

**UNIVERSITY OF NAIROBI
SCHOOL OF LAW
MASTER OF LAWS**

**REAL ESTATE INVESTMENT TRUSTS: AN ALTERNATIVE
SOURCE OF FUNDING FOR CONSTRUCTION AND
DEVELOPMENT IN KENYA**

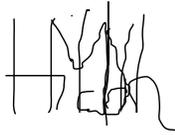
**A THESIS SUBMITTED TO THE SCHOOL OF LAW IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF
LAWS (LL.M) OF THE UNIVERSITY OF NAIROBI.**

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G62/77608/2009

DECLARATION

I, **HILDA MARIGU NJERU**, do hereby declare that this is my original work and has not been submitted and is not currently being submitted for a degree in any other University.



SIGNED..... **Date**.....**18TH JUNE 2015**.....

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This thesis has been submitted with my approval as the University of Nairobi Supervisor.

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God bless you all.

DEDICATION

TO MY PARENTS

For raising me to believe that anything is possible

TO OBADIAH

For making everything possible

TO AUSTIN

For believing that Mommy is everything possible

LIST OF ABBREVIATIONS

CBK	.....	Central Bank of Kenya
CMA	.....	Capital Markets Authority
D-REIT	.....	Development and Construction REIT
GDP	.....	Gross Domestic Product
IRA	.....	Insurance Regulatory Authority
I-REIT	.....	Income Real Estate Investment Trust
RBA	.....	Retirement Benefits Authority
REIT	.....	Real Estate Investment Trust
USA	.....	United States of America
US SEC	.....	US Securities and Exchange Commission
UK	.....	United Kingdom

LIST OF STATUTES

Constitution of Kenya 2010.

Capital Markets Act, Cap 485A Laws of Kenya.

Income Tax Act, Cap 420, Laws of Kenya.

Land Registration Act 2012.

Land Titles Act 2012.

Valuers Act, Cap 532 Laws of Kenya.

Retired Benefits Act, Cap 187 Laws of Kenya.

The Insurance Act, Cap 487 Laws of Kenya.

Stamp Duty Act, Cap 480 Laws of Kenya.

Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) 2013.

Capital Markets (Collective Investment Schemes) Regulations 2001.

ABSTRACT

This thesis underscores the fact that real estate investment trust (REIT) is a viable financing alternative for construction and development and highlights the need to make REITs an attractive investment product to boost its uptake in this country.

The study looks at the accessibility of REITs and researches on what can be done to make REITs accessible to a larger pool of investors. One of the ways this can be done is by giving tax incentives such as reduced taxation to investors and developers to consider REITs as an investment tool. The study points out that the existing legal framework has various entry barriers and fails to offer sufficient incentives to the structure of REITs so as to make it attractive to investors.

The study also looks at one unique type of REITs that is proposed to be introduced in Kenya and how it is fundamentally different from the historical REIT as it is known.

The study concludes that the establishment of real estate investment trusts is a positive step towards increasing investment options as well as sources of harnessing funds for development, but more needs to be done to make it accessible and affordable as an investment product and thus increase its uptake in Kenya.

TABLE OF CONTENTS

DECLARATION	ii
ACKNOWLEDGMENT	ii
DEDICATION	iii
LIST OF ABBREVIATIONS	iv
LIST OF STATUTES	v
ABSTRACT	vi
TABLE OF CONTENTS	vii
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the study	1
1.2 Statement of the Problem.....	5
1.3 Objectives of the study.....	6
1.4 Research questions.....	6
1.5 Hypothesis.....	7
1.6 Literature review.....	7
1.6.1 Real Estate Investment Trusts.....	9
1.6.1.1 Accessibility of REITs as an Investment Product.....	10
1.6.1.2 Incentives as a means of making REITs an attractive investment	16
1.6.1.3 REITs for Long-term Benefits: Development and Construction REITs.....	22
1.6.2 Conclusion	24
1.7 Justification of the study	25
1.8 Theoretical Framework.....	26
1.9 REITs Conceptualized	28
1.10 Research methodology	30
1.11 Limitations of the study	31
1.12 Projection of the Study.....	31
1.12.1 Chapter One: Introduction and Background	31
1.12.2 Chapter Two: REITs as an Investment Product	32

1.12.3	Chapter Three: REITs in Kenya.....	32
1.12.4	Chapter Four: Development and Construction REITs	32
1.12.5	Chapter Five: Conclusion and Recommendations	33
	CHAPTER TWO	34
	REITs AS AN INVESTMENT PRODUCT	34
2.1	Introduction.....	34
2.2	Understanding REITs.....	36
2.2.1	Unincorporated Associations	36
2.2.2	Distributions.....	37
2.3	Accessing REITs.....	38
2.3.1	Listed versus unlisted REITs	38
2.3.2	Minimum size	42
2.3.3	Management and ownership	43
2.4	Conclusion	46
	CHAPTER THREE.....	47
	REITs IN KENYA.....	47
3.1	Introduction.....	47
3.2	Challenges hampering the uptake of REITs.....	47
3.2.1	Regulatory processes.....	47
3.2.2	Restrictive legal regime	48
3.2.3	Fundamentals of real estate.....	49
3.2.4	Listed or unlisted?.....	50
3.3	Tax Incentives as a means to raise up take of REITs.....	51
3.3.1	Income Tax incentives for REITs	52
3.3.1.1	Incentives under the Income Tax Act	54
3.3.2	Stamp duty tax	57
3.4	Conclusion	59
	CHAPTER FOUR.....	60

DEVELOPMENT AND CONSTRUCTION REITs	60
4.1 Introduction.....	60
4.2 The Development and Construction REIT (D-REIT).....	61
4.2.1 Investments and borrowing by a D-REIT	61
4.2.2 Ownership and Management of a D-REIT	63
4.2.3 Distributions and Taxation of a D-REIT.....	66
4.3 Potential challenges to the D-REIT structure.....	66
4.4 Conclusion	68
CHAPTER FIVE	69
CONCLUSION AND RECOMMENDATIONS	69
5.1 Introduction.....	69
5.2 Proposed Policy and Operational Reforms	71
5.3 Conclusion	72
REFERENCES	74

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The Africa Development Bank recently conducted a research on African housing dynamics, with specific focus on the Kenya housing market.¹ The research noted that while much of the literature on the housing topic revolves around the concept of housing as a social need and hence attracting a lot of government and international funding in the form of social housing projects, the private sector also has a role to play in expanding housing supply in Kenya.

The research found that one of the major impediments for increased housing supply was access to finance, both for developers and buyers. The research noted that adequate funding system to facilitate mortgage provision was lacking and that the banking sector is still not in a position to offer the long-term finance that the housing sector needed and therefore alternative financing schemes need to be deployed.

More importantly, the research recommended that equity provision for developers would be a good alternative as this limit excessive debt leveraging of real estate developments. It was noted that the lack of equity finance in the residential housing sector has been a critical constraint contributing to the insufficient housing in several countries across the continent. Housing developments with too low equity make it difficult to access debt finance for construction, resulting in no margins for delays or in cost over-runs.

¹ Arvanitis, Y., 'African Housing Dynamics: Lessons from the Kenyan Market' (2013) 43 *AfDB Chief Economist Complex*.

REITS presents an affordable means for investors to participate in the real estate sector by buying securities (equities) which resemble unit trusts and is a funding option that sits very well with the research that has been conducted on the area of alternative funding for real estate development.

A Real Estate Investment Trust (REIT) is a mutual fund that pools together the capital of many investors to acquire a portfolio of income-producing properties.² Typically a REIT is an entity that restricts its investments to real estate and is owned by unit holders who acquire units in the trust.³

More particularly, Real Estate Investment Trusts, REITs, can be defined as collective investment undertakings the objective of which are acquiring, holding, administering, managing and selling income generation local and foreign real estate properties, either directly or indirectly.⁴

REITs give the investors the possibility to operate on real estate market without actually buying and selling properties and the cash flow that real estate provides but with the benefit of a common stock's liquidity.⁵

The role of the capital markets in an economy is to provide equity capital and infrastructure development capital that has strong socio-economic benefits - roads, water and sewer systems, housing, energy, telecommunications and public transport.⁶

² Block R. L., *Investing in REITs: Real Estate Investment Trusts*, (A.I.T.B.S Publishers and Distributors 2000) at 25.

³ *Ibid.*

⁴ McCall J. H., 'A Primer on Real Estate Trusts: The Legal Basics of Reits', (2001) *The James L. Clayton Center for Entrepreneurial Law of The University of Tennessee College of Law* at 3.

⁵ *Ibid.*

⁶ http://www.cma.or.ke/index.php?option=com_content&view=article&id=11:what-is-the-role-of-capital-markets-in-an-economy&catid=11&Itemid=217 accessed on July 18, 2013.

REITs as a financing model within the larger capital market eco system, has been used to provide the necessary vehicle to facilitate the participation by retail and institutional investors as well as both private and government agencies in raising capital for development of housing and other real estate development projects.⁷

The question that now begs is, with the noted inadequate supply of real estate and the challenges that attend to obtaining funding for both developers and buyers, why is the REIT alternative not gaining momentum?

This paper seeks to delve into the matter of REITs in Kenya. The paper analyzes some of the fundamental concepts that make REITs an attractive investment and those that preclude it from easy accessibility, which concepts must be addressed for REITs to be successfully introduced in the Kenyan market.

Unlike in developed nations, Kenyan investors do not invest in real estate so that they can earn modest regular income. These investors have plenty of other options to earn that — bank deposits that deliver 9 per cent, small savings schemes that offer 8-9 per cent, stocks and debt mutual funds that offer similar returns with any-time liquidity. When a Kenyan investor buys property, he's looking for an investment that delivers hefty capital gains and soundly trounces inflation over the long term.⁸

While policymakers are looking at REITs as a fixed-income option that will invest in commercial property, retail investors would prefer to bet on residential property for capital

⁷ *Supra*, n 4 at 3.

⁸ Noppen A.V., 'The ABCs of Affordable Housing in Kenya', (2012) *Acumen Fund* at 12.

gains.⁹ To make retail investors change their mindset, REITs will have to generate returns that are far higher than the fixed income options that are already available to the Kenyan investor.

Of course, all this does not even take into account the structural grey areas in the Kenyan real estate market. These include the endemic land issues and the inhibitive market stakeholder structure wherein only a handful of Kenyans can afford to develop or buy real estate.¹⁰

It is my opinion that a more stringent and water-proof but facilitative regulatory framework is needed to support REITs to usher in much-needed transparency, best practices and good governance into the sector. The REIT regime needs to be attractive enough to make it the preferred ownership vehicle for real estate.

The Capital Markets Authority gazetted the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations, 2013.¹¹

These Regulations constitute a legal framework that will facilitate participation in the secondary real estate investments market through the securities exchange.

The Regulations compare favorably to similar structures in other countries.¹² They have attempted to provide a framework for the introduction of a platform through which a bigger scope of investors can participate in real estate ownership thereby increasing capital availability in the real estate sector.

⁹ *Ibid.*

¹⁰ *Supra*, n 1 at 3.

¹¹ The Capital Markets Authority drafted and put on public exposure the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations in the year 2012, but it was not until June 18, 2013 that the regulations were gazetted by the Cabinet Secretary to the National Treasury via Legal Notice Number 116. Although this study was undertaken for the most part using the draft regulations, the gazetted regulations have not changed much from the draft hence the gazettement of the regulations has not had a significant effect on the course of this study.

¹² These Regulations borrow heavily from the REITs Regulations in Hong Kong. The Regulations also compare with those in the US, Canada, Australia and many other jurisdictions in which REITs have been adopted.

However, this regulatory framework falls short of meeting the threshold of accessibility, desirability and effectiveness and does not therefore offer REITs as an alternative platform that can be explored in sourcing funding for capital development in this country.

As will be discussed later in this paper the regulations and the tax incentives given there under offer little incentive to attract investors to invest in this new product as opposed to investing in the existing investment products. Moreover, the entry limits the regulations suggest are way beyond the reach of many small scale investors, who are presumably the target markets of the REITs.

1.2 Statement of the Problem

The problem this research seeks to address is the barriers and gaps in the legal and regulatory framework for REITs in Kenya that are making it difficult for their uptake.

The lack of an effective and facilitative legal framework for real estate investment trusts has been a major limitation to the exploration of the capital markets platform as both an investment option and as an alternative avenue in provision of funds for the development of infrastructure in this country.¹³

A new regulatory framework for REITs has been recently formulated in Kenya.¹⁴ However, as will be discussed in this paper, this framework has some legal gaps in that it does not offer incentives that can attract investors to take up REITs as an investment product. The framework also has entry barriers as to who can invest in REITs due to the high entry limits it provides for,

¹³ Capital Markets Authority, 'A Study on the Viability of Real Estate Investment Trusts in Kenya' (*Vista Capital Limited 2008*), Nairobi, Kenya at 3.

¹⁴ Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations 2013.

thus making REITs inaccessible to a large majority of investors. Hence to date there is not a single REIT structure established in Kenya.

1.3 Objectives of the study

This research will explore the objective of how the REITs can be made an attractive investment option as an additional capital markets investment and capital raising tool through the removal of the existing legal and regulatory barriers.

More particularly, this study will attempt:

- I. To look at how REITs can be made more accessible to a larger number of investors in Kenya, particularly the less affluent and small scale investors;
- II. To analyze the incentives that can support the legal framework for REITs in Kenya;
- III. To analyze the development and construction REIT as a special type of REIT;
- IV. To suggest proposals on how barriers and weaknesses identified in the legal framework can be remedied so as to make the REITs an attractive investment product in the real estate sector.

1.4 Research questions

This research aims at identifying and filling in gaps relating to accessibility and attractiveness of the REITs as an investment product in Kenya.

The specific research questions include:

- I. Does the current legal framework on real estate investment trusts adequately address the issue of making REITs accessible to investors to enable them participate in the capital markets?

- II. Does the current framework offer enough incentives to make REITs an attractive investment tool in Kenya?
- III. What are development and construction REITs and how do they work?
- IV. How can the barriers identified be remedied so as to make the REITs an attractive investment product in the real estate sector?

1.5 Hypothesis

This study is based on the hypothesis that there is a legislative and regulatory barrier in the regulation on real estate investment trusts; that this barrier is hindering accessibility of the REITs as capital markets investment product in Kenya.

The current regulatory framework does not make it easy to access REITs as an investment product for the ordinary small scale investor. Further, there are no sufficient incentives that would induce investors to consider investing in REITs.

The barriers ought to be eliminated to make it possible investors to take up REITs as an investment platform. More incentives are needed to boost the uptake of REITs in Kenya.

1.6 Literature review

A lot of literature has been written on the area of investments generally. However, most of the research done in the area of investments in REITs has been done in other jurisdictions, and notably mostly in the developed countries. Thus, little has been written on the subject of REITs in the developing world. Additionally, whereas the literature is rich on the commercial and infrastructure development aspect of real estate, there is limited literature on the legal aspects of REITs and specifically the development and construction REIT.

According to Enrol, historically infrastructure has been procured and funded by the public sector, with the taxpayer taking both the responsibility and risk of asset delivery (or lack of) cost and operation.¹⁵

Enrol writes that in order to share the burden of financing and overcoming constraints imposed by the public sector budgetary process, governments have recently begun turning to the private sector to assist in the development of infrastructure.¹⁶ Brueggeman opines that investors world over are keen to maximise their returns by putting their money in investments that offer a certain degree of certainty of returns.¹⁷ Carr writes that real estate investment trusts has been identified as one such financing model.¹⁸ These studies are significant to this study as they provide important background literature on the concept of REITs that is the topic of Chapter 2 of this thesis.

However, REITs are yet to take root in Kenya. As it will be seen later in this paper, the recently introduced legal framework for REITs contains a number of legal barriers and gaps that pose a challenge to the uptake of the product as an alternative investment product in Kenya.

This thesis thus seeks to research into a brief history on the concept of REITs, accessibility of REITs as an investment, incentives that are necessary to increase its take up as well as research into the development and construction REIT as a special REIT.

¹⁵ Erol T., Ozuturk D.D., 'An Alternative model of infrastructure financing based on capital markets: infrastructure REITs (InfraREITs) in Turkey', (2011) 32 3 *Journal of Economic Cooperation and Development* at 66.

¹⁶ *Ibid.*

¹⁷ Brueggeman W.B., Fisher J.D., *Real Estate Finance and Investments*, (13th Edition, McGraw-Hill/Irwin: New York 2008) at 134.

¹⁸ See Carr, J., 'Consultation on the potential for a social housing REIT to support the social housing sector', (2012) *National Housing Federation*, United Kingdom at 3.

1.6.1 Real Estate Investment Trusts

REITs are an investment vehicle that originated in the United States initially to overcome restrictions on collective real property ownership. Many articles and journals have been written to examine the characteristics of REITs in a rigorous and scientific manner. However, there is not much literature on REITs outside academic commercial and financial aspects of real estate. There is even less literature on REITs in Africa as a whole and specifically in Kenya. The majority of academic literature focuses on the REIT story in the U.S, Canada and Australia; many of the professional journals are U.S. or Canada-based with relatively little attention paid to developments overseas.¹⁹

According to Brueggeman, the concept of real estate investment trust goes back to the 1880s.²⁰ The writer notes that in the early years, trusts were not taxed if trust income was distributed to beneficiaries. After World War II the need for large sums of money to invest in real estate renewed interest in more extensive use of the real estate investment trust and a campaign was started with the aim of achieving for the REIT special tax treatment as was the case initially. In 1960 Congress passed the necessary legislation that gave REITs the necessary special tax consideration.²¹

A REIT is thus an entity that aggregates the capital of many investors to acquire a portfolio of income-producing properties or, in the case of mortgage REITs, to provide financing in the form of real estate-secured mortgage loans.²²

¹⁹ Andrieux B., 'Developing a National Framework for Introducing REITs in China - a Lengthy Process', (2010) *Shanghai China*, at 7.

²⁰ *Supra* n 17 at 621.

²¹ *Ibid.*

²² *Ibid.*

Brueggeman has written a great deal on the investment opportunities attending to real estates investments trust. His work however, focuses on the financial and investment returns rather than the legal aspects of REITs.

Block notes that one of the advantages of REITs is that they allow a property developer to gain capital from its real estate portfolio by placing it in a trust and listing it on a securities exchange.²³ This is then tradable, and the capital realized from its sale can be reinvested. This guarantees a steady flow of capital to the real estate investment sector.²⁴

Meretsky opines that investment restrictions, level of gearing, distribution requirements, corporate governance, and control of REIT status, sanctions for the loss of REIT status and adjacent regulations for institutional and private investors are also key pillars of a successful REIT regime.²⁵

The works by Brueggeman, Block and Meretsky are important in that they provide the necessary history and background on REITs that forms the backbone of Chapter 2 of this thesis. However, none of these works discusses the topic of REITs in Africa and more specifically in Kenya where REITs have not been introduced before. This thesis seeks to study the introduction of REITs in Kenya, identifying possible challenges and entry barriers to investing in REITs that are specific to the Kenyan content as well as proposing recommendations on how these can be eliminated.

1.6.1.1 Accessibility of REITs as an Investment Product

²³ *Supra* n 2 at 18.

²⁴ *Ibid.*

²⁵ Meretsky J., 'Real Estate Investment Trusts: An Analysis of the Investment Vehicle and Income Tax Implications', (1995) 53 *University of Toronto Faculty of Law Review* at 8.

Real Estate Investment Trust (REIT) is a financial vehicle that securitizes properties and allows private sectors to invest and trade securities of real estate.²⁶

A REIT is similar to a collective investment mutual fund that restricts its investments to real estate. Collective investment vehicles are financial structures for pooling and managing the monies of multiple investors.²⁷ Investors cede significant control over their money to professional managers who in turn make investments for the fund.

These funds enable investors to buy securities in companies that they could not otherwise hold due to the transaction cost, legal restrictions or lack of expertise.²⁸

Block notes that the REIT as structured currently has existed on the financial markets in the U.S. since the 1960s.²⁹ He writes that the REIT structure was officially sanctioned by Congress and signed into law in 1960, allowing individual real estate investors to pool their investments in order to enjoy the same benefits that were already available to large institutional investors, of owning and financing significant commercial real estate on a tax-advantaged basis.³⁰

Block notes of the 1960 law:

This legislation's goal was to enable small investors to pool their wealth in a single business enterprise, thereby collectively improving their access to investments in larger

²⁶Yuxuan, H., 'An investigation into the use of REITs to finance affordable housing in Mainland China', (2010) *Massachusetts Institute of Technology, Cambridge, Massachusetts* at 2.

²⁷ Capital Markets Authority, 'Investor Education, Collective Investment Schemes: What You Should Know' (2012), *Nairobi, Kenya* at 1.

²⁸ *Supra* n 25 at 567.

²⁹ *Supra* n 2 at 19.

³⁰ *Supra* n 2 at 121.

*income-producing commercial real estate programs, an opportunity that was largely unavailable to the average small investor.*³¹

The general objective of establishing REITs is to ensure that ownership of the REIT is widely spread and not restricted to a few people.³² Block writes that unlike the preferred open-ended structured for Collective Investment Schemes, the best structure for REITs is close-ended.³³ This is due to the illiquid nature of property investments. Closed-end funds generally do not continuously offer their shares for sale and are therefore permitted to invest in a greater amount of illiquid investments than mutual funds are.³⁴

Block notes that if the funds were structured as open-ended, managers could continually have to liquidate property investments so as to cash-out investors. As property takes a much greater length of time to liquidate this would greatly restrict REITs managers.³⁵ To meet this potential liquidity requirement they would be forced to keep a very large portion of the fund in cash. This would likely dampen investment returns for all investors, but particularly those investors with long-term investment horizons.³⁶ Globally, the vast majority of REITs are close-ended for this reason. For the individual retail investor a REIT is quite a convenient structure since the investor does not actually purchase the physical asset, but purchases trust units that give the investor access to the trust's cash flows from the rental income of a pool of revenue-generating properties.³⁷

³¹See *Supra* n 4 at 1.

³²*Supra* n 4 at 3.

³³*Supra* n 2 at 67.

³⁴*Ibid.*

³⁵*Ibid.*

³⁶*Ibid.*

³⁷*Ibid.*

However, this very preference for REITs to be closed-ended may pose as an entry barrier in that a lot of small scale investors are interested in investing in a product where they can exit easily. A closed-ended REIT is very restrictive on how to exit and Block's study offers suggestions that may work as entry barriers in the Kenyan set up.

Block has delved into the question of the legal form and access to REITs a great deal. The book offers insights into how the concept of REITs was born, the legal form of an investment Trust that has transcended centuries and how REITs have evolved over the years to fulfil the initial intention of the founders of small investors pooling resources together to invest in real estate. However, his work is based on the history and situation on the ground in the US which is a very sophisticated market with a well developed savings and investments culture and which has had REITs since 1863 and has had the opportunity to undergo various experiences and derive lessons from them. His opinions and recommendations are thus derived from a century and a half of experience with the REIT product but they offer no recommendations for jurisdictions that are still grappling with cultivating an investing culture amongst its people and are just introducing the concept to their investors and what would be the best model to adopt for increased up take of the same.

Kenya is still a nascent market with a very poor saving culture³⁸ as situation on the ground. Currently there is not a single REIT in the market. This current study investigates the gap in the law and the implementation thereof in the area of making REITs accessible as an investment product in Kenya.

³⁸ Ipsos-Synivate, 'Kenya's poor saving culture hurts growth, investment prospects' (2011) *Nairobi*.

Another accessibility question is the issue of whether a REIT ought to be listed or not. According to Meretsky, a REIT is owned by unit holders who acquire shares, which in the case of publicly-traded REITs, are listed on a major stock exchange.³⁹ The REIT investor receives a security, in the form of a share or unit, which entitles the investor to an unspecified proportionate share of the assets in the REIT trust. REITs are typically designed to enable the investing public to benefit from investments in large-scale real estate enterprises.⁴⁰ Listing on a securities exchange is therefore one of the ways that makes REITs accessible. However, such listing has to be reasonably priced for it to meet this objective.

Chan notes that REITs have been noted to behave significantly differently from other stocks and have certain unique characteristics that other stocks do not have. This is largely due to REITs unique trust structure and tax regulations.⁴¹

In markets where publicly listed REITs are available, individual investors can choose to participate broadly in the investment opportunities available in the property market by investing in REIT mutual funds. These are managed by portfolio managers with a high degree of expertise in the real estate industry and provide investors with an effective and cost-efficient opportunity to add to a balanced investment portfolio broad and diversified exposure to the real estate asset class.⁴²

McCall notes that unlike direct real estate investment which requires a lengthy transaction process, REITs securities can be bought or sold on the securities exchange at any time.⁴³ Listing

³⁹*Supra* n 25 at 96.

⁴⁰ *Ibid.*

⁴¹ Chan S.H., Erickson J., Wang K., *Real Estates Investment Trusts: Structure, Performance and Investment Opportunities*, (2003) Oxford University Press at 7.

⁴² *Ibid* at 54.

⁴³ *Supra* n 4 at 5.

in the stock market makes it possible for investors to invest in the real estate market with a small amount of money.⁴⁴

Crompton S notes that prices of REITs IPO can range from one dollar to as high as one hundred dollars per unit.⁴⁵

In Kenya investors do not have access to real estate through the secondary market since all property investment is either directly through the direct purchase of property or through the private placement of equity or debt of privately held real estate or property companies.⁴⁶

Additionally, there is very limited information on property investment. Information such as where the property is located, who is the owner and how much it is valued at is closely guarded by the affluent and is generally unavailable to the common investor.⁴⁷

Therefore, many investors only have exposure to the property market through their purchase of an owner-occupied residential property, which only a small percentage of the population can afford.⁴⁸

Gichuki, N notes that there is a very low penetration of the alternative financial model with estimates indicating that only 19% of the adult population invests in the capital markets, with particular emphasis to investment in shares.⁴⁹ Gichuki's work is important in that it identifies the challenge of low penetration of capital markets amongst the populace in Kenya, thereby evidencing the gap in the implementation of the law on capital markets in general. This paper

⁴⁴ *Ibid.*

⁴⁵ Crompton S., 'REITS: There's just no one else', (2010) 28 *International Financial Law Review* at 4.

⁴⁶ Capital Markets Authority, 'Presentation on Real Estate Investment Trusts', (2013) *Continuing Professional Development Workshop, Kenya School of Law, Nairobi.*

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

⁴⁹ Gichuki N., 'The Paradox in the Implementation Matrix in Capital Markets Reforms in Kenya', (2011) *Workshop on Emerging Trends in Commercial and Financial Law (Banking Law, Capital Markets Law and Corporate Governance)* KCB Leadership Centre, Karen, Nairobi, at 10.

seeks to build on the gaps identified and attempts to make proposals on how REITs can be made more accessible to a larger population, especially the less affluent investors to boost investment in capital markets.

The World Bank paints a grim picture of the Kenyan population in terms of poverty level. It is reported that 48% of the Kenyan population lives below the poverty line.⁵⁰ An even greater percentage (74%) earns less than five hundred dollars per month.⁵¹ These statistics show that a very small percentage of Kenyans have the capacity to participate in real estate investments. This is so considering the prices of property are very high⁵², and as noted above only a very small percentage of the population can afford.

Meretsky, Chan, McCall and Crompton do not delve into the question of possible barriers to trading the REITs securities on the exchange and what impact such barriers would have on the securities investors. This study investigates the barriers in the law in the area of listing and trading REITs securities on the securities exchange.

For REITs to be accessible to a larger population other than the affluent investors in Kenya, the units must be favourable priced and easily tradable at the securities exchange.

1.6.1.2 Incentives as a means of making REITs an attractive investment

⁵⁰ <http://data.worldbank.org/country/kenya> accessed on November 8 2013. This poverty line is determined and based on the expenditure required to purchase a food basket that allows minimum nutritional requirements to be met and is currently estimated to be about KSh.1, 239 and Ksh. 2,648 for rural and urban households respectively.

⁵¹ *Ibid.*

⁵² Ministry of Housing, Proposed Housing Sector Incentives & Market Re-Engineering Measures (2007) *Ministry of Housing, Nairobi*. According to this report, the lowest market price for a three bedroomed bungalow is not anything below four million, and in some areas that price is even as high as eight million.

REITs originated in the US in the 1960s and are now well established in the US, Europe, Australia and Asia. The REIT model is recognised and understood by large and institutional investors and is therefore more attractive to these investors.

Buenning notes that governments influence investments in a number of ways. Most directly, they define the legal and fiscal regulations such as taxation of funds and capital markets. Governments also determine the macro economic and regulatory environment for private activities in the economy generally.⁵³

Tax has been defined as a compulsory levy imposed by an organ of government for public purposes.⁵⁴ The law requires that tax must be paid. There are several types of taxes, including income tax that can broadly be defined as taxation on income. Capital gains tax is a tax imposed on the gain represented by the difference between the price at which an item was acquired and the price at which it was sold.⁵⁵

Williams and Morse write that taxation of trusts has a kind of a two tier system: to some extent income tax is charged on the trustees (or the trust as a body) and to some extent it is charged on the beneficiaries.⁵⁶ The income tax payable by the trust is charged on income arising to the trust if it is to be accumulated or is payable to beneficiaries at the discretion of the trustee.⁵⁷

A tax incentive is defined as a provision that grants any person or activity favorable conditions that deviate from the normal provisions of the tax legislation. This impacts the person in a

⁵³ Buenning, M., 'Reits take shape in draft law', (2006) 17 52 *International Tax Review* at 3.

⁵⁴ Williams D.W., Morse, G., *Principles of Tax Law* (5th Edition, Sweet and Maxwell: London 2004) at 3.

⁵⁵ *Ibid* at 12.

⁵⁶ *Ibid* at 180.

⁵⁷ *Ibid*.

positive manner, for that person or activity or any measure that provides for a more favorable tax treatment of certain activities or sectors compared to what is available to the general industry.⁵⁸

Today the REIT has a tax advantage in that it is not subject to corporate tax. The REIT must however pay out 95% of its net income to its shareholders as distributions in order to enjoy this tax advantage.⁵⁹

Marvin S K notes that the REIT as an investment enjoys a number of tax incentives that make it an appetizing form of investment.⁶⁰ If a regulated investment company⁶¹ meets certain statutory tests and distributes at least ninety per cent of its ordinary income, it is taxed only on its undistributed income. The investment company thus avoids the tax imposed on corporate income generally, and accords the investment company's shareholders substantially the same tax treatment that they would have received had they held directly their proportionate share of the investment company's portfolio.⁶²

Marvin further notes that another objective Congress had in creating the REITs was to extend the same type of tax treatment to real estate investment trusts specializing in investments in real estate equities and mortgages as is already accorded to stock and security holdings of regulated investment companies. This special treatment would tax the beneficiaries of the REIT in substantially the same manner as if they had held the real estate equities and mortgages directly.⁶³

⁵⁸ Institute of Economic Affairs, 'Tax Incentives and exemption regime in Kenya: Is it working?' (2012) 30 *Institute of Economic Affairs Budget Information Programme* at 2.

⁵⁹ *Supra* n 4 at 52.

⁶⁰ Marvin S. K., 'Taxation of Real Estate Investment Trusts', (1962) 48 *Virginia Law Review* at 1012.

⁶¹ As defined in the Internal Revenue Code of the US.

⁶² *Supra* n 60 at 1012.

⁶³ *Ibid* at 1013.

Marvin notes that this conduit treatment is desirable since the REIT constitutes a pooling arrangement whereby small investors can secure advantages normally available only to those with larger resources.⁶⁴

Marvin opines that the main tax incentive provided is that a qualifying trust would not be taxed on income distributed to the beneficiaries.⁶⁵ He however, makes no recommendation for reduction of the beneficiary level taxation rate or its removal altogether, albeit for a period, as another tax incentive. This study makes a case for reduced taxation at beneficial level or ‘zero-rated’ REITs for purposes of giving small scale investors an incentive to invest in REITs.

Meretsky J notes that the trust entity is not subject to tax when all income and capital gains are distributed on an annual basis.⁶⁶ He notes that income from the REIT is generally subject to tax at the investor level only and in most cases, little or no income tax liability will arise because of the capital cost allowance and interest deductions inherent in real estate.⁶⁷ However, just like Marvin, Meretsky only focuses on tax incentives that benefit the REIT and has made no suggestions on reduction of taxation on the beneficiary level and what impact such an incentive would have on the uptake of REITs.

McCall writes that the significant advantages available to entities qualifying for REIT tax treatment are the keys to their success and growth during the 1990s. A REIT generally is not subject to corporate income tax to the extent that it distributes the lion's share of its earnings to

⁶⁴ *Ibid.*

⁶⁵ *Supra* n 45 at 595. For a trust to qualify for these tax incentives, it had to meet certain requirements which assured that the trust was primarily involved in the real estate business. The trust was also prohibited from offering property for sale to customers in the ordinary course of business and additionally must contract with an independent contractor to provide services to the tenants and to manage and operate the property.

⁶⁶ *Supra* n 25 at 102.

⁶⁷ *Ibid* at 106.

its shareholders on a current basis. Pass-through tax treatment for REITs is achieved by allowing them a dividends-paid deduction.⁶⁸

Donaghy has gone into great lengths to expound various tax rationales for the REIT structure.⁶⁹ Her work however is focused on protecting tax revenues for the state and thus makes no suggestions on how investors can benefit from reduced taxation at beneficiary level.

Hamilton, Harrison and Mathews opine that the amount of tax to be levied as a REITs tax ought to be minimal.⁷⁰ This is to ensure that the tax so levied does not destabilize the market. This is mainly because the securities market is not very well developed in this country as is in other developed countries where REITs have taken root.

However, the study offers no literature on what specific level of taxation or how much tax incentive would lead to increased uptake of the REIT, especially for a market like Kenya. Additionally, there is no literature on the impact of such tax incentives, and in particular whether the removal of all taxation on the individual investor as an incentive would be an option worth consideration on the discussion of accessibility and uptake of REITs.

McCall notes that if an owner of appreciated real estate transfers the real estate to a REIT in exchange for REIT shares, such a transfer is taxable if it results in any material diversification of the owner's investment.⁷¹ In addition, even if there is no diversification of investment, taxable gain is recognized to the extent that the REIT assumes any liabilities encumbering the transferred

⁶⁸ *Supra* n 4 at 3.

⁶⁹ Donaghy D., 'Real Estate Investment Trusts (Reits): Tax Policy Rationale', (2013) *Business Tax Team, Fiscal Policy Division, Department of Finance, Ireland* at 71.

⁷⁰ Hamilton Harrison & Mathews, 'A guide to investing and doing business in Kenya', (2012) *Hamilton Harrison & Mathews, Nairobi* at 6

⁷¹ *Supra* n 4 at 9.

property in excess of the owner's basis in that property. Accordingly, it is generally unusual for appreciated real estate to be transferred directly to a REIT.⁷²

He notes that because transfers to a partnership are subject to more lenient tax rules than transfers to a REIT the existing owners typically are able to defer part or all of the taxable gain embedded in the transferred properties.⁷³

Other forms of tax incentives that can be made for REITs include taxes relating to transfer of property. The key tax in the transfer of property is stamp duty. In Kenya, all instruments relating to a transaction carried out and expected to be enforced in Kenya are required to be stamped with the requisite stamp duty.⁷⁴ The rates of the specific stamp duty chargeable vary depending on the instruments to be stamped.

According to Nabutola W, for a borrower to access financing for real estate, they are expected to meet stamp duty, legal fees and other consolidated fees.⁷⁵ The stamp duty fee can be quite high and inhibitive as it ranges within two to four percentage of the property purchase price depending on the location of the property.

Nabutola notes that the law on stamp duty was amended so that the rate of penalty on the principal amount of duty was reduced from 25% to 5% in 2010. This was done in order to reduce the penalty burden on new property owners and also encourage others who have not been able to effect transfers within stipulated period to come forward.⁷⁶

⁷² *Ibid.*

⁷³ *Ibid.*

⁷⁴ Stamp Duty Act Cap 28 Laws of Kenya.

⁷⁵ Nabutola, W., 'Affordable Housing – Some Experiences From Kenya', 2004 *Housing – Costs and Finance*, Nairobi at 5.

⁷⁶ *Ibid.*

There is a legal impediment because while the law was amended to reduce the rate on penalty for defaulters, the principle provisions of the law pertaining to the rates of stamp duty payable on transfer of property remain unamended and very inhibitive.

1.6.1.3 REITs for Long-term Benefits: Development and Construction REITs

Not much literature is available on a REIT that is set up primarily for purposes of developing property and later generating income from such property either from rental income or from capital gains upon disposal of such properties.

McCall notes that there are two primary categories of REITs: equity REITs and mortgage REITs. He notes that an equity REIT is a publicly traded company that buys, manages and maintains, and occasionally sells property. An equity REIT specializes in income-generating property ownership. By directly owning, investing in or acquiring or managing real property, an equity REIT derives its revenue primarily from income generated by rental and lease payments⁷⁷.

A mortgage REIT on the other hand makes and holds loans that are secured by real estate collateral.⁷⁸ A mortgage REIT invests in financing real estate owners and generates its revenue from the interest earned on such loans.⁷⁹

There is also another category of REITs, the hybrid REIT that is typically a hybrid of the equity and mortgage REIT.⁸⁰ Mortgage and hybrid REITs use debt to finance purchase of mortgage products.

⁷⁷*Supra* n 4 at 3.

⁷⁸*Supra* n 2 at 15.

⁷⁹*Supra* n 4 at 4.

⁸⁰*Ibid.*

McCall's work does not address the kind of a development REIT that owns and does the construction and development itself as opposed to a mortgage REIT which gives loans for this purpose. This paper seeks to delve into the topic of REITs that own and carry out development and construction of properties as contrasted to mortgage REITs.

According to Michael J Brill one of the threefold purpose Congress had in sponsoring the REIT enabling statutes was that the small investor should be able to participate in large-scale and diversified real estate investments and thereby gain the benefits previously available only to wealthy investors.⁸¹ Brill gives a rich judicial and legislative history of REITs. He also makes mention of the mortgage REIT, which makes construction and development loans as well as long term mortgage loans on real property.

However, just like McCall, his study does not address the element of a development REIT that owns and does the construction and development itself as opposed to his mortgage REIT which gives loans for this purpose. My work seeks to discuss construction and development REITs and does not delve into mortgage REITs.

Block notes that it is not common for REITs to engage in property development, the historical REITs is one that owns already income-generating property.⁸² This is because a development venture is an exceedingly risky affair for the traditional REIT whose main focus is a structure that yields returns almost immediately. His work therefore, just likes McCall and Brill, has no recommendations on how a D-REIT ought to be structured for accessibility.

⁸¹ Brill M.J., Real Estate Investments Trust, A current Assessment', (1973) 39 *Brooklyn Law Review* at 592.

⁸² *Supra*, n 2 at 74.

Gumbs⁸³ notes that a development REIT may be a good source of relatively inexpensive capital for construction and development and the developer may be able to obtain more financing than would otherwise be available with conventional financing. He opines that in real estate, development activity is what creates more value than any other business initiatives and that the practice of real estate development was becoming more institutional and less of an individual investment. His study is thus focused on opening up development REITs to create wealth and provide capital access to institutional investors and high net worth entrepreneurs to enable them enhance their already existing real estate investments.⁸⁴ This paper focuses on the development and construction REIT as an investment opportunity and avenue for individual small scale investors to access real estate investments that they would otherwise not access due to the high capital requirements of putting up a real estate development.

According to CMA, the traditional REIT structure as is found in most jurisdictions was deemed not to meet Kenya's policy objectives and those of Vision 2030. A unique approach was therefore required in order to balance the policy objectives of developing robust capital markets, giving effect to Vision 2030 as well as building on lessons learnt from the global financial crisis that was witnessed in the 2008 to 2010 period.⁸⁵ Hence the concept of the development and construction REIT, or the D-REIT as it is now called.

1.6.2 Conclusion

Based on the above literature review, it can be concluded that there is a literature gap on the area of making REITs more accessible in the Kenyan market. The main gap is on the gap in the law

⁸³ Gumbs, B., *The Viability of the REIT Structure as a Vehicle for Real Estate Development* (1997) *Yale University* at 28.

⁸⁴ *Ibid*, at 93.

⁸⁵ *Supra* n 47.

and its implementation. There are specific literature gaps on the topic of the elimination of entry barriers and limitations for investors. There are also literature gaps on what would be ideal taxation incentives for REITs and how much of incentive will yield the required uptake levels.

There is also a literature gap on the subject of development and construction REITs and how best it can be rolled out, the extent of risks it carries as well as the general impact of a development and construction REIT on the larger objective of improving accessibility of REITs in the Kenyan market.

1.7 Justification of the study

This research is intended to provide a suitable rooting for investing in REITs.

Although various studies on the REITs concept have been conducted in other jurisdictions, it is difficult to reciprocate the same in Kenya as there are variant dynamics attending to the Kenyan scenario that have not been conclusively addressed in the various studies conducted.

It is the writer's opinion that the current legislation and tax regimes in this country do not provide enough incentives for participation in the REITs investment category. Suggestions will thus be made as to how this gap can be addressed as well as to what the ideal framework of laws and regulations should look like.

The thesis is premised on the assumption that it is presently a favourable market environment under which to launch REITs, owing to pent up demand for real estate amongst investors as well as the increasing demand for land and housing in this country and hence a need to develop a framework that facilitates access to alternative modes of investment as well as financing for the housing sector in Kenya.

The existence of a proper legislation for REITs, harmonized with other laws such as the land laws and the tax laws, could improve in Kenya the development of real estate companies. The real estate market in Kenya can benefit from the utilization of the capital markets in raising funds in that investors will have easier access to capital, and can even spread risk to other shareholders. The lack of supply of low and medium cost housing can be reduced if developers are able to access the capital markets to raise funds.

REITs offer developers an alternative, less risky way to raise money. They would also provide real estate owners with an exit strategy for their investment.⁸⁶

REITs will give investors a platform to transform their illiquid assets into immediate liquidity through marketable instruments and will ensure the improvement of the risk management.

1.8 Theoretical Framework

Sociological jurisprudence views law as an instrument for addressing societal needs.⁸⁷ Jhering notes that law is intended to serve the needs of the human society.⁸⁸ These needs arise in the society as a result of the conflicting societal interests verses selfish individual interests.

Jeremy Bentham, in his utilitarianism theory, holds that morality requires the doing of whatever would maximize the sum total of pleasure while minimizing the sum total of pain.⁸⁹ The theory argues that seeking of pleasure and avoiding pain are the common and universal aspects of all human life.

⁸⁶*Supra* n 2 at 2.

⁸⁷ Freeman, M.D.A., *Lloyd's Introduction to Jurisprudence*, 8th Edition, (Sweet and Maxwell: London, 2008) at 835

⁸⁸ *Ibid* at 834

⁸⁹ Bix B., *Jurisprudence: Theory and Context*, (2nd Edition, Sweet and Maxwell: London 1999) at 40.

Viewed from this perspective, the basis for proposal for taxation incentives for REITs is to ensure that investors are able to enjoy some tax relief (therefore reduce the pain of taxation) while at the same time enjoying the benefits that accrue to their investments (hence the pleasure of the returns).

The case for the introduction of taxation incentives for REITs in Kenya may also be looked at from the Natural law perspective as propounded by Thomas Aquinas, John Finnis, Francisco Suarez and Hugo Grotus. Thomas Aquinas argue that

*A just law is one which is “ordered to the common good of all”, the law giver has not exceeded its authority and one that does not burden citizens unfairly.*⁹⁰

The early natural law theorists were concerned with what legislations and citizens and governments ought to do in good conscience and for the common good of all.⁹¹

Is taxation fair? The theory of horizontal equity argues that people in equal circumstances should pay an equal amount of tax. One economic view that supports this proposition is the ability to pay argument. On that basis, those with equal ability to pay should pay equally.

This study is therefore grounded on the argument that natural law contemplates that legislation, governments and citizens ought as a common good, to ensure that there is a system of offering investors returns for their investments while at the same time not burdening them unfairly with too many taxes for their hard work in investing.

⁹⁰ *Supra* n 39 at 64.

⁹¹ *Ibid.*

1.9 REITs Conceptualized

The basic concept of the REIT originated with the business trusts that were formed in Boston, Massachusetts in the mid-19th Century when the wealth created by the industrial revolution led to a demand for real estate investment opportunities.⁹² The business trust form of enterprise was first used as a medium for collective real estate investment.

The state laws at that time prevented a corporation from owning real estate unless the property was an integral part of the business. Thus the Massachusetts trust was designed in response to these laws as the first legal entity allowed investing in real estate.

The Massachusetts trust offered favourable tax treatment that eliminated federal tax at trust level and allowed investors to receive distributions of rental income free of taxes at individual levels.⁹³

The concept of REITs has been understood differently. For many years, REITS were regarded as odd investment and there was little or no interest from the investors. In the 1990s, they became more popular and transactions with REITs shares have since grown immensely.⁹⁴

The concept of REITs spread all over the world since the first REIT was set up in the US in after Congress in 1960 passed the Real Estate Investment Trust Act as well as sections of the Internal Revenue Code that provided numerous tax advantages to real estate trusts. The US Congress in passing this Code argued that investors in real estate should be afforded the same tax treatment as those who invest in regulated investments companies. That small investor should be able to participate in large-scale and diversified real estate investments and thereby gain the benefits previously available only to wealthy investors. Congress further argued that a new source of

⁹² Caplin M., 'Taxation of Real Estate Investment Trusts', (1962) 48 6 *Virginia Law Review* at 1013.

⁹³ *Supra* n 25 at 48.

⁹⁴ *Supra* n 25 at 62.

funds should be made available to the construction industry so as to reduce the shortage of private capital and mortgage financing.⁹⁵

Public authorities have taken measures to create different legal framework for establishment of REITs depending on the jurisdictional requirements. REITs have been set up in Australia, Japan, Bulgaria, Belgium, France, Canada, Singapore, Malaysia, Taiwan, Korea and Hong Kong. Many of these companies are traded on exchanges like London Stock Exchange (LSE), Australian Stock Exchange and Tokyo Stock Exchange.⁹⁶

In Europe, REITs were first set up in 1969 in the Netherlands, then in Belgium and France, and more recently in United Kingdom and Germany.⁹⁷

REITs, now widely dispersed throughout the world, are companies that own and most often actively manage income-producing commercial real estate such as office blocks, apartments, hotels and even hospitals. The shares of most REITs are publicly traded globally on major stock exchanges.⁹⁸

REITs are typically designed to enable the investing public to benefit from investments in large-scale real estate enterprises. REITs have much to offer the institutional and retail investing communities. They provide ongoing dividend income along with the potential for long-term capital gains through share price appreciation. They can also serve as a powerful tool for long-term portfolio diversification.⁹⁹

⁹⁵Brill M. J., 'Real Estate Investment Trust: A Current Assessment', (1973) 39 *Brooklyn Law Review* at 9.

⁹⁶*Ibid* at 1.

⁹⁷*Ibid*.

⁹⁸*Supra* n 25 at 62.

⁹⁹*Ibid*.

In markets where publicly listed REIT's are available, individual investors can choose to participate broadly in the investment opportunities available in the property market by investing in REIT mutual funds. These are managed by portfolio managers with a high degree of expertise in the real estate industry and provide investors with an effective and cost-efficient opportunity to add to a balanced investment portfolio broad and diversified exposure to the real estate asset class.¹⁰⁰

As an investment, the REIT combines the best features of real estate and stocks. It affords the investor a practical and efficient mechanism to include professionally managed quality real estate in an investment portfolio. The REIT investor receives a security, in the form of a share or unit, which entitles the investor to a proportionate share of the assets in the REIT.¹⁰¹

1.10 Research methodology

This thesis will be based on secondary research which was conducted at the Capital Markets Authority resource centre and University Libraries. I have read various books, journals articles, reports and other articles that have been written on the topic of REITs, taxation, investment and real estate. I have also researched on the internet as well as capital markets and Securities Exchanges websites.

Secondary research data is available on the area of accessibility (or lack thereof) of investments in REITs, taxation of REITs as well as REITs for long term benefits.

Primary research was not possible as the main object of my thesis, REITs is not available in Kenya and indeed in East Africa. Due to financial and other constraints, it was not possible for

¹⁰⁰ *Ibid.*

¹⁰¹ *Supra* n 45 at 18.

the writer to travel to jurisdictions where REITs have been established in order to conduct primary research.

1.11 Limitations of the study

This thesis is modest in its ambitions. It acknowledges the lack of REITs schemes in Kenya so an incisive quantitative study is not possible. It also acknowledges that most of the literature and studies on REITs are based on the developed and Asian markets, with little information of REITs in Kenya and Africa at large.

It is acknowledged that this is a new product in the capital markets in Kenya whose regulations have been recently gazetted and are expected to face teething problems in their implementation.

This study is limited to the study of the real estate investments trusts under the capital markets and does not therefore include the study of other financial sectors. It is also focused on prerequisites than on providing detailed technical advice.

The study is also limited to the study of real estates investment trusts and does not include study of the general real estates law, land law or the study of the law of trusts or trusts in general.

1.12 Projection of the Study

This study is divided into five chapters.

1.12.1 Chapter One: Introduction and Background

This chapter introduces the legal issues being researched in this paper. This begins with an introduction/background and a statement of the research problem. It is then followed the objectives and research question of this paper. The hypothesis of the study then follows. The literature review comes next, giving an overview of some of the texts consulted in the conduct of

this study. This is followed by a justification for undertaking the study. The research methodology proposed to be used during the course of the research is outlined. The chapter concludes with an assessment of some of the limitations of this study.

1.12.2 Chapter Two: REITs as an Investment Product

This chapter begins with a more detailed introduction of the concept of REITs, followed by a look at the key characteristics of REITs and the operational mechanism that enhance its accessibility to the investors. Some of the documented challenges facing REITs have also been considered.

1.12.3 Chapter Three: REITs in Kenya

This chapter discusses the accessibility of REITs in Kenya. Challenges hampering uptake of REITs are highlighted. Some of the key taxation incentives that make REITs an attractive investment option including income tax and stamp duty exemptions are also reviewed. Tax advantages and listing on a securities exchange are the main driver of the REITs structure. They are the key to their success and growth

1.12.4 Chapter Four: Development and Construction REITs

In this chapter, a study is undertaken of the REITs that do not offer immediate benefits unlike Income REITs. This type of a REIT has taken several forms in the various jurisdictions where it has been established including the mortgage REIT and the hybrid REIT. Another example of such REITs is the Development and Construction REITs model that has been proposed in the new REITs Regulations. D-REITs hold properties that are in the development phase and the investor derived income when the property is sold upon completion or begins to earn rent.

1.12.5 Chapter Five: Conclusion and Recommendations

This chapter discusses how the gaps identified in the foregoing chapters can be filled so as to increase the uptake of the REITs product in Kenya. This chapter is also the culmination of the thesis and it contains the proposals, recommendations and conclusion of the study.

CHAPTER TWO

REITs AS AN INVESTMENT PRODUCT

2.1 Introduction

When the US Congress gave real estate investment trusts their first stimulus in 1960 by the passage of the federal legislation, the intent was to form a pooling arrangement that was needed to spur investment by the private sector in an era when private capital for land and housing was scarce.¹⁰²

For a long time real estate was believed to be a risky business and a preserve of the mighty corporates that could afford to spend hundreds of millions of shillings in major office buildings, residential apartments, hotels, hospitals and other capital intensive real estate investments. Investments in real estate are heavily capitalized and highly illiquid.¹⁰³

Real Estate Investment Trusts offer small investors the opportunity to participate in a broad range of real estate investments. REITS provide access to capital and are thus a means to acquire, build and develop properties in addition to building investor portfolios. Capital markets can be used as an effective environment for mobilizing long term investment funds to the housing sector. Capital markets funding will motivate the participation of private sector in infrastructure projects thus easing the constraints of the government budget on the tax payers.¹⁰⁴

¹⁰²*Supra* n 2 at 23.

¹⁰³ *Ibid.*

¹⁰⁴ *Ibid.*

There has been a significant increase across the globe in the involvement of the private sector in the development and funding of infrastructure in recent years. Private sector is able to bring technical expertise and thus increased efficiency whereas the government facilitates the projects by providing assets such as land and licenses, subsidies or incentives to the private sector.¹⁰⁵

REITs provide a way for individual investors to earn a share of the income produced through commercial real estate ownership without actually having to go out and buy commercial real estate. For the individual retail investor a REIT is quite a convenient structure since the investor does not actually purchase the physical asset, but purchases trust units that give the investor access to the trust's cash flows from the rental income of a pool of revenue-generating properties.¹⁰⁶

REITs are heavily regulated with detailed legislation and rules on their legal structure, REIT management and Trustees, investment restrictions, taxation restrictions, gearing limits and minimum distribution requirements. REITs have to be licensed or authorized to operate by the securities regulators in the jurisdictions where they exist. They are subject to stringent and detailed regulatory requirements that offer investors the security in knowing that they have invested in a product that is well regulated.¹⁰⁷

¹⁰⁵ *Ibid.*

¹⁰⁶ *Ibid.*

¹⁰⁷ *Supra* n 4 at 5.

2.2 Understanding REITs

A REIT is a business trust, corporation or association which combines capital of investors to own and operate income producing real estate or to engage in real estate finance activities. REITs are analogous to mutual funds as they pool investors' funds.¹⁰⁸

The main purpose of the REIT is to hold property investments. A minimum percentage typically around three-quarters must be held in rental income producing real estate assets.¹⁰⁹

The legal structure is tax transparent, meaning REIT shareholders are taxed as if they were direct owners of the underlying property and the REIT itself generally does not pay tax on either the income or its gains from its qualifying property investment activities.¹¹⁰

In Hong Kong for instance, a REIT is a collective investment scheme constituted as a trust that invests primarily in real estate with an aim to provide returns to holders derived from the rental income of the real estate. REITs in Hong Kong are constituted as closed-ended funds and have to be listed on Hong Kong Stock Exchange.¹¹¹

A high proportion of income the REIT receives, typically 90% or more, must be distributed to shareholders. This stops the REIT from being used as an income tax shelter.¹¹²

2.2.1 Unincorporated Associations

It was intended that to qualify for the tax conduit treatment, a REIT must be an unincorporated trust or an unincorporated association.¹¹³ Corporations are specifically excluded from REIT treatment in almost all jurisdictions where REITs are found.

¹⁰⁸ *Ibid.*

¹⁰⁹ *Ibid.*

¹¹⁰ *Supra n 12 at 63.*

¹¹¹ *Supra n 74 at 18.*

¹¹² *Supra n 25 at 63.*

Legally, REITs are historically structured as closed-end funds. In a closed-end fund, a given sum of money is raised and then the share group is closed. Subsequently shares in the fund can be traded on the stock exchange as a listed entity or can remain unlisted. The fund can have a definite or indefinite life.¹¹⁴

Closed-end fund shares generally are not redeemable. This means that a closed-end fund is not required to buy its shares back from investors upon request and investors can only recover their investment by selling their shares on the stock exchange.

The property trust's money is invested in the property market. The investors' money usually stays in the property trust until it ends, when the properties are sold and the net proceeds are distributed to investors. Some property trusts allow one to withdraw early. This usually happens when the investment manager buys back your units, usually at their current value.¹¹⁵

2.2.2 Distributions

Distributions are payments the investors receive from the property trust during the year. These payments could come from income received for example, rental payments, gains from properties being revalued at a higher price which allow the property trust to borrow more, money from new investors joining the property trust or from an investor's own original investment in the trust i.e. their capital.¹¹⁶

¹¹³ Caplin M., 'Taxation of Real Estate Investment Trusts', (1962) 48 *6 Virginia Law Review* at 1016.

¹¹⁴ International Finance Corporation, 'Investment Funds in Emerging Markets' (1996) 2 *Lessons of Experience* at 4.

¹¹⁵ *Ibid.*

¹¹⁶ *Supra* n 4 at 6.

Distributions are not guaranteed and a REIT may fail to make distributions for various reasons. However, REITs are generally required to distribute a great percentage of their taxable income to their beneficiaries.¹¹⁷

This distribution requirement provides an attractive incentive for many investors to consider making investments in REITS, as it means combining long-term growth with a reasonable assurance of periodic dividends on their investment.¹¹⁸

2.3 Accessing REITs

The general objective of establishing REITs is to ensure that ownership of the REIT is widely spread and not restricted to a few people.

The REIT has several features that are designed to make it accessible to as many investors as it possibly can. Some of these features include the requirement to list on a securities exchange, requirements to do with minimum number of investors and requirements on the minimum level of investments an investor is allowed to invest in the REIT.

2.3.1 Listed versus unlisted REITs

Publicly traded REITs offer investors the protection of investing in a public company that owns long life, income producing physical assets and secured financings underlying those physical assets, and in the securities of a company subject to capital markets and stock exchange regulation.¹¹⁹

¹¹⁷ In the US and Hong Kong for instance REITs are required to distribute at least 90% of their income.

¹¹⁸ *Supra* n 4 at 3.

¹¹⁹ *Supra* n 2 at 56.

REITs are professionally managed by officers generally skilled in real estate acquisition, management, financing, development and operations, and the performance of public REITs is overseen by independent directors, independent public auditors and financial analysts, whose collective scrutiny helps provide investors with an added degree of protection and accountability.¹²⁰

The stock market provides information about the profitability of an investment. A well-functioning securities exchange may induce high levels of investments because it helps in the identification of fundamental projects that may not be undertaken otherwise. The capital market also affects the quality of investment or the allocation of capital by channeling funds to the most desired areas. This enhances innovation and competition as cash deficit firms compete for scarce capital resources.¹²¹

Availability of information is a key determinant to investor participation in any given market. Listing on the securities exchange also means that real time market prices and a wide range of analysts' reports on the performance of the REITs are publicly available. This is contrary to the unlisted REITs where no independent information on the performance of the REITs shares is available to the public.¹²²

In many European countries, the REITs law imposes the listing of these companies to the stock exchanges (as is the case in Belgium, Germany, and France). This brings a higher liquidity of these companies, attracts more investors and hence greater transactions at exchanges.¹²³

¹²⁰ *Supra* n 4 at 3.

¹²¹ The Exchange, 'The Role of Foreign Investors in a Stock Market' (2010) 2 *Nairobi Securities Exchange* at 42.

¹²² US Securities and Exchange Commission, 'Investor Bulletin; Real Estate Investments Trusts', (2011) *Office of Investor Education and Advocacy, US SEC* at 2.

¹²³ *Supra* n 74 at 1.

In Germany, a REIT is structured as a listed stock corporation¹²⁴ while in Belgium the Royal Decree of 7 December 2010 imposes on the promoters to permanently ensure a free float of at least 30% as from the first year after having obtained the public REIT status. In addition, the regular market rules of Euronext Brussels should be met by a public REIT, so that a sufficient number of shares would be available to the public.¹²⁵

The shares of a French REIT must be listed on a French regulated stock market or on a foreign stock market.¹²⁶ In Finland the shares of a REIT must be admitted to trading in a regulated stock exchange or in a multilateral trading facility within the European Economic Area. However, a REIT may be excused from this requirement for the first two years.¹²⁷

Unlisted trusts pose several disadvantages to the investor. These include but are not limited to the fact that with an unlisted property trust, one cannot see the price of the investment (and whether it is going up or down) and decide to buy or sell when they want to.¹²⁸

Additionally, unlisted property trusts are not subject to ongoing supervision by a market supervisor and it can be more difficult to get out of an unlisted property trust any time one wants. Further, if one is allowed to withdraw money from an unlisted property trust, it is usually subject to strict conditions and there might be fees for taking money out early.¹²⁹

¹²⁴ Buennin M., 'REITs take shape in draft law', (2006)17 51 *International Tax Law Review* at 2.

¹²⁵ PwC, 'Worldwide Real Estate Investment Trust Regimes: Country Summaries', (2011) PwC at 4.

¹²⁶ *Ibid* at 12.

¹²⁷ *Ibid* at 10.

¹²⁸ *Supra n 4* at 4.

¹²⁹ *Ibid*.

Redemption options for unlisted REITs are very limited and investors may have to wait for the company to engage in a transaction such as listing on a securities exchange or liquidation of the company's assets before one is able to redeem their investment.¹³⁰

The new regulatory framework provides that only REITs that have been authorized by the CMA should be listed on the securities exchange.¹³¹ However, the Regulations make listing optional and some REITs are not required to list on a securities exchange. The Regulations also provide that trading of REITs securities shall be restricted to minimum parcel sizes of five million shillings.¹³²

Moreover, the regulations have provided that in order to be eligible to list on an exchange the minimum value of the initial assets of real estate investment trust shall be one hundred million shillings for the D-REIT and three hundred million shillings for the I-REIT.¹³³

These provisions are very limiting as to how many people can afford to invest in REITs. This is informed by the World Bank report on poverty levels in this country which as noted, indicate that a large percentage of the population does not earn an income that would allow them to afford the kind of investment these regulations propose.¹³⁴

The regulations thus need to be amended and the investment limits brought down to amounts that a good number of investors can afford. Suggestion is made to fix such an entry limit at one hundred thousand shillings for starters before bringing the figure further down to fifty thousand shillings as the REIT picks up in this country.

¹³⁰ *Supra* n 113 at 2.

¹³¹ Regulations 28 and 30 of the REITs Regulations.

¹³² Regulation 28 (a).

¹³³ Regulations 27 (3) and 28 (4).

¹³⁴ See *Supra* n 45.

2.3.2 Minimum size

A REIT must meet a diversity of ownership test as evidence that broadly it is held for the benefit of more than five persons. A REIT must have at least 100 shareholders and must have less than fifty per cent of the outstanding shares held by five or fewer individuals.¹³⁵

REIT's beneficial ownership should be evidenced by transferable shares or by transferable certificates of beneficial interest. In the US a REIT must be owned by at least one hundred persons and must not be a personal holding company.¹³⁶

The optimal size is important in that it will help the fund attract good managers and investors as well as enable it to invest enough to cover management costs and spread risks wisely.

The Finnish law provides that any one shareholder's shareholding in a REIT must be less than ten percent of the REITs share capital. The law does however, allow up to thirty percent shareholding threshold is applied until the end of 2013.¹³⁷

In Germany at least fifteen percent of the shares must be freely available to the public (free float), with the further provision that the holders of these shares each hold less than three percent. In regard to the remaining eighty five percent of the shares, a single shareholder is not allowed to hold ten percent or more in the G-REIT directly.¹³⁸

In Japan, the number of units held by the lead investor at listing is expected to be seventy five percent or less of the total and that there are expected to be at least 1,000 investors other than the

¹³⁵ *Supra* n 2 at 52.

¹³⁶ *Supra* n 2 at 115.

¹³⁷ *Supra* n 116 at 10. REITs were introduced in Finland effective January 2010.

¹³⁸ *Ibid* at 14.

lead investor¹³⁹ while at least twenty five percent¹⁴⁰ of a Singapore REIT share capital or units must be held by a minimum of 500 public shareholders.

Under the Hong Kong REITs Code, there are no requirements on the minimum number of investors.¹⁴¹ A US REIT must have at least one hundred shareholders, but no minimum value for each shareholder is required. Generally, five or fewer individuals cannot own more than fifty percent of the value of the REITs stock.¹⁴²

The new REITs Regulations provide for much fewer investors compared to those found in other jurisdictions where REITs have been rolled out successfully. The regulations provide for a minimum of seven investors for a REIT to be authorized by the CMA.¹⁴³

This number in my opinion is too low and is not facilitative of the objective of REITs, being, having as many investors invest in real estate as possible. The regulations ought to be amended and to borrow from the practice in jurisdictions where REITs have been implemented successfully such as Finland, Germany, Japan and the US.

2.3.3 Management and ownership

Block notes that at inception, Congress envisioned that to qualify as a REIT a corporation must be managed by at least one or more trustees.¹⁴⁴

Management is the most important determinant of fund performance and is one of the key issues in the structuring of a REIT. The investment manager is the cornerstone of the trust. The

¹³⁹ *Ibid* at 22.

¹⁴⁰ *Ibid* at 28.

¹⁴¹ *Ibid* at 18.

¹⁴² *Ibid* at 42

¹⁴³ Regulation 27 (2) and 29(3).

¹⁴⁴ *Supra* n 2 at 66.

investment manager selects and buys investment properties and is responsible for all maintenance, administration, rental collection and improvements to the properties. The investment properties can be commercial, retail, industrial or other property sector assets.¹⁴⁵

Strong management is a very important attribute for successful businesses. A management that is experienced, intelligent and imaginative will be continually scanning the market in order to produce excellent returns for the shareholders and attract more investors in its business.¹⁴⁶

Block notes that external administration can cause a conflict of interest, as was the case years ago when REITs had outside companies handling administration, property acquisitions and management.¹⁴⁷ These outsiders' fees, he notes, were based not on the profitability of the REIT but on the dollar value of its assets. This gave the outsider company an incentive to increase the REITs asset value simply as a basis for increasing their fees, but not necessarily for the long term benefit of the REIT or its shareholders.

Internal management and administration ensures that the management's interests are aligned closely with the shareholders' interests.¹⁴⁸

The REITs Regulations provide that the promoter of a REIT shall appoint a trustee to act as a trustee of the REIT who shall be a company or an incorporated in Kenya and shall either be a bank, a subsidiary of a bank or such other company that has sufficient financial, technical and operational resources and experience to enable it conduct its business effectively¹⁴⁹.

¹⁴⁵ *Ibid.*

¹⁴⁶ *Supra* n 77 at 7.

¹⁴⁷ *Supra* n 2 at 212.

¹⁴⁸ *Ibid.*

¹⁴⁹ Regulation 44.

According to the regulations a REIT must have a REIT manager who is a company incorporated in Kenya and must demonstrate that it has the capacity, experience and skills to implement the objectives of the REIT including property management¹⁵⁰.

It is the duty of the REIT manager to acquire, manage, maintain and dispose assets of the REIT¹⁵¹. The REIT manager also has a duty in his capacity as a fiduciary on behalf of the REIT securities holders to exercise the degree of care and diligence that a reasonable and skilled person would exercise in the position of a management company and act in the best interests of the REIT securities holders¹⁵².

It appears that the regulations envisage a scenario where the REIT management is external and not internal. This poses the danger discussed above, to the effect that an external management may not have the interests of the unit holders aligned to those of itself, noting that it is a company that is also in business to make money.

In Malaysia for instance the Guidelines on REIT provides that the management company must be a subsidiary of either a company involved in the financial services industry in Malaysia; or a property development company; or a property-investment holding company; or any other institution which the Securities Commission may permit¹⁵³.

In Hong Kong the management company must be responsible for the overall management of the Reit and remains fully liable to unit holders and the trustee. The management company must be licensed by the Securities Commission to manage collective investment schemes; must have at

¹⁵⁰ Regulation 55(2).

¹⁵¹ Regulation 56 (2).

¹⁵² *Ibid.*

¹⁵³ Dusuki A. W., 'Practice and Prospect of Islamic Real Estate Investment Trusts (I-REITs) in Malaysian Islamic Capital Market' (2010) 6 2 *Journal of Islamic Economics, Banking and Finance*, Kuala Lumpur Malaysia at 27.

least a five-year track record in managing public funds and have at least two key personnel with at least five-year' experience in analyzing the property market in Hong Kong¹⁵⁴.

Kenya can also borrow this provision so as to ensure REITs retain competent, accountable and suitable managers.

2.4 Conclusion

This chapter has given some insights as to how REITs can be made more accessible to a larger number of investors.

It is noted that the REIT has been considered in some jurisdictions as a funding platform for provision of residential properties. REIT has also been approached as an alternative investment product for retail investors.¹⁵⁵

Finally the chapter has given an overview of the major challenges cutting across the REIT platform.

These are important learning points that should inform the implementation of the REIT platform in Kenya.

¹⁵⁴ Vasilopoulos E., 'Can Reits resurrect Hong Kong's ailing property market?', (2008) 22 37 *International Financial Law Review* at 37.

¹⁵⁵ *Supra* n 125 at 54.

CHAPTER THREE

REITS IN KENYA

3.1 Introduction

Following the comprehensive study that has been undertaken in Chapter 2 on the structure of a REIT, this Chapter aims at delving into more specific details on the challenges bedevilling the uptake of REITs in Kenya as well as a study on how other jurisdictions have overcome this challenges and how Kenya can apply those studies and domesticate them.

3.2 Challenges hampering the uptake of REITs

3.2.1 Regulatory processes

According to a survey conducted on the Asian REITs in 2009¹⁵⁶, regulatory process, adverse tax regimes and effects of financial engineering have been cited as the major challenges in the development of a REITs framework. Cumbersome regulatory requirements can be seen as a hindrance to the establishment of a REITs regime. This is especially so given that a detailed framework is necessary to govern the various aspects of REITs which traverse legal, financial and real estate sectors, all in one.

In my opinion, the new regulatory framework for REITs in Kenya, the Capital Markets (Collective Investment) (Real Estates Investment Trusts) 2012 is one of the most cumbersome pieces of legislation to understand and apply. The provisions are very lengthy and often necessitate detailed analysis and engagement of consultants and specialists to break it down for easier understanding.

¹⁵⁶ Robinson, A, 'Asia-Pacific REIT Survey', (2009) *Trust Company (Asia) Limited*, Singapore at 12.

3.2.2 Restrictive legal regime

The Regulations portend a big barrier to accessing REITs by investors in that Regulation 27 that requires that an offer of REIT units in a D-REIT be made to professional investors¹⁵⁷ only and be in minimum subscription offers of Kshs 5million to invest in a REIT.

Regulation 28 offers further limitation when it comes to listing and trading of REITs securities on an exchange. It provides that trading of D-REIT securities be limited to parcels of Kshs 5 million and above and be open only to professional investors.

The Retirement Benefits Act¹⁵⁸ restricts the maximum investment in the quoted equity of any one company to thirty per centum of the aggregate market value of the total assets of the scheme, or pooled fund.¹⁵⁹ This means that a pension fund can only invest up to thirty percent of the value of its assets in a REIT. This is very restrictive because pension funds usually have high value assets under their management and should be allowed to invest larger proportions of their funds in REITs.

The Insurance Act¹⁶⁰ sets out the specified investment vehicles in which insurance companies may invest in. Section 50 outlines some of the investments as government securities, debentures, commercial paper, preference shares or ordinary shares of public companies whose shares are quoted on the stock exchange in Kenya and instruments of title to immovable property in Kenya.

¹⁵⁷ According to the Capital Markets (Collective Investment Schemes) (Real Estate Investment Trusts) Regulations 2013, a professional investor is defined as:

- (a) any person licensed under the Act;
- (b) an authorized scheme or collective investment scheme;
- (c) a bank or subsidiary of a bank , insurance company, cooperative, statutory fund, pension or retirement fund; or
- (d) a person including a company, partnership, association or a trustee on behalf of a trust which, either alone, or with any associates on a joint account subscribes for REIT securities with an issue price equal to at least five million shillings.

¹⁵⁸ Chapter 197 Laws of Kenya.

¹⁵⁹ Section 31 (1) (b).

¹⁶⁰ Chapter 487 Laws of Kenya (Revised 2013).

The Act does not have provision for investment in collective investment schemes or pooled funds akin to REITs.

The limitations on pension funds and insurance companies are a big hindrance because pension funds and insurance companies are big industries that hold very high value assets. A report published in one of the local dailies indicates that pension schemes are currently holding funds in excess of Kshs 490 billion.¹⁶¹

3.2.3 Fundamentals of real estate

Pressure on real estate value can also undermine the competitive advantage of a REIT as its underlying asset is real property. A threat to or an actual decline in the value of property and real estate will impact negatively on the valuation of REITs.

Investments are usually based on estimates or projections of investment cash flows. It is not possible to have a guarantee that the actual investment cash flows will match those targeted and give the expected return to the shareholders and may end up yielding lesser returns than anticipated and thus occasioning a loss to the investors.¹⁶²

Additionally, real estate securities are sensitive to the fundamental factors associated with the various real estate cycles. Higher inflation, shorter than anticipated asset lifespans of assets or higher building costs may result in the life cycle costs being higher than anticipated.¹⁶³ They are also subject to a series of other factors associated with the equity markets and financial markets as a whole. The domestic economy needs to remain competitive for the REIT to remain viable as an investment.

¹⁶¹ The Standard, May 8th 2015, available at <http://www.standardmedia.co.ke/procurement/article/2000161548/pension-funds-in-kenya-reap-big-from-equities>

¹⁶² *Supra* n 72 at 11.

¹⁶³ *Ibid.*

Changes in the tax legislation or tax status could adversely affect the investment return of the investing trust. Many REITs undertake infrastructure projects such as housing which are usually based on assumptions and incentives regarding prevailing taxation laws and practice and may suffer reduced returns or loss of tax exemption status should the law change unfavourably.

3.2.4 Listed or unlisted?

Unlisted REITs which are not publicly traded or freely marketable may be difficult to value and liquidate. Realization of such assets may involve significant time and cost and a sale may require the consent of other interested parties who may not be ready or willing to grant the consent in the wake of requirement of more capital injections.¹⁶⁴

Like any other corporate business, management expertise and understanding of the business is important. This may pose a serious challenge to the new sector and the entrants into the REITs industry may suffer the disadvantage of having inexperienced managers running the funds.

There is also the challenge of little or no understanding of how REITs work. This can be experienced in jurisdictions where REITs are being set up for the first time. Although it is expected that a lot of study and planning goes into the formulation of the framework under which they will be set up, teething problems cannot be ruled out.

Other challenges include poor management by the REIT managers and misuse of power by trustees or pursuit of personal interests thereby exposing the REITs to possible risks of potential loss. The potential for tenant defaulting on their rent payments, high interest rates, high construction costs and high costs of acquisitions are also rife.

¹⁶⁴ *Supra* n 72 at 74.

3.3 Tax Incentives as a means to raise up take of REITs

Governments influence investments in a number of ways. Most directly, they define the legal and fiscal regulations of funds and capital markets. Governments also determine the macro economic and regulatory environment for private activities in the economy generally.¹⁶⁵

Taxation has a great impact on the levels of investment. Tax has been defined as a compulsory levy imposed by an organ of government for public purposes.¹⁶⁶

Taxation is an appropriate policy instrument in attracting investments. Raising tax revenue is a key and direct objective of a tax system, thus striking the appropriate balance in meeting the ever increasing competing needs vis a vis encouraging investment through lower taxes remains a major challenge.¹⁶⁷

Tax incentives can be defined as fiscal measures that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country.¹⁶⁸ Tax incentives are geared towards encouraging private sector participation in economic and social programs where government plays a key role.¹⁶⁹

Tax incentives should however be carefully implemented as they tend to make the tax system less transparent, less predictable and potential investors are likely to perceive taxation as less stable.¹⁷⁰

¹⁶⁵ Buening, M., 'Reits take shape in draft law', (2006) 17 52 *International Tax Review* at 3.

¹⁶⁶ Williams D.W., Morse, G., *Principles of Tax Law* (5th Edition, Sweet and Maxwell: London 2004) at 3.

¹⁶⁷ *Supra* n 53 at 1.

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

¹⁷⁰ *Ibid.*

3.3.1 Income Tax incentives for REITs

The 1960 Real Estate Investment Trusts Act provided for a conduit (or pass-through) tax treatment for certain real estate investment trusts similar to the treatment accorded regulated investment companies.¹⁷¹

According to the legislation, if a regulated investment company meets certain statutory tests and distributes at least ninety per cent of its ordinary income, it is taxed only on its undistributed income, thereby avoiding the tax imposed on corporate income generally, and according the investment company's shareholders substantially the same tax treatment that they would have received had they held directly their proportionate share of the investment company's portfolio¹⁷².

REITs have an advantage in that a REIT is not subject to corporate tax. This means that it avoids the double taxation that attends to corporates and their shareholders.¹⁷³ In most jurisdictions however, for a REIT to qualify for this, it must by law pay out a certain percentage, usually 90% or more of its net income to its shareholders. The shareholders then pay income tax on their dividends.¹⁷⁴

To qualify for the special tax treatment, a REIT must be an unincorporated trust or an unincorporated association, managed by one or more trustees.

In creating the REIT, the US Congress stated that the objective of the new legislation was to extend the same type of tax treatment to real estate investment trusts specializing in investments

¹⁷¹ *Supra* n 4 at 15.

¹⁷² *Supra* n 127 at 1018.

¹⁷³ Double taxation of corporates means a company is taxed at corporate level on the profits it declares and again at the shareholder level on the dividends paid to shareholders.

¹⁷⁴ *Supra* n 2 at 51.

in real estate equities and mortgages as was already accorded to stock and security holdings of regulated investment companies.¹⁷⁵

This special treatment would tax the beneficiaries of the REIT in substantially the same manner as if they had held the real estate equities and mortgages directly, making comparable the tax treatment applicable to both the trusts and the regulated investment companies.¹⁷⁶

The Congress House Ways and Means Committee considered it appropriate to remove taxation, to the extent possible, as a factor in determining the relative size of investments in real estate equities and mortgages, thus encouraging the flow of private capital into such investments.¹⁷⁷ To qualify as a REIT an entity is required to be the type of entity that would ordinarily be taxable as a domestic corporation but for the REIT provisions of the Code.¹⁷⁸

During each taxable year for which the trust seeks to qualify as a REIT, it must derive at least ninety per cent of its gross income from its investments (including real estate investments), and from abatements and refunds of taxes on real property. The entity must also derive at least seventy-five per cent of its gross income from its passive real estate investments, and from abatements and refunds of taxes on real property and derive less than thirty per cent of its gross income from the sum of its short term capital gains on stock or securities and its gains from the sale of real property held less than four years¹⁷⁹.

¹⁷⁵ *Supra* n 27 at 1020.

¹⁷⁶ *Supra* n 87 at 1012.

¹⁷⁷ *Ibid.*

¹⁷⁸ *Ibid.*

¹⁷⁹ *Ibid.*

If a REIT meets all the statutory requirements, it will not be subjected to a tax on any of its capital gains or ordinary income which it distributes to its shareholders during, or with respect to, the taxable year.

Income Tax Act provisions relating to RETs should greatly promote their use as a favourable format for the holding of institutional real estate.

Income from a REIT is generally subject to tax at the investor. A REIT is responsible for withholding tax on distributions.¹⁸⁰

Dividends derived from UK REIT shares held by individuals are subject to a withholding tax of twenty percent. However in many jurisdictions such as Australia and the United State no interest is charged on distributions to domestic investors, the tax is only levied on foreign investors.¹⁸¹

There is also no withholding tax charged on interest, dividends or distributions from a REIT in Hong Kong.¹⁸²

3.3.1.1 Incentives under the Income Tax Act

Section 20 of the Income Tax Act¹⁸³ provides that:

Subject to such conditions as may be specified by the Minister under section 130;

a unit trust; or a collective investment scheme set up by an employer for purposes of receiving monthly contributions from taxed emoluments of his employees and investing them primarily in shares traded on any securities exchange operating in Kenya or a real estate investment trust registered by the Commissioner, shall be exempt from income tax

¹⁸⁰ *Supra* n 116 at 3.

¹⁸¹ *Ibid.*

¹⁸² *Ibid* at 18.

¹⁸³ Chapter 470, Laws of Kenya as amended by the Finance Act 2012.

except for the payment of withholding tax on interest income and dividends as a resident person as specified in the Third Schedule to the extent that its unit holders or shareholders are not exempt persons under the First Schedule.

We note that the above provision provides for the exemption from payment of withholding taxes on interest income and dividends accruing to REITs unit holders. It is noteworthy that REITs earnings are in the form of distributions from rental income and capital gains and not interest and dividends in the strict sense. Hence it is proper to infer that the above exemption is a null provision.

Further, under the same provision, REITs are not automatically exempted from corporation tax unless they apply for an exemption under the Income Tax Act Registered Unit Trust/Collective Investment Schemes Rules, 2003. A REIT will be exempt from income tax if it is registered with the Commissioner of Income Tax in which case dividends earned from a REIT will be subject to withholding tax at 5% for East African residents and ten percent for non-residents¹⁸⁴.

For a REIT to qualify for exemption under the Income Tax Act Registered Unit Trust/Collective Investment Schemes Rules the Commissioner for Income Tax must be satisfied that the REIT shall undertake portfolio investments to carry on investments in accordance with the policies and guidelines under the Capital Markets Act; that the sole purpose of the REIT is to carry on investments on behalf of the unit holders; that after six months of registration or exemption no member shall hold more than 12.5% of the units at any one time and that the REIT shall within six months of its commencement maintain at least 25 unit holders at any particular time.¹⁸⁵

¹⁸⁴ *Ibid.*

¹⁸⁵ PKF Kenya (2013) *Real Estate Investment Trust; Tax Treatment*, available at www.pkfea.com accessed on July 12, 2013.

All distributions of income and all payments for redemption of units or sale of shares received by unit holders shall be deemed to have been already tax paid.

This incentive is only specific for investments in real estate investment trusts by collective investment schemes formed by employers for the benefit of their employees. As such there is generally no tax incentive for REITs that are formed by ordinary investors coming together as an investment group as is the case in other jurisdictions.

This writer proposes that a number of amendments are necessary so as to give incentives for REITs in order to make them viable.

To ensure effective implementation of the tax neutrality provision provided for under the Income Tax Act through the amendment made to section 20 in 2012, a new sub section should be introduced to provide that a real estate investment trust and its trustee or trustees, shall be exempt from income tax on any gains or profits derived or accrued from Kenya.

Further provision should be made to provide that where a real estate investment trust makes a capital distribution to a unit holder the gross amount thereof shall be deemed not to be income chargeable to tax and that all distributions of income by a real estate investment trust, received by unit holders or deemed to have been made shall be deemed to have been already tax paid.

Section 35 should be amended to indicate that for purposes of exemption of distributions from taxation any reference to a person also includes a real estate investment trust.

Consideration should also be made towards eliminating in total the withholding tax charged on distributions to domestic investors. Withholding tax on foreign investors can be retained. This

can be given as timed incentives for a particular period, say ten years within which the uptake of REITs is expected to improve and the product stabilize in the market.

3.3.2 Stamp duty tax

The stamp duties are the oldest regular taxes to be introduced, having been introduced in the UK in 1694 by William of Orange.¹⁸⁶

Stamp duty remission is granted on the transfer of any Singaporean immovable property (on or before 31 March 2015) into a listed S-REIT or into one to be listed within six months from the date of transfer. Stamp duty remission is also available for the transfer of shares in a special purpose vehicle that holds, directly or indirectly, immovable property located outside Singapore.¹⁸⁷

In Hong Kong stamp duty is charged on transfers of real estate in Hong Kong. The maximum rate of 4.25% applies where the transfer consideration or value of real estate exceeds a fixed value. Stamp duty is also chargeable in respect of the transfer of the REIT units.¹⁸⁸

In Malaysia exemptions from stamp duty are provided in respect of all instruments of transfer of real property and instruments of deed of assignments to REITs.¹⁸⁹

In Singapore, Stamp duty remission is granted on the transfer of any Singaporean immovable property (on or before 31 March 2015) into a listed S-REIT or into one to be listed within six months from the date of transfer. Stamp duty remission is also available for the transfer of shares

¹⁸⁶ *Supra*, n 153 at 22.

¹⁸⁷ *Supra* n 116 at 29.

¹⁸⁸ *Ibid* at 19.

¹⁸⁹ *Ibid* at 25.

in a special purpose vehicle that holds, directly or indirectly, immovable property located outside Singapore.¹⁹⁰

There is no special exemption for UK REITs from transaction taxes.¹⁹¹

In Kenya all instruments relating to a transaction carried out in Kenya and expected to be enforced in Kenya are required to be stamped with the requisite stamp duty. There is no provision for incentives for REITs under the Stamp Duty Act and other tax regimes.

Stamp duty is charged at four percent of the value of the transaction to transfer land that is within a municipality and at two percent for land outside a municipality. Transfer of shares attracts stamp duty at a rate of one percent.¹⁹²

This rate translates to a substantial amount of money when applied against the transaction values of real estate properties.

This thesis makes a case for an amendment in the stamp duty law to give incentives for REITs. Section 96 of the Stamp Duty Act should be amended to provide that stamp duty shall not be chargeable to instruments of transfer between trustees and transfers between unit holder and trustee for a real estate investment trusts whose effect is to convey or transfer a beneficial interest in property from one trustee to another trustee or to an additional trustee, or from a unit holder to the trustee.

¹⁹⁰ *Ibid* at 29.

¹⁹¹ *Ibid* at 39.

¹⁹² Hamilton, Harrison and Mathews, 'A guide to investing and doing business in Kenya', (2012) *Hamilton Harrison and Mathews* at 6.

3.4 Conclusion

Several tax incentives as outlined above are necessary to ensure that REITs are viable in this country. If the government wants to foster a vibrant REIT market, it will need to take a long-term view and extend tax breaks to REITs similar to those that exist in other jurisdictions where REITs are treated as tax pass-through instruments.

Incentives under Income Tax are vital in making REITs viable especially in light of the stringent distribution requirements wherein they are required to distribute at least eighty percent of their income.¹⁹³

Incentives under the Stamp Duty law are pivotal in facilitating property owners to transfer their assets to real estate investments trusts without incurring the huge stamp duty costs.

Only then will it make investment sense to investors to consider REITs as opposed to direct investment in real estate as is the case today.

¹⁹³ Regulation 72

CHAPTER FOUR

DEVELOPMENT AND CONSTRUCTION REITs

4.1 Introduction

Not much literature is available on a REIT that is set up primarily for purposes of developing property and later generating income from such property either from rental income or from capital gains upon disposal of such properties.

Block notes that it is not common for REITs to engage in property development, the historical REITs is one that owns already income-generating property.¹⁹⁴

In Hong Kong, a REIT is not permitted to hold non-income generating real estate in excess of ten percent of the total asset value of the REIT. A Hong Kong REIT must not hold real estate for a period of less than two years unless approved by unit holders nor invest in vacant land or property development except for refurbishment and renovation.¹⁹⁵

According to CMA, the traditional REIT structure as is found in most jurisdictions was deemed not to meet Kenya's policy objectives and those of Vision 2030. A unique approach is therefore required in order to balance the policy objectives of developing robust capital markets, giving effect to Vision 2030 as well as building on lessons learnt from the global financial crisis that was witnessed in the 2008 to 2010 period.¹⁹⁶

¹⁹⁴ *Supra*, n 2 at 74.

¹⁹⁵ *Supra* n 145 at 37.

¹⁹⁶ *Supra* n 46.

Traditionally the REIT was conceived as an Income REIT which owns already income generating assets.¹⁹⁷

Provision has been made in the new regulations for three categories of REITs, the income REIT (I-REIT), the Development and Construction REIT (D-REIT)¹⁹⁸ and the Islamic REITs.¹⁹⁹

4.2 The Development and Construction REIT (D-REIT)

The Kenyan REITs Regulations have been drafted to provide for a unique category called the development and construction REIT.²⁰⁰

A D-REIT may be structured as either an open ended or a closed ended fund and may convert from one status to the other. Furthermore the minimum value of the initial assets of D-REITs has been set at Kenya Shillings one hundred million.²⁰¹

An issue of securities in a D-REIT may only be made as a restricted offer to professional investors and can only be offered in minimum subscription parcels of Kenya Shillings five million. Further a D-REIT is required to have a minimum of seven investors.²⁰²

4.2.1 Investments and borrowing by a D-REIT

A D-REIT is required to investment predominantly in development and construction projects either for sale, retention or leasing as income producing property²⁰³ and may be formed with the

¹⁹⁷ *Supra* n 4 at 28.

¹⁹⁸ Regulation 8.

¹⁹⁹ Regulation 122.

²⁰⁰ *Supra* n 11 at 7.

²⁰¹ Regulation 27 (3).

²⁰² Regulation 27.

²⁰³ Regulation 76 (7).

objective of provision of buy to let housing, development of to let housing or for sale housing as well as the provision of shelter, housing and accommodation.²⁰⁴

A D-REIT may provide a mortgage or other form of secured loan or financing for the purpose of assisting a tenant or purchaser to acquire a house from the D-REIT.²⁰⁵

A D-REIT is required by law to, within one year of the date of its authorization, invest at least thirty per cent of the total asset value directly either in development and construction projects or income producing real estate which the D-REIT has developed or constructed.²⁰⁶

Regulation 81 (3) provides that borrowings entered into by the trustee on behalf of a DREIT or by any investee company or investee trust shall not exceed, in aggregate, at the time the liability is incurred, sixty percent of the total asset value, with a provision to borrow up to sixty five percent of the total asset value upon approval by the REIT unit holders by way of an ordinary resolution.

A DREIT may lose its classification as a REIT for taxation purposes if these borrowing limits are exceeded. The REIT securities holders may also institute a cause of action against the trustee or the REIT manager while the CMA may revoke the authorization issued to the under regulation 18²⁰⁷.

These borrowing restrictions are aimed at ensuring that the investors interests are protected and that the REIT is not heavily indebted to a level that it may not have funds to support its core mandate, being investments.

²⁰⁴ Regulation 10 (a).

²⁰⁵ Regulation 12.

²⁰⁶ Regulation 76 (5).

²⁰⁷ Regulation 81 (6).

4.2.2 Ownership and Management of a D-REIT

To encourage existing property management companies and property investment firms to convert to REIT structures, majority ownership should be allowed up to fifty percent for the primary sponsor or promoter.²⁰⁸

All other investors' stake should be restricted to a maximum of twenty five percent to any individual investor subject to a minimum of 100 shareholders being required for a publicly listed REIT to ensure liquidity and free float of units in the market.

For private REITs, shareholding must be set at a minimum of 50 unit holders in order to qualify for any fiscal or tax incentives. This is to avoid REIT managers and other stakeholders taking advantage of the pass-through status of REITs for their personal benefits.²⁰⁹ It is also significant that many properties in Kenya are family owned and that those families may be reluctant to lose control of key property assets.

Due to the complex nature of property development, the regulations have made provisions for appointment of several key players to manage a development and construction REIT.

McCall notes that real estate is a narrow field which requires very technical expertise and the average investor will not usually have this expertise.²¹⁰

The regulations provide that the promoter of a REIT shall appoint a trustee to act as a trustee of the REIT who shall be a company or an incorporated in Kenya and shall either be a bank, a

²⁰⁸ Currently, as noted earlier in this paper, majority ownership is allowed up to a maximum of fifteen percent per unit holder.

²⁰⁹ Regulation 29 provides for a minimum of seven investors. This number is very low and may lead to abuse of the benefits accorded to REITs by a few investors and hence defeating the purpose of the incentives.

²¹⁰ *Supra* n 4 at 10.

subsidiary of a bank or such other company that has sufficient financial, technical and operational resources and experience to enable it conduct its business effectively.²¹¹

The trustee will be independent of the REIT manager and any other project manager of the REIT and must be licensed by the Authority as such.²¹² The trustee is required to act honestly and in a fiduciary capacity as trustee in the best interests of the REIT securities holders as beneficiaries of the REIT and to fulfill the obligations and duties set out in the scheme documents.²¹³

The trustee is mandated to appoint a REIT manager for the D-REIT. It is the duty of the REIT manager to acquire, manage, maintain and dispose assets of the REIT.²¹⁴ The REIT manager also has a duty in his capacity as a fiduciary on behalf of the REIT securities holders to exercise the degree of care and diligence that a reasonable and skilled person would exercise in the position of a management company and act in the best interests of the REIT securities holders.²¹⁵

In Malaysia for instance, the Guidelines on REIT provides that the management company must be a subsidiary of either a company involved in the financial services industry in Malaysia; or a property development company; or a property-investment holding company; or any other institution which the Securities Commission may permit.²¹⁶ Kenya can also borrow this provision so as to ensure REITs retain competent and suitable managers.

The REIT manager of a D-REIT will also be required to appoint a project manager certifier who shall be required to have the requisite project management and quantity surveying skills and

²¹¹ Regulation 44.

²¹² *Ibid.*

²¹³ Regulation 45.

²¹⁴ Regulation 56 (2).

²¹⁵ *Ibid.*

²¹⁶ *Supra* n 144 at 27.

expertise to enable him monitor and report on constructions and developments being undertaken by the REIT.²¹⁷

The project manager certifier is required to have the requisite project management and quantity surveying skills and expertise that will enable him monitor on the progress of the development or construction work being undertaken.²¹⁸ The property manager must be a member of a property-related professional association.

The property manager certifier is a key personnel in a D-REIT.

The trustee is required to appoint a structural engineer in consultations with the REIT manager.²¹⁹ The structural engineer's role is to conduct an appraisal of a specific real estate property or properties which are proposed to be acquired by a REIT.²²⁰

A trustee is also required to, in consultation with the REIT manager, appoint a valuer to value the real estate assets which have been vested in the trust or acquired or proposed to be acquired by the trust.²²¹ The persons to be appointed valuers of REITs will be persons registered and licensed as a valuer by the Valuers Registration Board in accordance with the Valuers Act²²² provides real estate and other property valuation services on a regular basis and carries on business of valuation of real estate in Kenya.²²³

²¹⁷ Regulation 63 (5).

²¹⁸ Regulation 63 (5).

²¹⁹ Regulation 62.

²²⁰ Regulation 62 (5).

²²¹ Regulation 111.

²²² Chapter 532 Laws of Kenya.

²²³ Regulation 111 (4).

4.2.3 Distributions and Taxation of a D-REIT

Regulation 82 provides that the trustee shall make the distributions of income upon the recommendations of the REIT manager and in accordance with the scheme documents.

In making the distribution the trustee is required to put into consideration the investment objectives of the D-REIT as well as its liabilities and financial obligations.

The regulations anticipate a scenario where a D-REIT may not make annual distributions.²²⁴ However, no clear provision has been given as to how the income of the D-REIT will be treated for taxation purposes for the period that it will not make distributions. This may have implications for the unit holders because in the absence of specific provisions to the contrary, the D-REIT will be taxed as an ordinary corporation.

4.3 Potential challenges to the D-REIT structure

The provision that a D-REIT may be structured as either an open ended or a closed ended fund and may convert from one status to the other poses serious challenges as to its operationalization and risks involved especially at the conversion points. It may give rise to a situation where investors simply dump an underperforming REIT on the public and exit.²²⁵

In cases of development or construction REITs, assets in construction phases are not yet cash generative. Primary stage projects require a construction phase prior to operation during which phase the REIT may not be generating any income and this may pose a higher risk given that construction project timeframes may vary due to a number of factors, both internal and external

²²⁴ Regulation 82(3).

²²⁵ *Supra* n 4 at 11.

to the project. These uncertainties may dampen the investor appetite for D-REITs hence affect their uptake.

The REIT may also not become income generating immediately after construction thus the waiting period during which the investors will not be receiving any distributions could be prolonged further than initially planned.

The Regulations have provided that an issue of securities in a D-REIT may only be made as a restricted offer to professional investors and can only be offered in minimum subscription parcels of Kenya Shillings five million.²²⁶ Furthermore the minimum value of the initial assets of D-REITs has been set at Kenya Shillings one hundred million.²²⁷ These provisions pose serious limitations to the intention of the REIT structure of enabling as many investors as possible invest in real estate. As noted previously in this paper²²⁸, not many Kenyans can afford to make the investments envisioned in these provisions.

The potential conflicts of interest between the trust and its management also require careful management. The key risk here could arise when a property company manages assets under the REIT that compete with those owned by the management company. A proper conflict management mechanism should be ingrained in the Regulations to offer clarity and certainty.

As Gumbs notes, REIT share prices, more often than not, are more volatile than private real estate prices. Stock market conditions change faster and with less predictability than private real

²²⁶ *Supra* n 200 Regulation 27.

²²⁷ *Ibid* Regulation 27 (3).

²²⁸ See n 45.

estate prices.²²⁹ This calls for sound investor awareness if the REITs mechanism is to gain ground.

4.4 Conclusion

The development and construction REIT is a positive step towards widening the investor base for real estate. It is also a great incentive and a boost to the construction industry because if well implemented it has the potential to

However, the challenges noted above must be addressed in order for the government wants to foster a vibrant REIT market in this country.

Great care should be taken when setting up the D-REIT as there is not much precedence on the same, making it prone to pitfalls. Clear provisions should be laid down on how default with distribution and other requirements will be handled. This will seal any loopholes that may be exploited especially by investors who may want to take advantage of the REIT's tax pass-through status.

²²⁹ *Supra* n 83 at 48.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This paper has highlighted a number of components that the legal framework should have in order to create an enabling legal and regulatory environment so as to facilitate achievement of the objectives of introducing REITs in this country.

Access to capital is integral to development. The REIT structure provides some great financing flexibility. Due to its very nature, a REIT provides a very strong balance sheet, which is a critical bargaining tool should it decide to approach the debt market. This strong equity position in turn translates to ability of the REIT to produce excellent returns for its unit holders, the investors. Additionally, it also enhances a REIT's accessibility to capital that private developers could have a hard time accessing. This is even more so for listed REITs which can access public funding through the securities exchanges.

Challenges have been noted with the REIT structure, but these limitations are not onerous, especially given the substantial benefits of the structure. Regulatory and policy refinements are necessary in a number of areas for the REIT structure to pull through in Kenya.

Having noted the increased benefits of a REITs structure as compared with private development, it is the writer's opinion that a case for more tax incentives at the investor level has been made. The writer has also made a case for reduction or elimination of the high listing limitations as a way of improving accessibility for REITs. Entry barriers especially for large investor blocks such as pension funds, banks and insurance companies should also be reviewed. D-REITs have been

discussed in great length and the writer hopes that lessons will be derived for better formulation of this product

One of the key amendments should be the trans positioning of some provisions in the REITs Regulations into the Capital Markets Act. This is designed to give them the weight and force of law that a Statute contains which may not be the case with Regulations. One such provision is the income tax exemption incentive which is a key driver for the REITs world over.

The Capital Markets Authority should look into ways of making the Regulations more clear and eliminating vagueness and ambiguity. This will enhance conception and understanding of the Regulations leading to guided application of the same. This could also lead to an improvement in the uptake of the product once the regulation around is more clear and easily comprehensible. The Regulations also contain various spelling and type setting errors that should be corrected for clarity and consistency.

The Real Estate Investment Trusts Regulations should be amended to align them closer with the worldwide provisions. To this regard, it is proposed that to qualify for the incentives set out in this paper a REIT must be required to distribute ninety percent of its net income²³⁰. This is the standard in several other jurisdictions, including Australia from where the Kenyan framework has borrowed heavily. This will help stem unfair practices amongst the REIT managers who may want to exploit the unit holders while at the same time benefiting from the tax incentives.

²³⁰ As has been discussed in this paper, the international standard practiced in most jurisdictions is that REIT's distribute ninety percent of their income to unit holders in order to qualify for the tax incentives.

5.2 Proposed Policy and Operational Reforms

The CMA needs to work closely with other government organs and other stakeholders who have a role to play in the successful implementation of the REITs framework. Key among these stakeholders is the KRA, so as to facilitate grant of the tax incentives that are necessary in order to make REITs an attractive investment vehicle.

The KRA should be approached to reduce the level of income tax charged on individual investors in REITs or abolish the tax altogether. This is the practice in Australia, Hong Kong and the United States as has been seen in Chapter 3.

Working with the RBA will also be important to ensure any hurdles pertaining to pension funds investing in REITs such as upper ceilings on how much a pension fund can invest in real estate are removed at an early stage. Pension funds are major investors in real estate and it will be crucial to give them the necessary incentive so that they take up REITs as investment alternatives.

The IRA will be important to facilitate insurance firms that will be interested in taking up REITs as an investment. Again, it is worth noting that insurance firms are major real estate investors in this country and removal of any investment barriers will go a long way in improving the uptake of REITs as an alternative investment product.

Banks may too invest in real estate investment trusts and the CBK should put measures in place to ensure that it is in a facilitative position. Such measures would include removal of the ceiling capping for banks to invest in fixed assets and real estate.

The CMA should also work closely with the Ministry of Lands, Housing and Urban Development for the necessary support in ensuring that the operations at Lands Offices at all levels are streamlined and bottlenecks removed.

The need for legal or policy reform in all of the above cited cases should be assessed and implemented as soon as possible.

The existence of specialized REITs like development REITs is important for investment strategies. Establishment of these REITs is set to offer a new investment instrument for Kenya and foreign investment companies and will give an impulse to development of real estate and the capital markets.

REITs is a new concept in many African countries and more so in Kenya. Although the real estate investment trust means owning a part of the real estate in which the trust has invested, one cannot pin point at a particular property or section and claim ownership to it. The Capital Markets Authority will therefore need to carry out intensive investor education to sensitize the public of the rationale behind this unique form of investment and to manage investors' expectations.

5.3 Conclusion

In conclusion, this study acknowledges that milestones have been made at opening up the capital markets to more investors by the offering of real estate investment products that are tradable at a securities exchange. However, the noted challenges are key and should be addressed in order to ensure that the product is accessible to the intended investors. The REITs framework has been implemented in other parts of the world with proper guidelines and structures and it can also be

practiced in Kenya if it is prudently managed. With the various amendments, the REIT structure is suitable for development activity.

The fact that the REIT has just been introduced in Kenya made it necessary to impose restrictions on investment activities in REITs, but this makes it even more difficult to access the product as envisaged under the regulations. It therefore remains a challenge to the regulators how to draw the line between prudential and restrictive regulations especially as the REIT takes root in Kenya.

The above suggestions are only meant as a guide and are not exhaustive nor should they be taken as complete list of all the legal and regulatory provisions that require amendments in order to have a smooth implementation of the REITs framework in Kenya.

When all is said and done, the financial and capital markets legal framework will have to keep evolving in order to keep abreast with the fast changing economic environment.

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