AN ASSESMENT OF THE VIABILITY OF REAL ESTATE SECURITIZATION IN KENYA

BY

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DECLARATION

This management research project is my original work and has not been presented for a degree in any other university.

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Signed.................................. Date...27 November 2006.......................

This management research project report has been submitted for examination with my approval as University Supervisor.

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List of abbreviations

CPI	: Consumer Price Index
S&P 500	: Standard and Poor's 500 index of common stocks
NCREIF	: National Council of Real Estate Investment Fiduciaries
EREIT	: Equity Real Estate Investment Trusts
REIT	: Real Estate Investment Trusts
NSSF	: National Social Security Fund
RBA	: Retirement Benefits Authority
NPV	: Net Present Value
NAV	: Net Asset Value
Co-op	: Co-operative
Sacco	: Savings and Credit Co-operative

Abstract

This research examines the attitudes of Kenyans towards real estate securitization. To a large extent the respondents' answers as to why there were no listed property companies seemed to mirror the findings of Kimura and Amoro (1996). Most felt that the stock exchange was not well understood by investors and particularly by entrepreneurs. Other reasons included the need for confidentiality largely so they did not have to pay all their taxes and the feeling that the stock exchange could understate their wealth for no concrete reason by having the shares of their properties trade at below their net asset value.

Overwhelmingly professionals and ordinary investors said they would be ready to put their money in securitized real estate. However the readiness to invest in shares of property companies went down as the amount involved went up. Compared to owning a property most of the respondents favoured owning a rental house to shares in a property company.

Individuals who controlled entities which own property were however hesitant to bring to the market their property holdings. A most interesting finding among collectively owned property organization officials is an extreme risk aversion. To a large extent, officials of property owning organization feel that an attempt to divest part of their holding to the public would be viewed as an attempt to benefit themselves by the other members, the majority of whom did not understand the basics of investments. Any innovative actions on the part of these officials is always viewed with suspicion by the members. Even with the best intentions, any action not well understood by members results in accusations of corruption.

Chapter 1

Introduction

1.1 Background

Real estate may be defined as land and anything permanently affixed to the land, such as building, fences and those things attached to the buildings, such as light fixtures, plumbing and heating fixtures, or other such items that would be personal property if not attached. It may also refer to rights in real property as well as the property itself. Quite often the word property is used interchangeably with real estate. As an investment it generates returns from rent payments and capital appreciation. Where the property is owner occupied, the returns include savings in rent together with the capital appreciation.

Real estate can be identified as one of the oldest form of investment known to man. Many references can be found in the bible relating to the ownership and use of land (Genesis 47: 20 circa 2000 BC): “And Joseph bought all the land of Egypt for Pharaoh; for the Egyptians sold every man his field, because the famine prevailed over them: so the land became Pharaoh's”. Even in the modern high technology economies. real estate is a dominant economic factor. Real estate is the largest asset class in the world—the value of housing in the United States alone is $16 trillion, (Johnston 2004). In the US Market capitalization of the New York Stock Exchange (NYSE) is over $13 trillion, NASDAQ over $4 trillion. Real estate is the greatest source of wealth for most families and makes up to 50% of the world’s wealth (Johnston 2004). In Nairobi land alone is estimated to have a value of Kshs. 140 billion (Abdikadir 2001; cited by Njiru 2003).

However real estate is the most imperfect of all asset classes (Johnston 2004). A simple example that illustrates imperfections in the real estate market is the high level of transaction costs involved with the purchase or sale of a typical home. There are estate agency fees (minimum 3% of the value), legal fees, title processing fees and stamp duty (at 4% of the value). This compares to the minimum 1.5% of value depending payable in brokerage fee for listed securities.

Most investment in real estate requires huge financial resources. And once the funds are invested, the resources are sunk. Liquidating the full investment will usually take months or in some cases even years. Based on the foregoing an investor in property takes, in addition to the normal business risk, a liquidity risk. In seeking a return on his investment (as rent or capital gain), the investor will then seek to be compensated for this additional risk. In addition the high capital outlay required for real estate investment reduces the supply of properties available for occupation. Based on the simple demand and supply model the tenant is therefore forced to pay more than the equilibrium rent to get accommodation.

Another problem of real estate ownership is indivisibility. It is extremely difficult to liquidate part of the investment if the investor was to find another investment opportunity that afforded him a higher net present value (NPV). The Kenyan Sectional Properties Act (1987) which provides a framework for ownership of a part of property was designed specifically for resale of self contained units and cannot be said to enhance divisibility.

Efficient diversification involves combining assets with less than perfect positive correlation between the returns of the assets involved in order to reduce risk without sacrificing the portfolio's returns, (Adair et al 1994, 33). In a multi-asset portfolio, it is extremely difficult to attain the ideal weight for property, especially for small funds. Consider a small fund with assets totaling fifty million shillings. In order to increase its property exposure by 5%, it would need to invest 2.5 million shillings in property. This amount is hardly enough to buy an acceptable property in Nairobi today for such a fund. The fund may therefore be forced to increase its property weighting in order to acquire an acceptable property, or carry less than the desired weight for property in the portfolio. For such a fund there may therefore almost always be a mismatch between the ideal weighting for property and the possible weight.

According to Dominic Mwinzi[1], an associate director in a leading property consulting company, more than 50% of the properties in Nairobi's central business district are owned by the government, co-operatives and the life funds of insurance companies. It was possible to put up these buildings because of the large pool of funds available in these sectors. Ownership of these properties is so widely diversified that the above problems are not likely to significantly adversely affect any one of the "owners" (tax payers, co-operators, or the insured). However inefficiency in the co-operative sector has made it extremely difficult to extract reasonable returns from these properties. The researchers own experience in managing properties for a number of co-operatives was that the organizations are very poorly managed. This experience is also collaborated by a research carried out by the Centre for Corporate Governance (2003) on the governance in

[1] Personal conversation with the author, 22 February 2006.

co-operatives. On the other hand the returns obtaining from public sector real estate would be very difficult to measure because the objective of the investment may not always be financial. The RBA regulations (2000) will also considerably reduce the amounts the pensions sector will be putting into real estate in the foreseeable future. These models of ownership however possibly hold the key to future investments in property in Kenya. This could be done through investment in a modern well run corporate entity, financed by a large number of individuals who hold their claims to the asset in the form of marketable securities. This concept is known as real estate securitization.

In real estate securitization, a real estate operator (the fund raiser) converts the ownership or profit rights from real estate properties into negotiable securities through a conduit, and sells them to investors, (Oka 2001). In the US there are over $5.5 trillion of securitized home mortgages, $500 billion of commercial mortgage-backed securities (CMBS) and $200 billion of Real Estate Investment Trusts (REITs), much of which did not exist prior to the early 1990s, (Johnson 2004).

Two categories of real estate securitization exist. These are mortgage-backed securitization and real property securitization. This research deals specifically with Real property securitization.

Real property securitization involves selling of claims to property to investors who in return enjoy the returns generated by the property or group of properties. The defining criterion of securitized real estate is the fact that the shares are easily tradable. This eliminates the earlier stated problems of liquidity, divisibility and non-diversification. If a one building entity with 100,000 shares whose market value is Ksh. 70.00, it is at least in theory possible to own 1/100,000 of the building. It is also possible to sell the share within reasonable time and at a price which is reasonably predictable. Transaction costs on property securities are also much lower as stamp duty is currently not chargeable on transfer of listed securities. Stock brokerage costs are also much lower than estate agency fees.

In the last few years any new securities coming into the Nairobi Stock Exchange have been oversubscribed. The KenGen share issue was oversubscribed more than three times at twenty four billion compared to the 7.8 billion required. According to the April 24 2006 issue of The East African, there has been an increasing shift of investment funds from the newly industrialized economies specifically being put into bonds at the exchange. This indicates that the number and types of instruments available at the exchange are not enough for the market. Indeed, According to World Bank (2002) of the about 47 companies listed, only 15 are traded regularly. This is because of the others, only about 35% of the shares are available for trading. A High incidence of buy and hold strategy also aggravates the problem. Financial innovation, which is the process of introducing new instruments, institutions and process, would therefore be welcome.

Property securitization would help in further completing the market by increasing the number and types of instruments available. As previously indicated the RBA regulations

(2000) will reduce the amounts the retirement benefits sector will be putting in to real estate in the foreseeable future. However converting the property into equity will provide a way of avoiding this constraint. One organization that would benefit immensely by promoting property-backed securities is the National Social Security Fund (NSSF). These ideas are consistent with the two theories of financial innovation, which are market completeness theory and constraint-induced theory, (Saunders 1993).

The growth of securitized real estate in the recent past has been so tremendous that in 2005 the Global Industry classification standard found it necessary to split the Real Estate industry into two industries promoting the Real Estate Investment Trusts and Real Estate Management and Development Sub-Industries to Industry status.

1.2 Statement of the problem

According to Newell (1995) securitization of property affords both investors and existing property owners several advantages. Chief among these is the improved tradability and liquidity of the investments. According to Benveniste et al (2001, 633) creating liquid claims on relatively illiquid property assets increases the value by 12 – 22%. These are important issues, which one would expect, would spur the growth of this type of security. However despite these advantages of securitized real estate over private real estate holdings, these securities do not exist in Kenya. The Cairo and Alexandria Stock Exchange (CASE) has 66 real estate companies listed in it. So, why are there no property companies in Kenya?

Brueggeman and Fisher (2001) among many other researchers in the real estate sector have shown that securitized real estate as an asset has different characteristics from the underlying asset. Given this situation, securitized real estate presents a new asset class. For the purposes of diversification, it would therefore be a good idea to include securitized property in a portfolio. A lot of Kenyans from all walks of life yearn to own their own property or a rental property. In a lot of cases this is not possible given the amount of money required to invest in a reasonable property. Securitization would however reduce the capital outlay required for one to own some real estate. Based on the foregoing, would the Kenyan investor be ready to put their money in such an asset?

While there are many benefits associated with listing, many Kenyan companies are hesitant to list. According to Kimura (1996) the main reason behind this is the general lack of awareness and information on the role, function and operations of the stock exchange. They also found out that the perception of the listed companies is that the risks associated with the additional disclosure are not adequately compensated by the additional returns that accrue as a result of being listed. However there are tangible benefits of listing generally as indicated by Kimura (1996) and property securitization specifically as per Newell (1995). However Kimura (1996) does give indications that there are disadvantages that might outweigh the advantages of being listed. Given this scenario, would the Kenyan real estate holder be ready to float part of their ownership to the public?

1.3 Objectives of the study

This study focuses on three main objectives. The most important objective is to establish why this and other securities backed by property do not exist in Kenya. The second objective is to establish to what extent real estate owners would be interested in listing their holdings. The final objective will be to establish what extent Kenyan investors would be interested in buying such a security.

1.4 Significance of the study

The study is expected to be significant to finance researchers and professionals: Very little work[2] has so far been done on real estate finance in the country despite the fact that it is one of the most vibrant investment sectors in the country. This is study is expected to stimulate interest in the field. The study is also expected to be of interest to policy makers. It is expected that this study will bring into the country a new view of property investment. The CMA will need to look again at the vehicles available for such an investment. Should it become necessary to create a vehicle like the US REIT, then Kenya Revenue Authority (KRA) would be expected to make amendments to the income tax act. Additionally, the study is also expected to sensitize holders of private real estate investors as to the possible advantages and disadvantages of going public.

[2] Notable exceptions to this are Njiru (2003) which attempted to determine commercial returns in Nairobi CBD and Njoroge (2001) on the position of the NSE with regard to property.

Chapter 2

Literature Review

2.1 Benefits of real estate securitization

Newell (1995) identifies several benefits of real estate securitization. These include; improved tradability and liquidity; ability to invest in high quality assets of a value that would otherwise be beyond normal prudent investment criteria, ability for investors to achieve better investment mix by diversifying risk in terms of geographic spread and property type, greater investment flexibility, with ability to react more quickly to changes in market conditions and partial disposal of an asset while retaining significant management benefits. He further points to the ability for investment managers to reduce costs through economies of scale and specialization, enabling investors to develop strategic links with other institutional property investors, Enabling institutions to re-weight property sector exposure, while retaining management control, Prestige of investing in "trophy" property assets, Possible reduction in differentiation between fund managers on basis of quantum of funds and Redirection of attention to investment performance as other possible advantages.

Attributes like liquidity and ability to dispose part of an asset would be expected to be important to any investor. However the absence of such assets in the Kenyan economy seems to suggest that there are other conditions that outweigh such advantages. However it could just be a lack of awareness as suggested by Kimura (1996).

5.2 Risk-return characteristics of securitized property.

Table 1: Comparative performance measures for selected investment alternatives (1985-2000)

	CPI	Corporate Bonds	S&P 500	T-Bills	NCREIF Index	EREIT Index
Arithmetic mean	1.13%	2.31%	4.06%	1.76%	2.32%	3.94%
Standard deviation	0.90%	3.80%	7.41%	0.70%	1.76%	10.26%
Coefficient of variation	0.80	1.64	1.83	0.40	0.76	2.60
Geometric mean	0.79%	2.24%	3.98%	1.40%	1.73%	2.58%

(Source: Brueggeman and Fisher, 2001, pg 593)

Table 1 above shows the risk return characteristics of various asset categories in the US. The Standard and Poor 500 (S&P 500) proxies for common stocks, the National Council For Real Estate Fiduciaries (NCREIF) index for private real estate while the Equity Real Investment Trust (EREIT) index proxies for securitized real estate. While all expectations would be that the returns between EREITs and property would be similar, research shows that the returns on EREITs are closer to those of common stocks than those of unsecuritized property. It can be seen that while traditional property holdings have a low risk exposure, EREITS have the highest risk exposure within the asset classes, (Brueggeman & Fisher 2001).

2.3 Correlation between securitized property returns and other assets

Traditionally, property has been regarded as a reliable hedge against inflation, with this being one of the main arguments (along with portfolio diversification benefits) for institutional investors having property in a mixed-asset portfolio, (Newell 1996, 6). Empirical research has been carried out to determine to what extent this belief holds.

Table 2: Correlation between selected investment alternatives and CPI (1978-2000)

	CPI	Corporate Bonds	S&P 500	T-Bills	NCREIF Index	EREIT Index
CPI	1					
Corporate Bonds	-0.2440	1				
S&P 500	-0.1349	0.2766	1			
T-Bills	0.5868	0.1284	-0.0737	1		
NCREIF Index	0.3317	-0.1469	-0.0521	0.4700	1	
EREIT Index	-0.0199	0.4862	0.5986	0.0044	-0.0642	1

(Source: Brueggeman & Fisher 2001, pg 602)

The table above shows that the proxy for private real estate (NCREIF) is positively correlated to the CPI. This implies that as inflation rises the returns from unsecuritized real estate rises. Unsecuritized real estate therefore provides an effective hedge against inflation. However EREITS are negatively related to inflation indicating that they are not effective as an inflation hedge. The EREIT index though is not purely positively correlated to S&P 500 and corporate bonds showing that EREITS may offer some diversification benefits. However the benefits that accrue from investment in unsecuritized real estate are much higher given the lower corresponding correlation between the NCREIF and the S&P 500 and corporate bonds, (Brueggeman & Fisher 2001).

In summary securitized real estate returns behaves more like returns of shares and bonds than the returns of the underlying asset. Simply for the purposes of diversification the Kenyan investor would benefit from ad additional type of asset with different characteristics from the traditional offering at the stock exchange.

2.4 International trends in property securitization

Property securitization has enjoyed differing levels of success in various parts of the world in recent years.

By far the most successful and the most studied property securitization system in the world is the US Real Estate Investment Trust, (REIT). According to Brueggeman & Fisher (2001), a REIT is a closed-end investment company which offers investors the opportunity to invest in real estate assets. REITs pay no tax if they comply with the requirements of the US equivalent of Kenyan income tax act. Dividends paid to the shareholders are however taxable on their hands. The requirements are that the business must be incorporated as a trust or association managed by a board of directors or trustees, it must invest 75% of its total assets in real estate, cash items and government securities, it must derive at least 75% of its income from real estate and it must distribute 95% of its taxable income excluding capital gains. Such provisions do not exist in the Kenyan Income Tax Act (2004).

Property securitization has not been very successful in the UK. A number of investment vehicles such as the Single Property Ownership Trusts (SPOTs) and Single Asset Property Companies (SAPCOs) were proposed but they were not viable due to adverse market conditions and lack of tax transparency, (Newell 1995). Tax transparency provides investors access to investments with the same cash flow characteristics as owning real estate directly, but through a more liquid (and volatile) structure, (Conner

2005). Most indirect property investment in the UK has been achieved through listed property companies. According to Naubereit (2002) many property companies have gone private due to the high discount on their net asset values (NAV). Organisations like the real estate group MEPC went private. BPT and Delcaney followed in 2001. Other companies that delisted include, Burford Holdings, Frogmore Estates Regalian and the Moorfield Group. Share prices then lay 25% below the Net Asset Value and in some cases as low as 50% below the NAV! In March 2004 the UK government in a document titled "Promoting more flexible investment in property: a consultation" requested for opinions from interested parties on how to add value to the property market without creating a tax loophole. Based on the responses, a REIT type vehicle is expected to be legislated for in 2006, (Conner 2005). The consistent under-valuation may be comparable with Kimura (1996) findings in which 44% of the companies listed at the NSE felt that the market had understated their share value. All this is however inconsistent with Benveniste et al (2001) that additional liquidity could increase value by between 12 and 22 percent.

In Singapore indirect property investment was for years achieved through shares of listed property companies. In December 1995, investment in listed Singapore property stocks reported a market capitalization of approximately S$27.16 billion. This constituted about 13 per cent of the value of the market capitalization of the Stock Exchange of Singapore (SES), (Liow 1997). In 2002 Singapore legislated to have tax transparent S-REITs. In the period 2002 to 2004, five S-REITs with a market capitalization of $3 billion were listed. It is even possible to buy S-REIT shares at ATMs, (McDonald 2005). That the SES had a substantial proportion of property backed securities even before the introduction of the tax transparent S-REITs points to the fact that tax transparency is not a necessary condition for the existence of such securities. We may therefore expect such companies to thrive in Kenya even under the current tax conditions.

In Japan, the SPC (Special Purpose Company) Law was enacted in 1998. This paved the way for legislation of J-REITs which occurred in 2000. By 2001 the types of real investment schemes available were almost comparable to those in the US. As a result, real estate investment alternatives, once limited to a small number of investors in actual properties, rapidly expanded into new areas. Investment alternatives now range from equity investments such as SPC equity certificates and JREITs, which have market listings, to debt investments such as SPC bonds and securitized products such as commercial mortgage backed securities (CMBS) and residential mortgage backed securities (RMBS), (Matsumura 2001). Unlike Singapore it is however clear that in Japan the tax transparency afforded by J-REITs was an important factor in the growth of property securitization.

Australia has the most developed indirect property market in Asia dating back to 1970. In fact Australia is perhaps the most securitized market in the world with 52% of its investable real estate being listed, (McDonald 2005, 13). Listed property trusts (LPTs) have been the most successful indirect property vehicle in Australia, largely attributable to their tax transparency, liquidity and the ongoing acceptance among investors of the property trust structure. Listed property trusts had nearly AU$14 billion in assets at June

1995 and accounted for 4.7% of Australian equity market capitalization (Newell 1996, 9). Australia boasts the largest real estate company, Westfield Group with a market capitalization of over $21 billion. A unique factor that comes out of this is that the LPTs have acceptance among investors which may be the most basic condition for the success of any type of asset.

According to Schulte (2001) the German tax system has traditionally favored a private real estate investment over a corporate investment. This is because losses from private real estate investments were fully deductible from the personal income tax. A special tax law allowed investors to depreciate their investments in the former East Germany at a rate of 50 percent in the first year. Additionally there was no capital gains tax for the private investors if they held real estate for more than 2 years while corporate entities had to pay a capital gains tax.

However tax reforms of 1999 changed the bias for private real estate by disallowing deductibility of tax losses from any other class of income. On this basis the after tax cost of capital for individual real estate holders is now much similar to that of companies. On the basis of liquidity securitized real estate companies are therefore expected to be more competitive than private real estate when the law finally takes effect. Most indirect property holdings in Germany are held through open ended funds. However there have been corruption allegations in these funds which have accelerated the need for a tax transparent REIT-like vehicle, (Conner 2005, 9). In Kenya rental income is a specified source whether for companies or for individuals and losses from this source can only offset against future profits from the same class. Capital gains are currently not taxable whether for companies or for individuals, making investment in property especially profitable. The tax situation for Kenya therefore seems more favorable for the development of property companies than that of Germany. However, according to Corner (2005), Germany was ranked the 14th top listed property market in the world in 2005 with a global share of 0.5% in market capitalization.

Hong Kong enacted legislation for a REIT type vehicle in 2003. In December 2004 the Hong Kong Housing Authority floated a Real Estate Investment Trust with government-owned shopping centers and parking lots valued at $2.8 - $4.5 billion. The issue, called "The Link REIT", was oversubscribed 28 times with real estate assets of US$3.3 billion and orders of almost $80 billion, (Wikipedia 2005). However the above HKHA REIT issue was aborted in the final stages after a legal challenge. The government's position was ratified in July 2005 by the decision in Hong Kong's Court of Final Appeal and the issue was finally listed in November 25 2005. It is interesting however to note that Hong Kong REITs are not tax transparent. Again this seems to indicate that tax transparency may not be a necessary condition for the existence of property companies.

In Africa, the Cairo and Alexandria Stock Exchange (CASE) has 66 companies listed under the Housing and Real Estate sector. South Africa has listed companies included in the worldwide S&P/Citigroup BMI Property Indices. Such a sector does not exist at the NSE. It is unclear whether the property companies in Egypt and South Africa are incorporated under a tax transparent regime.

2.5 Possible use of unit trusts

The Kenya Income Tax Act (2004) exempts the income earned by from unit trusts from taxation. It could be argued that unit trusts could be used as a tax transparent vehicle for the purposes of setting up a REIT type property company in Kenya. However According to Ellingham (1995) unit trusts by their very nature of being open ended would treat incoming and outgoing unit holders inequitably in a falling and rising market respectively. As an illustration suppose a unit holder leaves in a falling market and his holding is worth the equivalent of a given property. He will be paid this amount but in the time it takes to complete the sale of this property its value will have gone down. The shortfall then has to be met by the existing unit holders. In Germany approximately $107 billion of real estate is held in open ended property funds. However as previously mentioned, Corner (2005), the funds have had to deal with corruption issues, possibly brought about by their open ended nature.

2.6 Securitization in Kenya

According to the Njoroge (2003) in 2001 a company known as Anglo African properties attempted to get a listing at the Nairobi stock exchange. However this attempt failed.

The failure of the IPO can be attributed to the fact that the shares were selling at 23.50 with a minimum number of shares per investor set at 10,000. This implied that anyone interested in the deal needed to have a minimum of Ksh. 235,000 which in effect shut out the ordinary retail customer. Another reason for the failure was because the major shareholders were not well known individuals within the public corporate domain. The issue was also not well marketed. Considering it was the first time this type of security was coming into the market then a substantial amount of funds ought to have been set aside for marketing it. In addition the major shareholders would continue to enjoy majority shareholding in the company even after listing, an issue that would have been worrying to the new shareholders.

Njoroge (2003) also indicates the failure to float the company as a REIT as a possible reason for the failure of the IPO. Considering that the majority of property companies in most of the world are not REIT type (though REIT type vehicles are the most successful), this reason cannot therefore hold. In any case this would have seemed to indicate that without specific legislation which is necessary for operation of a REIT, then listed property companies cannot work.

Other than the paper by the Nairobi Stock exchange (Njoroge 2003) the researcher did not find any other work directly on the subject of real estate securitization in Kenya. A preliminary investigation among the real estate practitioners found that most of them were unaware of the concept. Even after prompting, only a few could remember the Anglo African properties IPO which was fronted by a long time valuer from one of the oldest and well established property firms in the country.

Chapter 3

Research Methodology

3.1 Research design

This was an exploratory study and was mainly qualitative in nature. An exploratory study is research that aims to seek new insights into phenomena, to ask questions, and to asses the phenomena in a new light, (Saunders et al, 2003). This design was chosen since the concept is relatively new and had not taken root in the country. Indeed according to Saunders et al (2003), it may well be that time is well spent on exploratory research as it may show that the research is not worth pursuing.

While the research among professionals was relatively easy, among individuals in decision-making organs of the property holding entities was much more difficult because they felt that the information they were giving was confidential. Getting information from this group of individuals required tact and a lot of reassurance that confidentiality would be strictly maintained. Indeed it seemed that confidentiality was one of the most important tenets of their service since even individuals who were well known to the researcher said they found it difficult to share information with him.

3.2 Population

The population for this study consists of every potential investor in the stock exchange in Kenya. All owners of real estate whose value is equal to, or exceeds the minimum required share capital and net asset value for listing at the Nairobi stock exchange qualify as potential promoters of a securitized real estate IPO. These amounts are ten million shillings share capital and 20 million shillings net asset value for the alternative investment segment and fifty million shillings share capital and 100 million shillings net asset value for the main investment segment. It would be possible for a promoter who holds several properties to float individual units separately or in groups which makes it difficult to estimate the population size. The real estate may be either public or private.

3.3 Sample and sampling technique:

In line with the problems identified, institutional investors would be the most conveniently placed to provide insight into the questions raised. This is because they are reasonably well versed with investment management. Institutional investors employ professional managers. Their investment in property would be expected to be purely for the returns they would generate unlike private real estate holders whose judgment of their investment is clouded by the prestige of ownership. They also actually own real estate. They would therefore be well placed to say whether they would be willing to cede some of the investment to other investors to make the investment more liquid. Additionally as investors, they keep making new investments and reorganizing their holdings. They would therefore be well placed to say whether they would be willing to put money in such an investment.

Another class of respondents that was interviewed were the property consultants. In their capacity as advisors, this group has the ability to influence investment in a particular direction. Their perception of this type of asset will be impacted on investors and therefore may be used as a proxy of the actions that retail investors may be willing to take.

Other respondents that were interviewed were trustees of some of the pension funds and officials of co-operatives that hold substantial property. The nature of pension funds and co-operatives is very similar to that of investment managers in that they own real estate and are consistently making investment decisions. The table below shows the number of respondents that were interviewed by type and the spread of organizations covered.

Table 3: Number of respondents by category

	No. of respondents	**No. of organisations.**
Property consultants	12	6
Investment managers	10	5
Pension fund trustees	5	4
Co-operative officials	6	4
Total	**33**	**19**

3.4 The research tool

This information was obtained using an in-depth interview. Such an interview provided opportunities to probe answers and allowed the interviewee to build on their answers. In fact some of the significant findings of the research were areas that the researcher had not previously considered.

According to Saunders et al, (2003) managers are more likely to agree to be interviewed rather than complete a questionnaire especially where the interview topic is seen to be interesting and relevant to their current work.

As expected the majority of the stakeholders were not familiar with the concept of property securitization. However upon explanation, most respondents grasped the concept quite easily. A significant unforeseen challenge was that the respondents did not want to have the interview tape recorded. The responses therefore had to be recorded in longhand.

The survey addressed key issues concerning securitization including the existing portfolio of property, awareness of the concept and benefits of securitization, possibility of including shares of securitized real estate should the concept take off in future. The researcher also sought to know whether they thought that property securitization is necessary for Kenya or the existing structure of private ownership is superior. Property owners were also asked the possibility of floating part of their real estate holdings and why (or why not) they would not do this. As this research is exploratory the interview questions were developed as the interview progressed and any new issues that were brought up by an interviewee were carried on to the next.

3.5 How the results were analysed.

Qualitative data may be distinguished from quantitative data in that while the data is expressed through numbers in quantitative data, it tends to be expressed in words in qualitative data. This has implications for analysis of the data. Qualitative data is nonstandardized and requires to be classified in to categories. The analysis of qualitative data may be based on the researchers understanding and conceptualization of the responses, (Saunders et al 2003). According to Wood et al (2001), imagination and creativity determine how the original questions are framed, how the categories are identified what data is assigned and what patterns are identified.

Chapter 4

Results and findings

4.1 Introduction

This research examines the attitudes of Kenyans towards real estate securitization and real estate securities. Using a qualitative approach the researcher sought the views of individuals in the property and investment sector on a wide range of issues. The significant views and opinions of the respondents interviewed are summarized below along with what the researcher feels are the implications of those opinions organized according to the main objectives of the research.

4.1 Why are there no property securities in Kenya?

Table 4 on page 26 analyses the respondents' opinion on issues that came up as possible bottlenecks towards property securitization. The most common response as to why there are no property securities in Kenya was that Kenyan entrepreneurs did not generally understand the modalities of being listed in the stock exchange and the advantages that accrue from being listed in the stock exchange. 76% of all respondents believed that entrepreneurs did not know the advantages of being listed at the stock exchange. All the respondents interviewed knew of the existence of the stock exchange. About 61% of the respondents owned shares. However only the respondents in the investment management category and some pension trustees knew off-head what it took to be listed at the exchange. The other respondent categories thought that it was only something available to the large organizations. Only about 48% knew off-head the advantages of being listed at the stock exchange.

Overall about 76% felt that Kenyan entrepreneurs were not aware of the advantages of listing and what it took to be listed at the stock exchange. Property consultants and investment managers all agreed that most entrepreneurs did not want to reveal to the public details of performance of their investments. This was mainly because they generally did not want to disclose all their income for tax purposes. Some property consultants felt that most property owners paid little or no taxes on their earnings and no advantage gained by listing would be higher than the savings they were able to accrue in unpaid taxes. Only 25% of the property consultants thought that the REIT type tax concessions would spur growth in property securitization.

Another significant reason for the lack of interest in the stock exchange by the property owners was the difficulty in estimating future market prices despite the fact that they could reasonably estimate the incomes for a considerable future period. Owners and property consultants alike felt that it was possible to have their shares trading at prices that were not necessarily related to the performance of the companies. It was therefore possible to have their shares trading below the equivalent net asset values.

Property consultants said that most property owners hold property for prestige and not necessarily for their investment value. A lot of the individual properties are held to be passed onto the next generation for inheritance and not because they are the best investment possible. To some extent the question of why such securities do not exist in Kenya seemed to a large extent to mirror Kimura and Amoro (1996) findings of on the

Table 4: Background analysis on the absence of listed property securities in Kenya

		Property consultants	Investment managers	Pension fund	Co-op officials	Average
	Issue	Percentage	Percentage	Percentage	Percentage	Percentage
1	Thought entreprenuers did not know the advantages of being listed.	83%	60%	60%	100%	76%
2	Knew of the Nairobi Stock Exchange	100%	100%	100%	100%	100%
3	Had investment in shares listed at the Nairobi Stock Exchange or any other exchange	58%	80%	60%	33%	61%
4	Knew the requirements for being listed at the Nairobi Stock Exchange.	0%	80%	40%	0%	30%
5	Could count off-head three advantages of being listed.	25%	100%	60%	0%	48%
6	Thought that property owners did not want to reveal details of their investments.	100%	100%			100%
7	Thought that REIT type taxation would spur property securitization	25%	100%	60%	17%	52%
8	Felt that the market prices at the exchange were not related to the performance.	83%	50%	100%	100%	79%

stagnation of the Nairobi Stock Exchange. This seemed to indicate that there are no major differences in the reasons for going public (or not going public), for a property company or for any other company.

4.2 To what extent would Kenyans be ready to invest in securitized real estate?

Table 5 on page 28 shows the respondents' opinions towards real estate securities. It further compares opinions in investments in actual real estate to real estate securities. All respondents without exception said they would be ready to buy shares in a property company. However interesting patterns emerged on further analysis. The willingness to invest in such shares reduced as the amount involved went up. 79% of the respondents favored owning a property privately compared to investing a similar amount in shares of a property company. Overall seventy 73% of the respondents felt that the risk-return characteristics in Kenya seemed to favor owning property to owning shares of listed property. This seemed to indicate that Kenyans consider shares to be much more risky than property. Further, ownership of shares was seen to be an exotic investment to be held more for the pride of it than for the returns.

Preferential taxation of securitized real estate did not seem to sway the opinions of most property consultants either way. All of them felt that on average the returns of real property were higher than the returns at the stock exchange. However they failed to incorporate the tax effects in arriving at the return figure. The argument given for this was that tax compliance among landlords was very low and deducting tax in arriving at the return would give a return that was artificial and lower than the actual returns

Table 5: Opinions on investment in listed property securities

		Property consultants	Investment managers	Pension fund	Co-op officials	Average
	Issue	Percentage	Percentage	Percentage	Percentage	Percentage
1	Would be ready to invest in securitized real estate	100%	100%	100%	100%	100%
2	Would prefer to invest in real property compared to a similar amount in property shares	83%	70%	80%	83%	79%
3	Thought the risk return characteristics favored own property to shares of listed property.	100%	30%	80%	83%	73%
4	Thought that preferential taxation would spur property securitization	8%	100%	60%	17%	45%
5	Felt the returns from own property would be higher than the returns from shares in listed property.	100%	30%	80%	83%	73%
6	Knew of the tax advantages allowed for newly listed companies.	25%	80%	40%	0%	39%

obtaining in the market. A small proportion of the consultants were aware that there were tax advantages for a newly listed company.

4.3 To what extent would owners be ready to float part of their holdings?

Among owners of property there was a marked difference among the professional managers employed in the organizations and the officials of the decision making organs. These included officials of co-operatives which own property and trustees of pension schemes.

The employees of the organizations felt that the idea was timely and that some or all of their properties should be securitized. They understood the advantages that would accrue to their members by of listing some or all their property holdings at the Nairobi Stock Exchange. At least one employee of a large pension scheme confirmed that their organization had received a proposal on how to divest their property portfolio through listing.

Officials and members of decision-making organs however tended to shy away from the concept. Most of them concurred that it was the right thing to do. They however feared that with a membership that did not understand the basics of investment they risked being accused of trying to take personal advantage of the investment. There was also the fear that in case the net asset value of the investment went down, they would be taken to court and whether or not they were found guilty, their public standing would already be damaged. With most of the officials being elected individuals, several officials confessed that they would rather sacrifice the benefits of being listed than risk their names being tarnished.

Chapter 5

Conclusion, limitations and suggestions for further research.

5.1 Conclusion

Most of the securitizable properties are held by the government and collectively owned entities such as pension funds and co-operatives. Other such properties are owned by amorphous groups such as welfare groups and church organizations. The opinions expressed above show that while the ordinary investor would be willing to put money in such an investment, the individuals who control the running of the organizations are not ready to bring the properties in to the market. It was quite clear that the main bottleneck was that in collectively owned entities most innovative actions by the officials are viewed with suspicion. According to the officials any action that deviated from the ordinary would be seen as corruption. While corruption in such entities and in deed the wider Kenyan context is a reality, the sad thing is that this paranoia, which transcends our public entities, holds back innovative actions such as property securitization. To the extent that collectively owned properties are seen to be the impetus that would drive property securitization, then this may have to wait until we get more confidence in our publicly elected officials before it can properly take off. In the meantime the property sector will miss the possible benefits of securitization.

5.2 Limitations of the study.

Two major events took place in the capital markets during the period of field research that may have distorted the respondents' attitudes towards the capital markets in general and securitization of real estate in particular. The first was the KenGen IPO, which was oversubscribed approximately four times. The second was the announcement by the directors of Uchumi Supermarket Limited, the oldest brand in retail shopping in Kenya that it was no longer able to trade and was closing down because it was insolvent. As expected, this was closely followed by de-listing of the company from the stock exchange. While overall there was no change in direction, there was however a dimming of the enthusiasm in attitudes towards securitization between the KenGen IPO and the announcement by the directors of Uchumi. Had these events not taken place there is the possibility that the responses may have been different from those captured in this research.

Property securitization is a hitherto unexplored field in Kenya. The research design used was therefore exploratory. This means that the research focused more on bringing out the issues involved rather than the extent to which they impede securitization of property. A more quantitative study of the issues involved would probably come up with a clearer picture of the extent to which each aspect impedes securitization.

5.3 Suggestions for further research

Agency theory looks at among others the constraints imposed on business where it is managed by a person or persons who are not the owners. To make sure that the proceeds from the business are equitably distributed between the stakeholders, the owner has to monitor the way the business is run by managers. This monitoring takes various forms. These include periodic reports by managers to shareholders, audits, legislation and others.

The findings of this work seem to indicate that monitoring by stakeholders while necessary and positive, also tends to suppress aggressive innovation by management.

This has the effect of increasing agency costs. The organizations studied are only significantly monitored by members and statutory bodies. However public sector entities such as parastatals and state corporations have a wider array of interested stakeholders. These have a multiplicity of statutory monitoring bodies. These include the Kenya National Audit Office, the Treasury, the line ministry, and under certain circumstances Office of the President's Efficiency Monitoring Unit. They also include individual taxpayers and even more notorious, the media who in a number of cases are only interested in a sensational story. In addition to this there is also a multiplicity of legislation to adhere to in performing the day to day operations. These include the Procurement act, the State Corporations Act, the Audit and Exchequer act, and many others depending on the individual organization. The managers also have to be guided by the terms of their individual performance contracts which could be even conflict with the legislation. Assuming the same response to monitoring as the findings of this research, this would indicate an even higher sacrifice on efficiency.

A survey could be carried out on the decision making officers of the public sector entities to determine to what extent they are monitored by each monitoring body and the individual monitoring requirements that affect efficiency. It is expected that compliance with legislation such as the Procurement Act would be among the most cumbersome bottlenecks to efficiency. The risk of being reported negatively by the media is also a significant deterrent to innovative actions by public officers. The survey could also seek to determine to what extent each aspect of monitoring affects the efficiency of their operations.

Appendix 1: Background analysis on the absence of listed property securities in Kenya

		Property consultants		Investment managers		Pension fund trustees		Co-op officials		Average	
	Issue	Total respondents	Respondents in agreement	Total respondents	Respondents in agreement	Total responden ts	Respondents in agreement	Total respondents	Respondents in agreement	Total respondents	Respondents in agreement
1	Thought entreprenuers did not know the advantages of being listed.	12	10	10	6	5	3	6	6	33	25
2	Knew of the Nairobi Stock Exchange	12	12	10	10	5	5	6	6	33	33
3	Had investment in shares listed at the Nairobi Stock Exchange or any other exchange	12	7	10	8	5	3	6	2	33	20
4	Knew the requirements for being listed at the Nairobi Stock Exchange.	12	0	10	8	5	2	6	0	33	10
5	Could count off-head three advantages of being listed.	12	3	10	10	5	3	6	0	33	16
6	Thought that property owners did not want to reveal details of their investments.	12	12	10	10	0	0	0	0	22	22
7	Thought that REIT type taxation would spur property securitization	12	3	10	10	5	3	6	1	33	17
8	Felt that the market prices at the exchange were not related to the performance.	12	10	10	5	5	5	6	6	33	26
9	Had or was planning to invest in property other than owner occupied property	12	12	10	8	5	5	6	6	33	31
10	Had or planned to have more than 50% of their wealth in real estate other than dwelling	12	9	10	3	5	3	6	5	33	20
11	Thought that Kenyan investors were familiar with the Nairobi stock exchange	12	8	10	6	5	3	6	2	33	19
12	Thought Kenyan property entreprenuers knew how to invest in the stock exchange	12	4	10	4	5	2	6	2	33	12

Appendix 2: Opinions on investment in listed property securities

		Property consultants		Investment managers		Pension fund trustees		Co-op officials		Average	
	Issue	Total respondents	Respondents in agreement	Total respondents	Respondents in agreement	Total respondents	Respondents in agreement	Total respondents	Respondents in agreement	Total respondents	Respondents in agreement
1	Would be ready to invest in securitized real estate	12	12	10	10	5	5	6	6	33	33
2	Would prefer to invest in real property compared to a similar amount in property shares	12	10	10	7	5	4	6	5	33	26
3	Thought the risk return characteristics favored own property to shares of listed property.	12	12	10	3	5	4	6	5	33	24
4	Thought that preferential taxation would spur property securitization	12	1	10	10	5	3	6	1	33	15
5	Felt the returns from own property would be higher than the returns from shares in listed property.	12	12	10	3	5	4	6	5	33	24
6	Knew of the tax advantages allowed for newly listed companies.	12	3	10	8	5	2	6	0	33	13
7	Thought property securitization would improve the property sector	12	5	10	10	5	4	6	2	33	21
8	Would advise clients or members to invest in shares of listed property.	12	8	10	10	5	3	6	2	33	23
9	Would advise clients or members to list properties in the stock exchange.	12	6	10	10	5	1	6	0	33	17

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