion of construction at an average price of Kshs. 34.5 Million each. On average, 29% of the total units were sold off-plan (that is 48 units out of the total 164 units).

Data from Central Bank of Kenya indicates that the average lending rate for commercial banks (interest rate) during the construction period between the years 2012 – 2015 was 17.4% as used in the computations in the table below.

Table 4.7.2 Analysis of savings by developers of Loresho Ridge through the use of off-plan sales as a source of finance for development

Unit Type	Number of Units	Units Sold Off-plan (x)	Off-plan Sale Price/unit {Kshs} (y)	Amount Realized {Kshs} (x*y)	Price per unit Upon Completion {Kshs} (z)	Amount that would have been Realized upon completion from units sold off-plan {Kshs} (x*z)
3 bedrooms apartments *(Johari Apartments)*	70	22	12,000,000	264,000,000	16,500,000	363,000,000
4 bedrooms villa *(Fahari Villas)*	12	2	28,000,000	56,000,000	38,500,000	77,000,000
Type A Townhouse *(Kilele Ridges)*	15	4	25,000,000	100,000,000	35,500,000	142,000,000
Type B Townhouse *(Makao Ridges)*	54	17	22,500,000	382,500,000	31,500,000	535,500,000
Type C Townhouse *(Watani Ridges)*	13	3	24,000,000	72,000,000	34,500,000	103,500,000
Total	**164**	**48**		**874,500,000**		**1,221,000,000**
Assuming the amount realized from off-plan sales was borrowed from a financial institution, the total amount repayable plus Interest @ 17.4% for 3 years **(a)** = (1.174^3) x 874,500,000 =						1,415,024,973
Less: Amount that would have been Realized (from units sold off-plan) had the units been sold at prevailing prices upon completion of construction **(b)**						(1,221,000,000)
Net savings on interest (a -b)						**194,024,973**

Source: Field Survey 2017

From the table above, the developer raised Kshs. 874,500,000/- from off-plan sales between the years 2012-2013 to finance the development. The alternative would be to take a construction loan of the same amount for 3 years at an interest rate of 17.4% per annum hence the total amount paid back to the bank would be Kshs. 1,415,024,973/- as illustrated in the table above. The amount that would have been realized by selling these units (the units sold off-plan) at the prevailing price upon completion would be Kshs. 1,221,000,000/-. Therefore, savings on interest by the developer from the use of off-plan sales as a financing strategy was Kshs. 194,024,973/-. This translates to 6.21% savings relative to total development cost of Kshs. 3,123,214,286/- as illustrated in Summary Table 4.12 on page 70.

b) Ramata Greens Apartments – Baba Dogo

Ramata Greens apartments are designed and developed in 3 phases, all in a secure gated community, about 200 meters off the Thika Super Highway at Alsops Junction. The first phase is complete has a total of 70 units comprising of 20 two bedrooms apartments and 50 three bedrooms apartments set in seven blocks. A separate commercial block with a supermarket, gym, sauna, entertainment areas and a club house is provided. The construction of the development took 3 years having commenced in the year 2013 and completed in 2016. The developer used a mix of equity, loan from financial Institutions and proceeds of off-plan sales to finance the development.

The study findings revealed that the selling prices of the units sold off-plan were lower than the selling prices of similar units upon completion of the development. A comparison of these prices indicated that the values of the units developed appreciated significantly over the construction period as illustrated in the table below.

Table 4.8.1 Comparison of off-plan prices of the units under development and prices of the units upon completion of the Ramata Greens Apartments development

Unit Type	**Off-plan Sale Price/unit {Kshs} (x)**	**Price per unit Upon Completion {Kshs} (y)**	**Price Appreciation over the construction period (y-x)**	**Percentage Appreciation in price (y-x)/x**
2 bedrooms apartments	7,500,000	10,000,000	2,500,000	33.33%
3 bedrooms apartments	8,800,000	11,500,000	2,700,000	30.68%
Average Appreciation				**32.01%**

Source: Field Survey 2017

The study findings indicate that the developer targeted to generate 30% of the total cost of development through off-plan sales and they managed to slightly surpass the target by achieving 31%. Out of the 20 two bedrooms apartments, 6 were sold off-plan at an average price of Kshs. 7.5 Million each while the remaining apartments were sold upon completion of construction at an average price of Kshs. 10 Million each. Out of the 50 three bedrooms apartments, 17 were sold off-plan at an average price of Kshs. 8.8 Million each while the remaining apartments were sold upon completion of construction at an average price of Kshs. 11.5 Million each. On average, 32% of the total units were sold off-plan (that is 23 units out of the total 70 units).

Data from Central Bank of Kenya indicates that the average lending rate for commercial banks (interest rate) during the construction period between the years 2013 – 2016 was 16.63% as used in the computations in the table below.

Table 4.8.2 Analysis of savings by developers of Ramata Greens Apartments through the use of off-plan sales as a source of finance for development

Unit Type	Number of Units	Units Sold Off-plan (x)	Off-plan Sale Price/unit {Kshs} (y)	Amount Realized {Kshs} (x*y)	Price per unit Upon Completion {Kshs} (z)	Amount that would have been Realized upon completion from units sold off-plan {Kshs} (x*z)
2 bedrooms apartments	20	6	7,500,000	45,000,000	10,000,000	60,000,000
3 bedrooms apartments	50	17	8,800,000	149,600,000	1,500,000	195,500,000
Total	**70**	**23**		**194,600,000**		**255,500,000**
Assuming the amount realized from off-plan sales was borrowed from a financial institution, the total amount repayable plus Interest @ 16.63% for 3 years **(a)** = (1.1663^3) x 194,600,000 =						308,726,325
Less: Amount that would have been Realized (from units sold off-plan) had the units been sold at prevailing prices upon completion of construction **(b)**						255,500,000
Net savings on interest (a -b)						**53,226,325**

Source: Field Survey 2017

From the table above, the developer raised Kshs. 194,600,000/- from off-plan sales between the years 2013-2014 to finance the development. The alternative would be to take a construction loan of the same amount for 3 years at an interest rate of 16.63% per annum hence the total amount paid back to the bank would be Kshs. 308,726,325/- as illustrated in the table above. The amount that would have been realized by selling these units (the units sold off-plan) at the prevailing price upon completion would be Kshs. 255,500,000/-. Therefore, savings on interest by the developer from the use of off-plan sales as a financing strategy was Kshs. 53,226,325/-. This translates to 8.48% savings relative to total development cost of Kshs. 627,741,935/- as illustrated in Summary Table 4.12 on page 70.

c) Kings Millennium Development – Imara Daima

The development, which is set on approximately 4.94 acres approximately, comprises a total of 180 three-bedrooms apartments set in 3 Blocks and 40 four bedrooms town houses each with a self–contained domestic staff room. Common amenities include a swimming pool with changing rooms, a children's play area, community hall and a club house. Construction commenced in 2013 and was completed in 2016 (3 years construction period). The developer used a mix of equity, loan from financial Institutions and proceeds of off-plan sales to finance the development. The land owner entered into a joint-venture with the developer whereby the developer was to fund and carry out the real estate development and later the two parties share the developed units as per the agreed formula.

Study findings revealed that the selling prices of the units sold off-plan were lower than the selling prices of similar units upon completion of the development. A comparison of these prices indicated that the values of the units developed appreciated significantly over the construction period as illustrated in the table below.

Table 4.9.1 Comparison of off-plan prices of the units under development and prices of the units upon completion of the Kings Millennium Development

Unit Type	Off-plan Sale Price/unit {Kshs} (x)	Price per unit Upon Completion {Kshs} (y)	Price Appreciation over the construction period (y-x)	Percentage Appreciation in price (y-x)/x
3 bedrooms apartments	6,500,000	9,000,000	2,500,000	38.46%
4 bedrooms Townhouses	12,000,000	16,500,000	4,500,000	37.50%
Average Appreciation				**37.98%**

Source: Field Survey 2017

The study findings indicated that the developer targeted to generate 40% of the total cost of development through off-plan sales but only managed to raise 24%. The developer noted that more would have been achieved had the marketing been carried out extensively. Out of the 180 three bedrooms apartments, 47 were sold off-plan at an average price of Kshs. 6.5 Million each while the remaining apartments were sold upon completion of construction at an average price of Kshs. 9 Million each. Out of the 40 four bedrooms villas, 8 were sold off-plan at an average price of Kshs. 12 Million each while the remaining apartments were sold upon completion of construction at an average price of Kshs. 16.5 Million each. On average, 25% of the total units were sold off-plan (that is 55 units out of the total 220 units).

Data from Central Bank of Kenya indicates that the average lending rate for commercial banks (interest rate) during the construction period between the years 2013 – 2016 was 16.63% as used in the computations in the table below.

Table 4.9.2 Analysis of savings by developers of Kings Millennium Development through the use of off-plan sales as a source of finance for development

<table>
<tr><th>Unit Type</th><th>Number of Units</th><th>Units Sold Off-plan (x)</th><th>Off-plan Sale Price/unit {Kshs} (y)</th><th>Amount Realized {Kshs} (x*y)</th><th>Price per unit Upon Completion {Kshs} (z)</th><th>Amount that would have been Realized upon completion from units sold off-plan {Kshs} (x*z)</th></tr>
<tr><td>3 bedrooms apartments</td><td>180</td><td>47</td><td>6,500,000</td><td>305,500,000</td><td>9,000,000</td><td>423,000,000</td></tr>
<tr><td>4 bedrooms Townhouses</td><td>40</td><td>8</td><td>12,000,000</td><td>96,000,000</td><td>16,500,000</td><td>132,000,000</td></tr>
<tr><td>Total</td><td>220</td><td>55</td><td></td><td>401,500,000</td><td></td><td>555,000,000</td></tr>
<tr><td colspan="6">Assuming the amount realized from off-plan sales was borrowed from a financial institution, the total amount repayable plus Interest @ 16.63% for 3 years (a) = (1.1663^3) x 401,500,000 =</td><td>636,966,184</td></tr>
<tr><td colspan="6">Less: Amount that would have been Realized (from units sold off-plan) had the units been sold at prevailing prices upon completion of construction (b)</td><td>555,000,000</td></tr>
<tr><td colspan="6">Net savings on interest (a -b)</td><td>81,966,184</td></tr>
</table>

Source: Field Survey 2017

From the table above, the developer raised Kshs. 401,500,000/- from off-plan sales between the years 2013-2014 to finance the development. The alternative would be to take a construction loan of the same amount for 3 years at an interest rate of 16.63% per annum hence the total amount paid back to the bank would be Kshs. 636,966,184/- as illustrated in the table above. The amount that would have been realized by selling these units (the units sold off-plan) at the prevailing price upon completion would be Kshs. 555,000,000/-. Therefore, savings on interest by the developer from the use of off-plan sales as a financing strategy was Kshs. 81,966,184/-. This translates to 4.9% savings relative to total development cost of Kshs. 1,672,916,667/- as illustrated in Summary Table 4.12 on page 70.

d) Muthaiga Valley Apartments - Parklands

The development set om approximately 0.499 of an acre land comprises a total of 50 three bedrooms apartments set in two inter-connected thirteen storey blocks. 30 apartments are provided with servant's quarters and three floors are set as parking. Construction commenced mid-2015 and completed in December 2017 (2½ years construction period). The developer used a mix of equity, loan from financial Institutions and proceeds of off-plan sales to finance the development.

Study findings revealed that the selling prices of the units sold off-plan were lower than the selling prices of similar units upon completion of the development. A comparison of these prices indicated that the values of the units developed appreciated significantly over the construction period as illustrated in the table below.

Table 4.10.1 Comparison of off-plan prices of the units under development and prices of the units upon completion of the Muthaiga Valley Apartments development

Unit Type	**Off-plan Sale Price/unit {Kshs} (x)**	**Price per unit Upon Completion {Kshs} (y)**	**Price Appreciation over the construction period (y-x)**	**Percentage Appreciation in price (y-x)/x**
3 bedrooms apartments	14,000,000	19,000,000	5,000,000	35.71%
3 bedrooms apartments with servants quarter	15,000,000	20,000,000	5,000,000	33.33%
Average Appreciation				**34.52%**

Source: Field Survey 2017

The study findings indicate that the developer targeted to generate 35% of the total cost of development through off-plan sales and they managed to surpass the target by achieving 41%.The developer noted that more would have been achieved had the marketing been carried out extensively. Out of the 20 three bedrooms apartments without servant's quarters, 8 were sold off-plan at an average price of Kshs. 14 Million each while the remaining units were sold upon completion of construction at an average price of Kshs. 19 Million each. Out of the 30 three bedrooms apartments with servant's quarters, 13 were sold off-plan at an average price of Kshs. 15 Million each while the remaining units were sold upon completion of construction at an average price of Kshs. 20 Million each. On average, 42% of the total units were sold off-plan (that is 21 units out of the total 50 units).

Data from Central Bank of Kenya indicates that the average lending rate for commercial banks (interest rate) during the construction period between the years 2015 – 2017 was 15.74% as used in the computations in the table below.

Table 4.10.2 Analysis of savings by developers of Muthaiga Valley Apartments through the use of off-plan sales as a source of finance for development

Unit Type	**Number of Units**	**Units Sold Off-plan (x)**	**Off-plan Sale Price/unit {Kshs} (y)**	**Amount Realized {Kshs} (x*y)**	**Price per unit Upon Completion {Kshs} (z)**	**Amount that would have been Realized upon completion from units sold off-plan {Kshs} (x*z)**
3 bedrooms apartments	20	8	14,000,000	112,000,000	19,000,000	152,000,000
3 bedrooms apartments with servants quarter	30	13	15,000,000	195,000,000	20,000,000	260,000,000
Total	**50**	**21**		**307,000,000**		**412,000,000**
Assuming the amount realized from off-plan sales was borrowed from a financial institution, the total amount repayable plus Interest @ 15.74% for 2½ years **(a)** = (1.1574^2.5) x 307,000,000 =						442,432,550
Less: Amount that would have been Realized (from units sold off-plan) had the units been sold at prevailing prices upon completion of construction **(b)**						412,000,000
Net savings on interest (a -b)						**30,432,550**

Source: Field Survey 2017

From the table above, the developer raised Kshs. 307,000,000/- from off-plan sales in the year 2015 to finance the development. The alternative would be to take a construction loan of the same amount for 2 ½ years at an interest rate of 15.74% per annum hence the total amount paid back to the bank would be Kshs. 442,432,550/- as illustrated in the table above. The amount that would have been realized by selling these units (the units sold off-plan) at the prevailing price upon completion would be Kshs. 412,000,000/-. Therefore, savings on interest by the developer from the use of off-plan sales as a financing strategy was Kshs. 30,432,550/-. This translates to 4.06% savings relative to total development cost of Kshs. 748,780,487/- as illustrated in Summary Table 4.12 on page 70.

e) Pearl Heights Apartments – Kileleshwa

The development, which is set on approximately 0.7129 of an acre land, comprises a total of 32 three bedrooms apartments each with a servants quarter, set in two inter-connected blocks. A common gate house, swimming pool, steam room, sauna, jacuzzi, changing rooms and club house will be provided. Construction commenced in 2013 and was completed in 2016 (3 years construction period). The developer used a mix of equity, loan from financial Institutions and proceeds of off-plan sales to finance the development.

Study findings revealed that the selling prices of the units sold off-plan were lower than the selling prices of similar units upon completion of the development. A comparison of these prices indicated that the values of the units developed appreciated significantly over the construction period as illustrated in the table below.

Table 4.11.1 Comparison of off-plan prices of the units under development and prices of the units upon completion of the Pearl Heights Apartments development

Unit Type	Off-plan Sale Price/unit {Kshs} (x)	Price per unit Upon Completion {Kshs} (y)	Price Appreciation over the construction period (y-x)	Percentage Appreciation in price (y-x)/x
3 bedrooms apartments with servants quarter	19,000,000	26,000,000	7,000,000	36.84%

Source: Field Survey 2017

The study findings indicated that the developer targeted to generate 30% of the total cost of development through off-plan sales and they managed to slightly surpass the target by achieving 32%. Out of the 32 three bedrooms apartments each with a servants quarter, 10 were sold off-plan at an average price of Kshs. 19 Million each while the remaining apartments were sold upon completion of construction at an average price of Kshs. 26 Million each.

Data from Central Bank of Kenya indicates that the average lending rate for commercial banks (interest rate) during the construction period between the years 2013 – 2016 was 16.63% as used in the computations in the table below.

Table 4.11.2 Analysis of savings by developers of Pearl Heights Apartments through the use of off-plan sales as a source of finance for development

Unit Type	**Number of Units**	**Units Sold Off-plan (x)**	**Off-plan Sale Price/unit {Kshs} (y)**	**Amount Realized {Kshs} (x*y)**	**Price per unit Upon Completion {Kshs} (z)**	**Amount that would have been Realized upon completion from units sold off-plan {Kshs} (x*z)**
3 bedrooms apartments with servants quarter	32	10	19,000,000	190,000,000	26,000,000	260,000,000
Assuming the amount realized from off-plan sales was borrowed from a financial institution, the total amount repayable plus Interest @ 16.63% for 3 years **(a)** = (1.1663^3) x 190,000,000 =						301,428,580
Less: Amount that would have been Realized (from units sold off-plan) had the units been sold at prevailing prices upon completion of construction **(b)**						260,000,000
Net savings on interest (a -b)						**41,428,580**

Source: Field Survey 2017

From the table above, the developer raised Kshs. 190,000,000/- from off-plan sales between the years 2013-2014 to finance the development. The alternative would be to take a construction loan of the same amount for 3 years at an interest rate of 16.63% per annum hence the total amount paid back to the bank would be Kshs. 301,428,580/- as illustrated in the table above. The amount that would have been realized by selling these units (the units sold off-plan) at the prevailing price upon completion would be Kshs. 260,000,000 /-. Therefore, savings on interest by the developer from the use of off-plan sales as a financing strategy was Kshs. 41,428,580/-. This translates to 6.98% savings relative to total development cost of Kshs. 593,750,000/- as illustrated in Summary Table 4.12 on page 70.

SUMMARY OF NET SAVINGS BY DEVELOPERS DUE TO FINANCING THROUGH OFF-PLAN SALES IN THE CASE STUDY DEVELOPMENTS

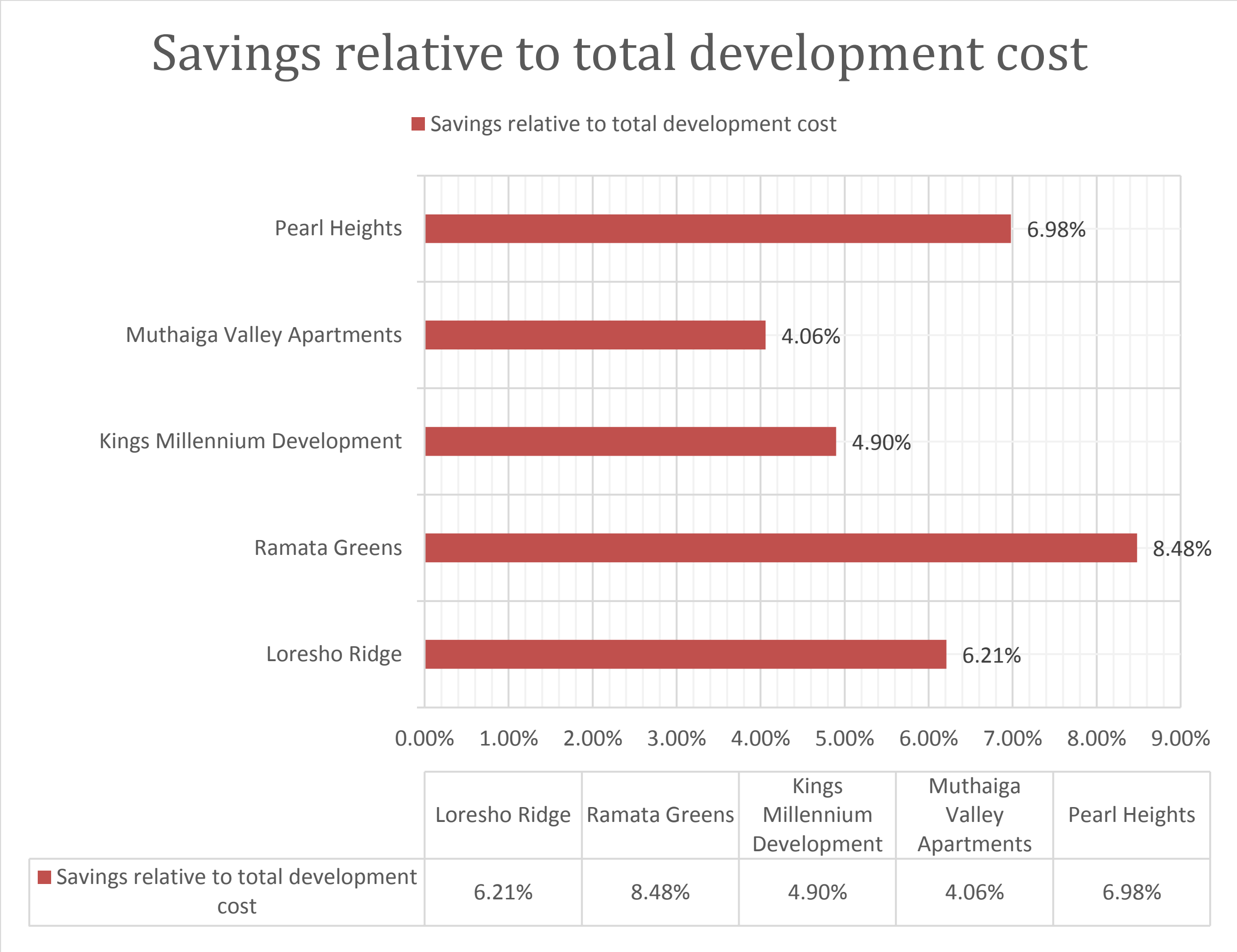
In summary, the analysis of data revealed that developers of the five case study real estate developments saved between 4% - 8.5% of the total cost of development by using off-plan sales as a financing strategy.

Table 4.12 Summary of net savings by developers due to financing through off-plan sales in the case study developments

Case Study Area (Real Estate Development)	Total amount raised through off-plan sales {Kshs} (x)	Percentage of total development cost financed through off-plan sales (y)	Derived Total cost of development {Kshs} (x/y)	Net savings on interest through the use of off-plan sales as a financing strategy {Kshs} (z)	Percentage of savings on interest relative to total cost of finance z/(x/y)
Loresho Ridge - Loresho	874,500,000	28%	3,123,214,286	194,024,973	6.21%
Ramata Greens - Baba Dogo	194,600,000	31%	627,741,935	53,226,325	8.48%
Kings Millennium Development – Imara Daima	401,500,000	24%	1,672,916,667	81,966,184	4.90%
Muthaiga Valley Apartments - Parklands	307,000,000	41%	748,780,487	30,432,550	4.06%
Pearl Heights - Kileleshwa	190,000,000	32%	593,750,000	41,428,580	6.98%

Source: Field Survey 2017

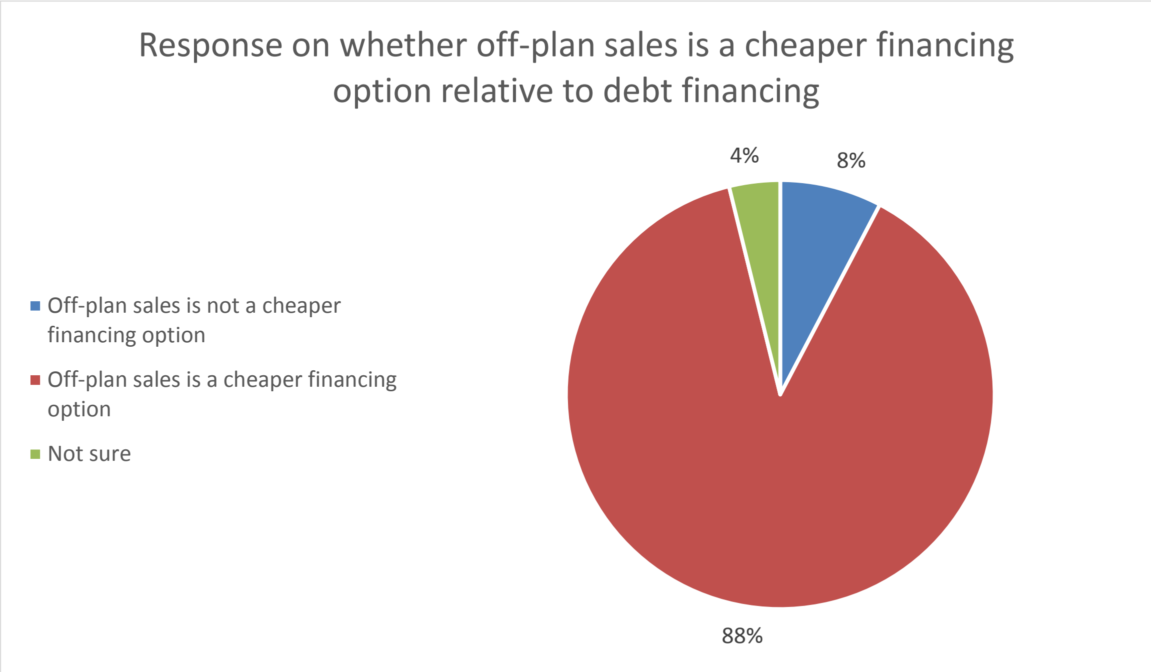
Graph 4.3 Savings relative to the total development cost



Source: Field Survey 2017

The study also sought the opinion of other developers outside the case study areas on what drives developers to use off-plan sales as a financing strategy. 88% of the respondents prefer using off-plan sales since it is a cheaper source of finance relative to debt financing, 8% were of the view that off-plan sales is not a cheaper financing strategy while 4% of the respondents were not sure.

Chart 4.4 Response by Developers on whether off-plan sales is a cheaper option relative to debt financing

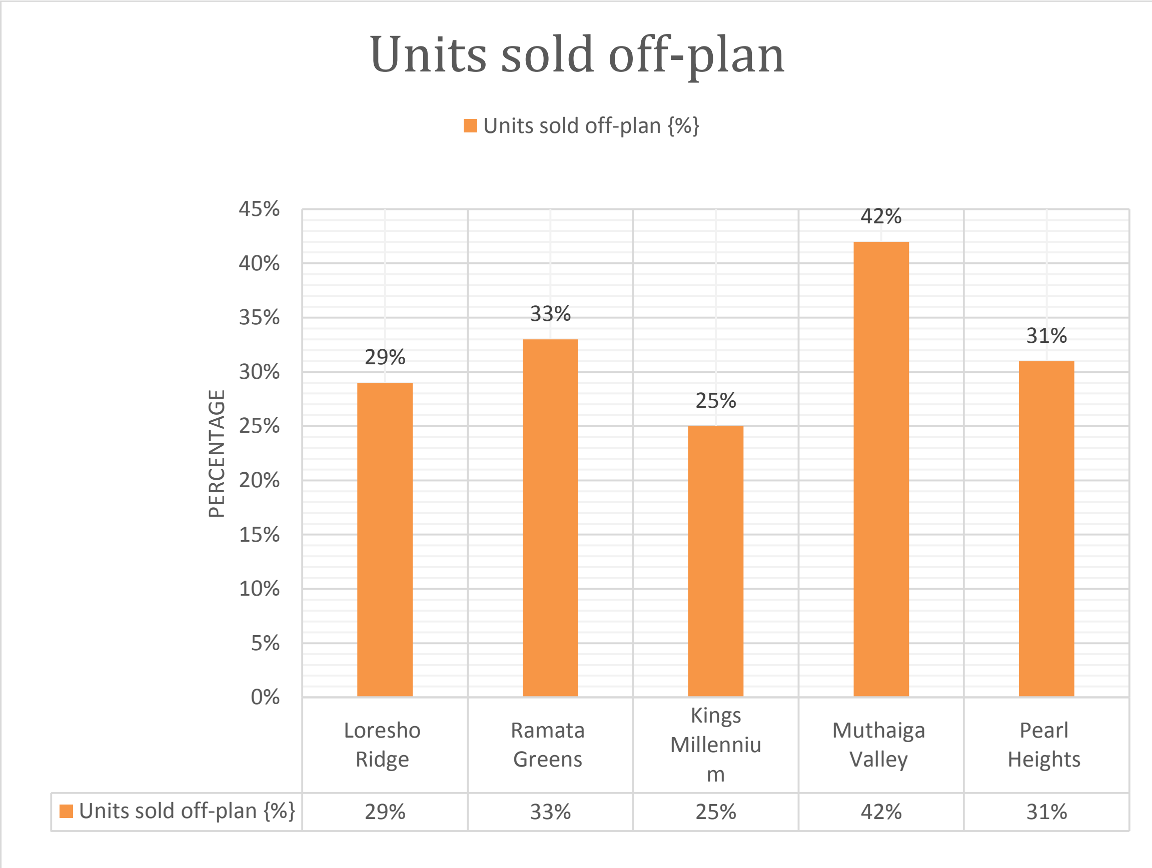


Source: Field Survey 2017

2. **Off-plan sales leads to an effective marketing strategy**

The study noted the developers view that property buyers are encouraged to purchase properties when they know others have already purchased ahead of them. Off-plan sales facilitate the selling of property units in a development prior to the actual construction or in the early stages of construction. Therefore, by the time construction is complete, a section of the development would have already been sold and ready for occupation. According to the developers, marketing the property as “percentage sold-off” is an effective strategy and reduces the time taken to sell the remaining units. They unanimously shared the same opinion that in developments whereby units are sold after completion of the construction would generally take a longer time to sell whereas the objective of developers is usually to recoup their investments plus profit in the shortest possible time.

Graph 4.4 Units sold off-plan in the case study developments



Source: Field Survey 2017

In the case study developments, between 25% - 41% of the total units in each development were sold off-plan as illustrated in the graph above. In Loresho Ridge, 48 units out of the total 164 units were sold off-plan translating to 29%; in Ramata Greens, 23 units out of the total 70 units were sold off-plan translating to 33%; in Kings Millenium development, 55 units out of the total 220 units were sold off-plan translating to 25%; in Muthaiga Valley, 21 units out of the total 50 units were sold off-plan translating to 42% while in Pearl Heights, 10 units out of the total 32 units were sold off-plan translating to 31%.

Other developers outside the case study areas also pointed out that off-plan sales attracts property buyers once the development is complete since a section of the development would already be sold off.

3. **Delivery of the development as per the plans and specifications boosts the reputation of a developer**

The research established that investor's/property buyer's confidence and trust in the developer to finish the development as per the approved plans and specifications is the basis of off-plan sales. Once a developer completes a development project and delivers the developed units as promised when selling them off-plan, the reputation of that developer is greatly boosted. The satisfied clients often make referrals of their friends, colleagues and other potential property buyers to the developer. Therefore, when the developer offers a subsequent proposed development for off-plan sales, the uptake would be great due to reference of the previous work done by the developer. A developer can use off-plan sales effectively to improve their market share by ensuring timely delivery of high standard development.

It was revealed that some developers ignore certain amenities that they promised the buyers of off-plan units. This may include a club house, gym, swimming pool, health centre or a kindergarten. The reputation of such developers who fail to deliver the developments that they promised to their clients severely dent their reputation and may lead to scepticism by potential buyers in their subsequent development projects.

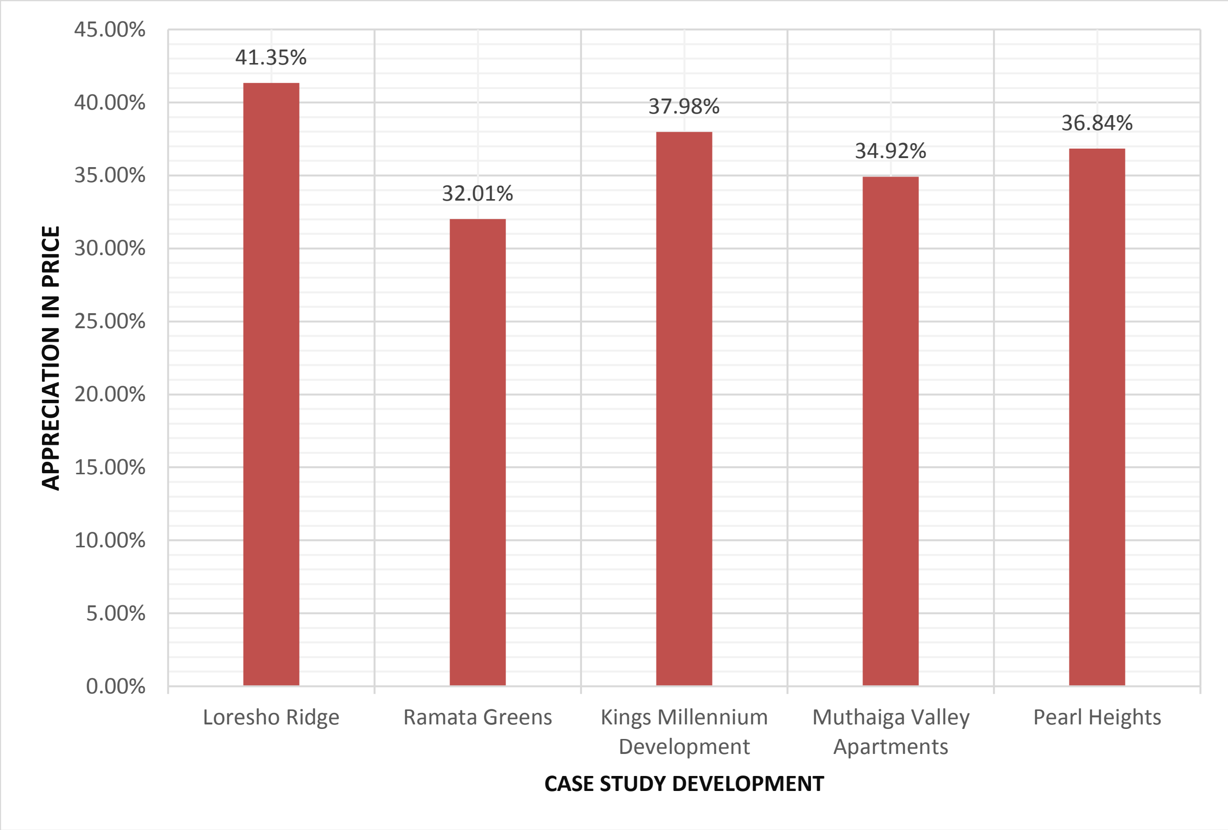
4.4.2 Effectiveness of off-plan properties as an investment to the property buyers

In determining what motivates buyers to purchase off-plan properties, the researcher sought the views of estate agents since they interact with buyers during the selling process or act as agents of the buyers when they purchase properties. Key-informant interviews were conducted on real estate agents involved as sales agents in the five case study real estate developments within Nairobi City County. Questionnaires were also issued to 69 randomly sampled registered estate agents of which 47 questionnaires were dully filled and collected. The drivers of off-plan sales to the buyers of off-plan properties were determined to include:

1. **Lower Purchase price and expected capital gains**

The interview results established that the purchase price for the off-plan units is lower than the price of the fully constructed units. This is due to the risk borne by the property investors in buying a property that is yet to be constructed. Therefore, the estate agents market the properties using "the early bird analogy" by convincing the potential buyers that they stand to benefit by purchasing the property units before construction. They unanimously indicated that the buyers are greatly motivated with the idea of property value appreciation and some even purchase multiple units off-plan.

Graph 4.5 Summary of appreciation in prices in the case study developments: Comparison of off-plan prices and prices upon completion of development



Source: Field Survey 2017

Analysis of the data from the case study developments, whereby a comparison is done between the off-plan prices and prices upon completion of development, revealed that the prices appreciated by 32% - 42% (as computed earlier in this chapter). If the buyers of the off-plan properties were also to sell their property units upon completion of the development, they would have made a profit of 32% - 42% over the construction period (2½ years – 3 years).

Other registered estate agents outside the case study areas were of the same view that expected increase in property value upon completion of development greatly motivates the buyers of off-plan property units.

2. Transfer of construction work and associated risks to the developer

It was noted that construction of property units take a lot of expertise as indicated by the number of different professionals involved. It also takes time as noted in the case study real estate developments which took about 2 ½ years – 3 years. The research revealed that the property buyers of the off-plan units transfer the various construction risks that may arise over the course of a project to developers. A strict set of codes, laws, and regulations must be adhered to during the construction process to best avoid these risks.

As discussed in chapter 2, the purchasers of off-plan properties usually enter into a contract with the developers whereby the terms and conditions are stipulated. The amount to be paid by the buyer is indicated as well as the terms of payment. The specifications of what the developer will provide as the final output of the construction is also provided together with the timelines for delivery and the penalties payable should there be any delays. The penalties would be in form of interest on the sum payable by the buyer of the off-plan property. Therefore, the property buyer of an off-plan unit effectively transfers the construction risks to the developer while having a remedy in the contract if the developer fails to deliver as required. These risks may include:

Technical Risks

This may arise due to uncertainty of resources and availability of materials, inadequate site investigation, or incomplete design. This may prevent the developer from delivering the desired development to the buyers of the off-plan units and other potential buyers. They risks can may occur when there are changes in project scope and requirements, and if there are design errors or omissions.

Logistical Risks

There are various logistical risks that need to be addressed before beginning the development project. They risks include: availability of transportation facilities; availability of construction equipment, fuel, spare parts and personnel to operate the equipment; and availability of trained personnel in the various aspects of the projects. Failure by developers and project managers to address these logistical issues may lead to project delays and losses. Any delays would require compensation in form of interest to the buyers of the off-plan units.

Environmental risks

Environmental risks include natural disasters, weather, and seasonal implications. These risks are may occur due to factors beyond human control and borne by the developers. The developer should therefore familiarise themselves with the local region's weather patterns and prepare for possible weather risks in order to avoid potential delays and losses.

Management related risks

There are various parties involved in real estate development as discussed in chapter 2. Therefore, management related risks would arise from difficulties in co-ordinating the various personnel in different stages of the project. Before beginning the real estate development, it is crucial to have sufficiently skilled staff with adequately defined roles and responsibilities to avert managerial related risks.

Financial risks

This would include inflation, changes in taxation, and availability and fluctuation in foreign exchange during a construction project. The off-plan property buyer transfers this potential burden to the developer since the only payment made is the purchase price and there are no any subsequent payments to carter for any fluctuations which negatively affect the project.

Socio-political risks

This may include opposition by the local community to the development project, changes in the country's political environment, customs and import restrictions on certain building materials and difficulties disposing of equipment after completion of the construction project. Therefore, depending on the location of the development project, there is need for the developer to familiarise themselves with the local community and seek their support and generally abide by the local regulations.

3. **Gated community set-up real estate developments**

The research findings revealed that property buyers are drawn to real estate developments in a gated community set up. This includes apartment blocks, multiple units of villas, maisonettes, townhouses or bungalows with a common entrance gate, various shared facilities and a common management company for the estate. This, according to the estate agents, provide the home owners with a neighbourhood whereby the income status of residents is almost the same and the benefit of sharing and solving potential problems.

Most residential real estate developments sold off-plan comprise of multiple units, therefore the property owners are assured of having neighbours as opposed to living a solitary life.

4. **Discretion of selecting preferred finishes and fittings**

It was noted that the buyers of the off-plan units may at times be given discretion by the developer to select the fittings and finishes. The developer may ask the buyer to increase his contribution by a small margin to meet the additional costs but the main issue is to ensure satisfaction of the home owner. This therefore ensures the buyer gets a housing unit that is in line with their tastes and preference as opposed to buying a complete house where he/she has to settle for whatever has been provided for by the developer.

4.5 Challenges and constraints of off-plan property sales in Kenya

The research sought to establish the challenges faced in selling off-plan properties from various respondents. This was analysed from the perspective of the developers who are using off-plan sales as a strategy of raising funds for real estate development and establishing whether their objectives are met. The research also sought to find out the challenges faced by the off-plan property buyers since their motivations are different from the developer.

4.5.1 Challenges faced by developers in using off-plan sales as a strategy of financing real estate development

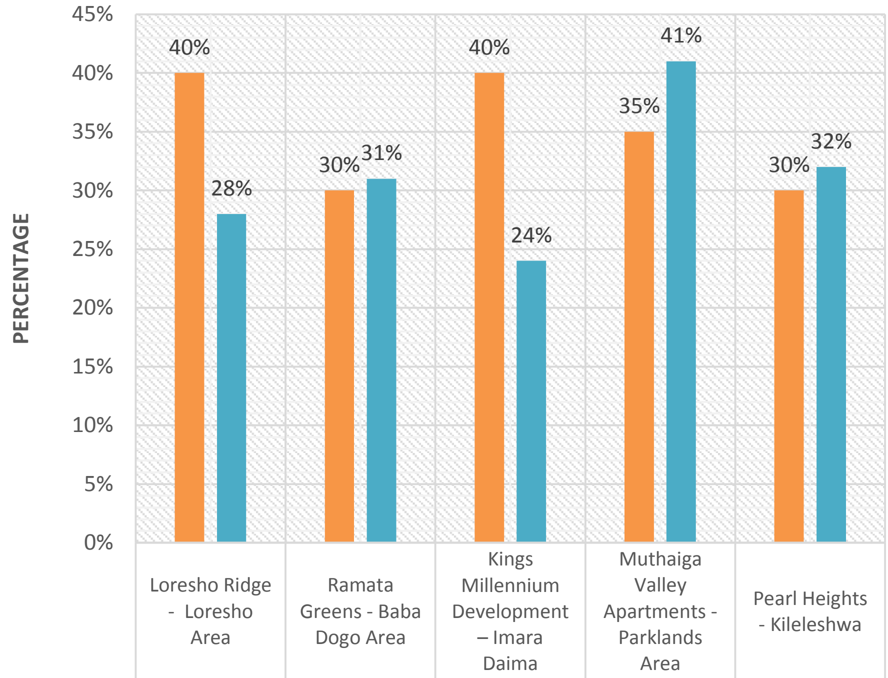
The responses by the interviewed developers of the case study real estate developments as well as the questionnaires filled by the randomly sampled developers were analysed to establish these challenges.

1. **Difficulty in achieving the target amount through off plan sales**

As discussed earlier in this chapter, the developers in the case study developments targeted to use off-plan sales in financing between 30% and 40% of the total cost of construction in the real estate developments.

Ramata Greens in Baba Dogo Area, Muthaiga Valley Apartments in Parklands Area and Pearl Heights in Kileleshwa all achieved their off plan sales target of 30%, 35% and 30% respectively by actually getting 31%, 41% and 32% of the total construction costs through off-plan sales respectively while Loresho Ridge in Loresho Area and Kings Millennium Development in Imara Daima each fell short of their 40% target and actually achieved 28% and 24% respectively.

Graph 4.6: Financing real estate development through off-plan sales by Developers in the Case Study developments



	Loresho Ridge - Loresho Area	Ramata Greens - Baba Dogo Area	Kings Millennium Development – Imara Daima	Muthaiga Valley Apartments - Parklands Area	Pearl Heights - Kileleshwa
Target financing through off-plan sales	40%	30%	40%	35%	30%
Actual financing through off-plan sales	28%	31%	24%	41%	32%

Source: Field Survey 2017

The research established from the case study developments that real estate developments which only focused in the development of apartments had success in achieving their target off-plan sales as opposed to those which incorporated villas and town houses. The estate agents in the case study areas who participated in the off-plan sales attributed this to the lower selling price of the apartments relative to the villas and townhouse.

Other developers outside the case study areas were of the view that achieving the target financing through off-plan sales is difficult due to scepticism by potential property buyers to commit their funds without seeing actual developed units.

2. **Penalties to developers in the event of project delays**

The contracts between developers and off-plan property buyers clearly outline the obligations of the developers with regard to specifications of the units under development and timelines for completion of the development.

The remedy provided to the buyers in case of delays by the developer is the payment of interest on the purchase price. The study findings reveal that the delays may occur from various construction risks beyond the developers' control such as environmental or political factors, leading to payment of interest to the off-plan property buyers.

3. **Failure by off-plan property buyers to complete payment of the purchase price**

The research established that that most sale agreements for the off-plan units between the developer and the property buyer require the purchaser to pay a deposit and later complete the payment of the residue amount within a specified period of time. Challenges would arise when the buyers fail to pay the residue amount on time or does not pay at all. Therefore the developer fails to acquire the necessary funds for development as budgeted and is forced to take action against the buyer for breach of contract. This further leads to additional cost in form of legal fees.

4. **Lower prices of the off-plan sales relative to sale prices of the units upon completion of the developments**

As discussed earlier in this chapter, research findings indicated that the prices of the off-plan units in the case study developments were lower relative to sale prices of the units upon completion of development. It was revealed that a comparison between these prices creates the notion that developers stand to gain more profit by avoiding the use of off-plan sales as a financing strategy, therefore discouraging them from using it in their subsequent developments. However, a careful analysis of the financing options indicates that off-plan sales would lead to savings on interest. Therefore, developers need to carefully craft an optimal mix of equity; off-plan sales and debt financing that would lead to lower cost of financing.

4.5.2 Challenges faced by buyers of off-plan property

In determining the challenges faced by buyers of off-plan properties, the researcher sought the views of estate agents since they interact with buyers during the selling process or act as agents of the buyers when they purchase properties. Responses from the interviewed real estate agents involved as sales agents in the five case study real estate developments within Nairobi City County as well as questionnaires issued to randomly sampled registered estate agents were analysed to determine these challenges.

1. **Potential loss of funds due to fraud by unscrupulous developers**

The research established that potential buyers are sceptical of purchasing off-plan property units as they are yet to be constructed or under construction. It is deemed that the purchasers are ‘buying into a concept’ having been briefed of the nature of development, amenities and facilities to be provided, timelines for completion and expected benefits to be derived as a resident or home owner in the estate. For one to ‘buy into the concept’ and accept to purchase the off-plan units, the purchaser must trust the developer to keep his word and deliver the project.

It was also revealed that most potential buyers of the off-plan properties do not have confidence that the developers will complete the developments as marketed off-plan. This idea is backed up by examples of unscrupulous developers who have collected funds for off-plan sales and stalled the construction due to misuse of funds or failed to commence construction and disappeared with the money altogether. A background check on the developer is essential for the buyer when carrying out due diligence before committing funds in off-plan purchase.

2. **Probability of distressed sale due to inability to complete purchase price**

Study findings revealed that most sale agreements for off-plan property units provide for payment of the purchase price in instalments. The buyer is required to pay a deposit of about 15% of the purchase price upon signing of the sale agreement and the residue payable within a certain stipulated time. It was further revealed that some property buyers only pay the deposit and later fail to pay subsequent instalments to complete the purchase price. A compromised investor in this situation often results to selling on the contract for little or no profit to other investors. However when the other investor carries out a valuation, properties usually value 10-30% higher than their bargain purchase price, showing the off plan investment did work, but unfortunately the first investor was not in the position to benefit from it.

3. **Poor quality of construction**

It was established that marketing for off-plan units is usually done using very attractive brochures, billboards, newspaper advertisements or television footages with beautiful artistic impressions of the real estate development upon completion. However, the final product delivered in some instances is substandard and below the expectations of the buyers. Therefore the buyers may not get value for money unlike when buying a complete unit where one visits and inspects the property then negotiates the purchase price based on the condition of the building.

4. **Lower returns on the development upon completion than anticipated**

Study findings revealed that buyers of the off-plan units have reservations that the market conditions may change during the development period making the anticipated returns from the completed development unachievable. Such changes in the market may include changes in demand and supply dynamics in the market or changes in government policy. In such an instance, it would be seen that the developer over-promised the expected returns such as rental yields and capital appreciation yet the buyer achieves lower returns on completion of the development.

5. **Delayed projects**

It was noted that the off-plan property buyers enter into contracts with real estate developers when purchasing the units. These contracts clearly stipulate the nature of units to be developed and timelines for delivery of the development. However, in most instances the developers fail to complete the developments within in the promised time frame and thereby affecting the buyers' financial plans.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The research sought to establish the effectiveness of financing of real estate development through off-plan sales in Kenya. The specific objectives of the study were as follows:

a) To determine the level of use of off-plan property sales as a strategy of financing property development in Kenya.

b) To determine the effectiveness of off-plan property sales, as a financing strategy to the developers and as an investment to the property buyers.

c) To establish the challenges and constraints of off-plan property sales in Kenya.

d) To recommend appropriate mechanisms of enhancing off-plan property sales in Kenya.

The objectives were further formulated into research questions in order to conduct the research while setting out to answer these questions. The previous chapter presented the data collected from the field and analysis while this chapter presents a summary of the findings and the conclusions for the study. Recommendations are made on the basis of the research objectives and findings.

5.2 Summary of research findings

The research established that developers use a combination of various modes of finance to facilitate real estate development. The developers do not use one source of finance due to risks and variations in cost of finance, thereby creating a need to find an optimal mix from various sources. Although equity and debt have always been the traditional modes of finance, the high cost of debt in the local financial institutions as well as unavailability of equity funds necessitated the incorporation of other innovative ways of financing real estate development. This includes real estate investment trusts, crowd funding and off-plan sales. It was established that off-plan sales is currently gaining popularity among real estate developers and is mostly included as one of the target sources of financing real estate development.

The findings revealed that main sources of finance for developers in the case study real estate developments included: internal company equity; bank loans from financial institutions; joint-venture arrangements (especially between a land owner and a developer - whereby the land owner offers the land for the real estate development while the developer sources for funds and carries out the real estate development and both parties agree on a formula for sharing the developed units); and off-plan sales. They targeted to have off-plan sales financing between 30% and 40% of the total cost of construction in the real estate developments and managed to achieve between 24% and 41%. The research also established from the case study areas that real estate developments which only focused in the development of apartments had success in achieving their target percentage of off-plan sales as opposed to those which incorporated villas and town houses.

The research sought to establish the general prevalence of the use of off-plan sales by other developers other than those in the case study area as well as the estate agents. Findings indicated that a majority of developers have used off-plan sales as a strategy of financing real estate development, but fell short of achieving their target financing through this strategy. Most developers in the case study real estate developments targeted to achieve between 30% and 40% of the total cost of development through off-plan sales of the units to be developed or under development but only managed to finance between 20% and 30. On participation of estate agents in sales/purchase of off-plan property units, findings revealed a majority of them have participated.

In determining the effectiveness of off-plan property sales, as a financing strategy to the developers, the study established that off-plan sales is a cheaper mode of finance relative to debt financing. It generates significant savings on the cost of development mainly through savings on interest since the alternative would be to take a construction loan of the same amount (amount raised through off-plan sales) which would be repaid with interest. However, it was noted that the selling price for off-plan properties was significantly lower compared to prices of these properties upon completion of the construction meaning the developer would generate higher returns in selling the properties upon completion of construction as opposed to off-plan.

To determine whether the sale of off-plan property units to finance real estate development leads to net savings on interest, researcher compared (for each of the case study developments) the cost of borrowing the funds raised through off-plan sales (assuming the developer was to take a construction loan) versus the amount that would have been realized from the units sold off-plan, had they been sold at the prevailing prices upon completion of the development Analysis of data established that the developers of the five case study real estate developments saved between 4% - 8.5% of the total cost of development by using off-plan sales as a financing strategy. The savings were: 6.21% for Loresho Ridge – Loresho Area; 8.48% for Ramata Greens – Baba Dogo Area; 4.90% for Kings Millenium development – Imara Daima Area; 4.06% for Muthaiga Valley – Parklands Area; and 6.98% for Pearl Heights – Kileleshwa Area.

It was also established that off-plan sales leads to an effective marketing strategy. Marketing the property as "percentage sold-off" reduces the time taken to sell the remaining units since property buyers are encouraged to purchase properties when they know others have already purchased ahead of them. In the case of off-plan sales, a section of the development would have already been sold by the time of completing the construction. Also, off-plan sales is effective to the property developer since successful completion and delivery of the development as per the plans and specifications boosts the reputation of a developer. Therefore, when the developer offers a subsequent proposed development for off-plan sales, the uptake would be great due to reference of the previous work done by the developer.

The study also sought to find out the effectiveness of off-plan properties as an investment to the property buyers. It established that the off-plan purchase price is usually lower and buyers expect increase in property value upon completion of development. Analysis of the data from the case study developments, whereby a comparison was done between the off-plan prices and prices upon completion of development, indicated that the prices appreciated by 32% - 42%. Off-plan properties are effective investments since construction risks are transferred to the developer, including technical risks, logistical risks, environmental risks, management related risks, financial risks and socio-political risks. It was also established that most residential property buyers prefer a gated community set up whereby they can have neighbors and a community. Most residential real estate developments sold off-plan comprise of multiple units and may include including apartment blocks, multiple units of villas, maisonettes, townhouses or bungalows with a common entrance gate and various shared facilities. Therefore the property owners are assured of having neighbors as opposed to living a solitary life. In some cases, the developer may give buyers the discretion to select the fittings and finishes for their units thereby ensuring their tastes and preference are met captured satisfactorily.

The study also attempted to find out the challenges and constraints of off-plan property sales in Kenya. The challenges faced by developers in using off-plan sales as a strategy of financing real estate development include: difficulty in achieving the target amount through off plan sales; penalties to developers (as per the off-plan property sale contract) in the event of project delays; failure by off-plan property buyers to complete payment of the purchase price; and lower prices of the off-plan sales relative to sale prices of the units upon completion of the developments. Challenges faced by buyers of off-plan property include: potential loss of funds due to fraud by unscrupulous developers; probability of distressed sale due to inability to complete purchase price; poor quality of construction; lower returns on the development upon completion than anticipated; and delays on project delivery.

5.3 Conclusion and assessment of propositions

In conclusion, property development requires huge capital outlay which most developers are not able to raise from their own internal equities. Although equity and debt have always been the traditional modes of finance, the high cost of debt in the local financial institutions as well as unavailability of equity funds necessitated the incorporation of other innovative ways of financing real estate development. Off-plan sales comes up as an effective strategy which would supplement debt and equity hence its increased popularity among real estate developers.

It has been established from the research findings that Off-plan sales is a financing strategy that is widely used by real estate developers in Kenya. It is also an effective strategy of financing real estate development as demonstrated in the data analysis of the case study real estate developments, whereby 4% - 8.5% of the total cost of development was saved. This is significant to developers and in the end leads to an increase in developer's profit. It also provides an effective marketing strategy as "percentage sold off" thereby reducing the time taken to sell the developed units upon completion of the development and rewards the developer by boosting their reputation if the work is well done. The off-plan property buyer also benefits through property price appreciation over the construction period, transfer of construction risks to the developer and enjoying the benefits of a gated community set up.

However, off-plan property sales comes with several challenges to the developer and to the buyer. The developer may fall short of achieving the target amount of finance through off plan sales as evidenced in some of the case study real estate development, pay penalties to the property buyers in case of project delays and face inconveniences when off-plan property buyers fail to complete payment of the purchase price. The off-plan property buyers may purchase properties from unscrupulous developers who may disappear with their funds or fail to complete the development. The buyers would also need to plan and budget for the payment of purchase price installments to avoid distressed sale of their property units due to inability to complete the payment.

5.4 Recommendations

From the findings above the researcher has identified a few areas to improve on when using off-plan sales as a financing strategy for the developers and as an investment to the property buyers:

1. **Need for developers to establish an optimum mix in their financing options**

As established earlier in the study, real estate developers do not use one source of finance due to risks and variations in cost of finance. Therefore, there is need for developers to find an optimal mix from various sources. Although equity and debt have always been the traditional modes of finance, the high cost of debt in the local financial institutions as well as unavailability of equity funds necessitated the incorporation of other innovative ways of financing real estate development including real estate investment trusts, crowd funding and off-plan sales. The study has demonstrated that the use of off-plan sales as a strategy of financing real estate development leads to significant savings. However, achieving the target amount of financing through off-plan sales is difficult therefore the developers need to carefully analyze and incorporate other sources depending on the costs associated. An optimal mix would lead to more savings by the real estate developers.

2. **Careful time planning by the developers**

The off-plan properties' sale agreements between the developers and the property buyers clearly outlines the obligations of the developers with regard to specifications of the units under development and timelines for completion of the development. The remedy provided to the buyers in case of delays by the developer is the payment of interest on the purchase price. The delays may occur from various construction risks beyond their control such as environmental or political factors, leading to payment of interest to the off-plan property buyers. The developers should therefore forecast on the possible construction risks and formulate a construction timetable taking into consideration the possible delays that may arise from the construction risks. Adherence to such a timetable will give the buyers an accurate indication of completion time and cushion the developers from payment of penalties.

3. **Early and vigorous marketing of the development**

Once the concept of the real estate development has been formulated (in terms of the nature of units to be constructed and amenities to be provided) vigorous marketing should be done to create awareness to potential buyers prior to offering the off-plan units for sale. This will ensure that the project is familiar to property investors and the uptake of the property in the market will be good once the off-plan units are offered for sale. Early and vigorous market of the development may enable the developers achieve the target financing amount through off-plan sales.

4. Pre-qualification of potential buyers prior to selling the off-plan units

Most sale agreements for the off-plan units between the developer and the property buyer require the purchaser to pay a deposit and later complete the payment of the residue amount within a specified period of time. Challenges would arise when the buyers fail to pay the residue amount on time or does not pay at all hence the developer fails to acquire the necessary funds for development as budgeted. This leads the developer to take legal action against the buyer for breach of contract and consequently additional costs in form of legal fees. To avoid such scenarios, the developer, through the contracted estate agents, should carefully prequalify the interested potential buyers of the off-plan units to determine their ability to complete the full payment of the purchase price. This may be through analysis of their bank statements and evaluating their income sources for the developer to be sure that the amount would be fully paid on time.

5. Buyers of the off-plan units should carry out due diligence prior to purchase

The buyers of the off-plan units which are yet to be constructed 'buy into a concept' having been briefed of the nature of development, amenities and facilities to be provided, timelines for completion and expected benefits to be derived as a resident or home owner in the estate. For one to 'buy into the concept' and accept to purchase the off-plan units, the purchaser must trust the developer to keep his word and deliver the project. The price for the off-plan units offered by the developers should be reasonable to the property buyer. As discussed in Chapter 2, if a developer offers an off-plan property at a price that is very low by market standards and not achievable under normal circumstances, and it is the only company offering such, then one should be cautious and evaluate it fully as it may be a scam. Therefore, the potential property buyers should conduct due diligence by carrying out a background check on the developer and previous projects undertaken. The potential buyers may even visit the sites for these projects to view the workmanship and enquire from the residents/home owners on their satisfaction with the developer's work. Once satisfied with the performance of the developer on their previous projects, the potential buyers can therefore commit and purchase the off-plan units.

The buyers should also procure the services of a conveyancing lawyer to review all contracts to be signed with a view to ensure they are all above par and the buyer is not exposed to unnecessary risk.

The study endorses the view by Cytonn (2017) that due diligence should be carried out by the potential buyer of the off-plan unit, both on the developer and the development project as follows:

a) Due diligence on the developer

The buyer should ensure that the developer is a registered company in the country of operation and establish its management personnel. The buyer should also look into previous real estate projects undertaken by the company if any and establish various aspects such as: workmanship of the construction; actual delivery timelines relative to the promised timeline; and issues raised by the off-plan buyers of the units. This will enable the buyers confirm whether the company is actually a reputable real estate developer or not thereby preventing potential loss of funds.

b) Due diligence on the real estate development project

The buyer should carry out due diligence on the real estate development project by doing the following:

i) Visiting the site - The buyer should visit the site to verify its existence. This should be done prior to any commitment to purchasing an off-plan unit and should be continuously done throughout the development. This would enable the buyer to follow up with the developer any issue that may arise.
ii) Confirming that the developer is the owner or has a title for the project site – The buyer should insist on getting a copy of title of the project site from the developer and carry out a search from the government lands department/office to confirm ownership and encumbrances.
iii) Project plan approvals – The buyer should also seek to know if the developer has obtained the necessary approvals for the real estate development and hence has complied with all the legal requirements to prevent delays in the delivery of the project.
iv) Understanding the project team – The buyer should seek information on who is in the project team (including the architects, engineers and the main contractors), their experience and history on project delivery in order to gauge their ability to deliver the given project.

v) Getting regular updates from the developer on the progress – As the construction is ongoing, the buyer should be briefed by the developer on a regular basis to be sure that the development is ongoing and will be delivered on time.

vi) Engaging a valuer to establish potential returns – The property buyer should engage a valuer to analyse and gauge the possibility of earning the potential returns promised by the developer including rents, prices, yields, occupancy and uptake. This also helps the buyer know if the development is overvalued make an informed investment decision.

6. Need for legal framework regulating off-plan sales

As discussed in Chapter 2, there is no express legal provisions on sale of off-plan developments in Kenya. Isthmus (2010) noted that 'caveat emptor' (i.e. let the buyer beware) is the market doctrine for buyers of units in off-plan developments. The Land laws have provisions for registration of properties, but no article or clause on registration of a property purchased off the plan yet a significant number of properties that are sold off-plan in Kenya.

Section 5 of The Sectional Properties Act, 1987, No. 21 of 1987 Laws of Kenya provides for the registration of sectional plans thereby enabling developers to come up with a concept, generate a sectional plan from an existing plan of the site and sell the concept to potential investors in the form of off-plan sales. The registration of such sectional plans give the investors confidence that the developer actually intends to undertake the proposed development.

However, in the event of dispute whereby the developer fails to deliver the development as agreed, there is no legal provisions to protect the buyer. As further discussed in Chapter 2, Dubai in the United Arab Emirates has comprehensive laws such as the interim registration law (Law 13 of 2008); the trust account law (Law 8 of 2007); and the jointly owned property law (Law 27 of 2007) which protect buyers of the off-plan units in different circumstances. There is need for Kenya to emulate this and enact such laws as a measure of consumer protection and good practice in the real estate development sector.

5.6 Areas of further study

This study mainly sought to investigate and establish the effectiveness of financing of real estate development through off-plan sales in Kenya. Further research should be done on the following areas:

1) Effectiveness of financing of real estate development through Crowd-funding in Kenya
2) Effectiveness of financing of real estate development through Real Estate Investment Trusts in Kenya
3) Innovative ways of financing Real Estate Development and their effectiveness

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APPENDIX I: Interview Schedule for Real Estate Developers of the Case Study Real Estate Developments

SECTION A: GENERAL INFORMATION

1. What is the name of your organization?
2. How long have you been carrying out real estate development?
3. What type of real estate do you develop?
4. How many projects have you carried out? Please give brief details.

SECTION B: USE OF OFF-PLAN PROPERTY SALES AS A STRATEGY OF FINANCING PROPERTY DEVELOPMENT

5. Have you used off-plan sales as a strategy of financing real estate development?
6. In detail, describe the nature of the real estate development you are/have carried out (case study real estate development). Kindly provide details on: location; size of land; total number of units developed and types of units developed; amenities provided for each unit; and common facilities.
7. When did the construction commence and how long did the construction take?
8. What mode of financing did you use? What was the ratio of each mode used to the total cost of development?
9. What was your target amount of financing through off-plan sales relative to the total cost of development? How much was achieved?
10. For each of the unit types developed, kindly give a breakdown of the number of units sold off-plan?
11. What were the selling prices for the different types of units sold off-plan?
12. How long did it take to sell the off-plan units?
13. What was the agreed payment plan with the buyers? Lump sum or periodic? If it was periodic, when was the final instalment paid?
14. What were the selling prices for the different types of units upon completion of development?
15. What would you consider as an alternative source of financing if you were not to use off-plan sales?

16. In your view, is the use of proceeds from off-plan sales to finance real estate development an effective financing strategy?
17. What causes delays in completion of real estate development as per the timelines agreed with buyers of off-plan properties?
18. What are the construction risks involved?

SECTION C: CHALLENGES OF OFF-PLAN SALES

19. What are the challenges of using off-plan sales proceeds to finance real estate development?
20. How can the challenges discussed be mitigated?
21. What would you recommend as mechanisms of enhancing off-plan property sales as a strategy of financing real estate developments?

APPENDIX II: Interview Schedule for Real Estate Agents in the Case Study Real Estate Developments

SECTION A: GENERAL INFORMATION

1. What is the name of your organization?
2. How long have you been offering real estate agency services?
3. What type of real estate do you mostly assist clients to purchase/sell?
4. How many projects have you participated in as a selling agent? Please give brief details.

SECTION B: OFF-PLAN PROPERTY SALES

5. Have you participated/offered your services to clients selling off-plan property units?
6. In detail, describe the nature of the real estate development (case study real estate development) where you have offered estate agency services in selling the off-plan property units. Kindly provide details on: location; size of land; total number of units developed and types of units developed; amenities provided for each unit and common facilities.
7. What was the target number of units to be sold off-plan relative to the total number of units to be developed? How many units were sold off-plan?
8. For each of the unit types developed, kindly give a breakdown of the number of units sold off-plan?
9. What were the selling prices for the different types of units sold off-plan?
10. How long did it take to sell the off-plan units? In your opinion, was this time too long, moderate or too short? What reason would you attribute to the time taken?
11. What was the agreed payment plan with the buyers? Lump sum or periodic? If it was periodic, when was the final instalment paid?
12. What were the selling prices for the different types of units upon completion of development?
13. What construction risks are transferred to the real estate developers by the buyers of off-plan property units?
14. What benefits are enjoyed by purchasers of off-plan property units as opposed to those who buy completed property units?

SECTION C: CHALLENGES OF OFF-PLAN SALES

15. What are the challenges facing buyers of off-plan properties as investment avenues?
16. How can the challenges discussed be mitigated?
17. What can be done by the estate agents to ensure that developers meet their target sales off-plan property units?
18. What would you recommend as mechanisms of enhancing the effectiveness of off-plan property sales as an investment to property buyers?

APPENDIX III: QUESTIONNAIRE FOR REAL ESTATE DEVELOPERS

Preamble:

My name is **KATWA KIRK KIMARU**, a final year student in the University of Nairobi pursuing Master of Arts in Valuation and Property Management. I would like to request your assistance in data collection for my research entailing: **An Investigation into the Effectiveness of Financing of Real Estate Development through Off-Plan Sales.** All information provided here is confidential, will be treated with utmost confidentiality and will be used for academic purposes only. Kindly answer the questions that follow by ticking the appropriate option (if provided) or providing written answers/comments for open ended questions.

Please answer the questions freely and objectively. Your assistance and co-operation is highly appreciated.

SECTION A: GENERAL INFORMATION

1. What is the name of your organization? (Optional)

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2. What type of company is your organization?

   Sole Proprietorship ☐ Partnership ☐

   Limited Liability Company ☐ Other – Specify ☐

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3. How long have you been carrying out real estate development?

   0 -5 Years ☐ 6 – 10 Years ☐

   More than 10 Years ☐

4. What type of real estate do you develop?

Commercial ☐ Industrial ☐

Residential ☐ Special Purpose ☐

5. How many residential developments have you carried out, when and in which locations?

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SECTION B: USE OF OFF-PLAN PROPERTY SALES AS A STRATEGY OF FINANCING PROPERTY DEVELOPMENT

6. What mode of finance do you use to finance these developments?

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7. Have you used off-plan sales as a strategy of financing real estate development?

Yes ☐

No ☐

8. a) What was your target amount of financing through off-plan sales relative to the total cost of development?

- 1% - 10% ☐
- 11% - 20% ☐
- 21% - 30% ☐
- 31% - 40% ☐
- 40% - 50% ☐
- Above 50% ☐

b) What was amount of financing was actually raised through off-plan sales relative to the total cost of development?

- 1% - 10% ☐
- 11% - 20% ☐
- 21% - 30% ☐
- 31% - 40% ☐
- 40% - 50% ☐
- Above 50% ☐

9. How long did it take to sell the off-plan units?

1 Year ☐

2 Years ☐

More than 2 years ☐

10. What was the agreed payment plan with the buyers? Lump sum or periodic?

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11. How did the selling prices for the different types of units upon completion of development compare with the prices of the off-plan units?

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12. What would you consider as an alternative source of financing if you were not to use off-plan sales?

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13. In your view, what would you say is the level of effectiveness of off-plan sales in financing real estate development?

Poor ☐ Average ☐ Good ☐ Excellent

Please explain ……………………………………………………………………………

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14. What causes delays in completion of real estate development as per the timelines agreed with buyers of off-plan properties?

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15. What are the construction risks involved?

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SECTION C: CHALLENGES OF OFF-PLAN SALES

16. What are the challenges of using off-plan sales proceeds to finance real estate development?

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17. How can these challenges be mitigated?

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18. What would you recommend as mechanisms of enhancing off-plan property sales as a strategy of financing real estate developments?

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Thank you for your time!

APPENDIX IV: QUESTIONNAIRE FOR REAL ESTATE AGENTS

Preamble:

My name is **KATWA KIRK KIMARU**, a final year student in the University of Nairobi pursuing Master of Arts in Valuation and Property Management. I would like to request your assistance in data collection for my research entailing: **An Investigation into the Effectiveness of Financing of Real Estate Development through Off-Plan Sales.** All information provided here is confidential, will be treated with utmost confidentiality and will be used for academic purposes only. Kindly answer the questions that follow by ticking the appropriate option (if provided) or providing written answers/comments for open ended questions.

Please answer the questions freely and objectively. Your assistance and co-operation is highly appreciated.

SECTION A: GENERAL INFORMATION

1. What is the name of your organization? (Optional)

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2. How long have you been offering real estate agency services?

   0 -5 Years ☐ 6 – 10 Years ☐

   More than 10 Years ☐

3. What type of real estate do you mostly assist clients to purchase/sell?

   Commercial ☐ Industrial ☐

   Residential ☐ Special Purpose ☐

4. How many residential projects have you participated in as a selling agent? When and in which locations?

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SECTION B: OFF-PLAN PROPERTY SALES

5. Have you participated/offered your services to clients selling off-plan property units?

Yes ☐

No ☐

6. a) What was the target number of units to be sold off-plan relative to the total number of units in the development?

- 1% - 10% ☐
- 11% - 20% ☐
- 21% - 30% ☐
- 31% - 40% ☐
- 40% - 50% ☐
- Above 50% ☐

b) How many units were actually sold off-plan relative to the total number of units in the development?

- 1% - 10% ☐
- 11% - 20% ☐
- 21% - 30% ☐
- 31% - 40% ☐
- 40% - 50% ☐
- Above 50% ☐

7. a) How long did it take to sell the off-plan units?

1 Year ☐

2 Years ☐

More than 2 years ☐

b) In your opinion, was this time too long, moderate or too short? What reason would you attribute to the time taken?

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8. What was the agreed payment plan with the buyers? Lump sum or periodic?

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9. How did the selling prices for the different types of units upon completion of development compare with the prices of the off-plan units?

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10. What construction risks are transferred to the real estate developers by the buyers of off-plan property units?

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11. In your view, what benefits are enjoyed by purchasers of off-plan property units as opposed to those who buy completed property units?

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SECTION C: CHALLENGES OF OFF-PLAN SALES

12. What are the challenges facing buyers of off-plan properties as investment avenues?

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13. How can these challenges be mitigated?

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14. What can be done by the estate agents to ensure that developers meet their target sales off-plan property units?

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15. What would you recommend as mechanisms of enhancing the effectiveness of off-plan property sales as an investment to property buyers?

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Thank you for your time!