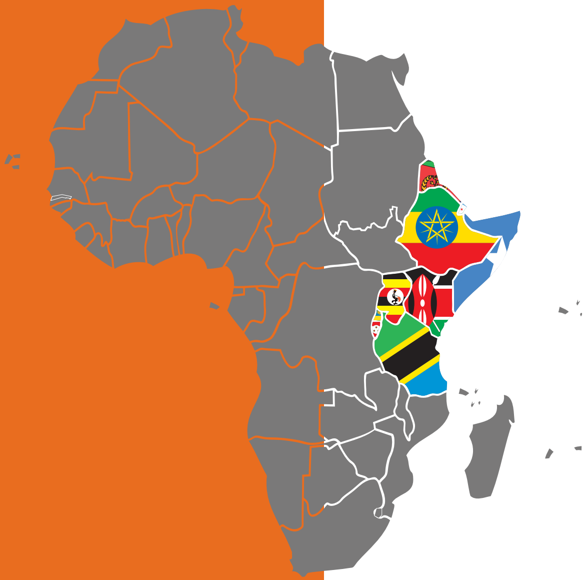
Regional Report 1

December 2017

Centre for Affordable Housing Finance in Africa



LANDSCAPES OF INVESTMENT

REGIONAL REPORT

East African Community (EAC)

The report forms part of The Centre for Affordable Housing Finance's Investor Programme which aims at addressing key information asymmetries on who, why and how investments are made in the African housing sector. With the intention of identifying and championing increased investment in affordable housing, the report includes insights and analysis into the depth and breadth of investment in the continent's housing and housing finance sector. The report represents the East African Community (EAC) segment of this study. The overall goal of this project is to quantify the breadth of investment activity with respect to housing and housing finance across Africa, and to establish a mechanism to track this on an ongoing basis. This project has collected data and highlights gaps and opportunities in the investment landscape. With the aim of stimulating greater investment in affordable housing and connecting investors with potential investments, the report profiles investors and investment instruments with the greatest impact on the housing finance market within the EAC Region.

This Regional Report was produced with the support of the following sponsors.

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The Centre for Affordable Housing Finance in Africa (CAHF) is a not-for-profit company with a vision for an enabled affordable housing finance system in countries throughout Africa, where governments, business, and advocates work together to provide a wide range of housing options accessible to all. CAHF's mission is to make Africa's housing finance markets work, with special attention on access to housing finance for the poor. We pursue this mission through the dissemination of research and market intelligence, supporting cross-sector collaborations and a market-based approach. The overall goal of our work is to see an increase of investment in affordable housing and housing finance throughout Africa: more players and better products, with a specific focus on the poor.

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1. BACKGROUND

Growing financial sector experience and increasingly sophisticated financial instruments are driving investor interest in African real estate. This includes new market opportunities related to a rising urban middle class, an increasingly localized construction material industry and innovations in housing finance such the emergence of Real Estate Investment Trusts and mortgage liquidity facilities across Africa[1].

However, a key barrier to this growth remains the chronic lack of rigorous data on the breadth and character of financial infrastructure investment. This is particularly true for the housing sector as stimulating targeted investments requires highly differentiated data that illustrates market segmentation. In providing market intelligence that makes the case for investment in underserved markets (segmenting and quantifying the demand side; and scoping, understanding and tracking the supply side), we can support a better policy environment & increased private sector activity in affordable housing markets. In this way, we catalyse scale interventions.

Without this data, targeted interventions become challenging and result in unresponsive housing finance packages, the high occurrence of Non-performing loans (NPLs) and poor uptake of new residential developments[2].

Within this context, the need for more rigorous and nuanced data collection, analysis and interpretation is central to facilitating evidence-based decision making in the sector. In the current environment, there is little information on investment activities and trends. Specific information gaps that require urgent address include,

- **Market overview data:** This includes data on who is investing in the housing delivery and financing value chains and at what level this investment takes place. It is important to understand the geographic distribution of this investment, the type of the capital used to invest and what the investment vehicles are. It is also crucial to relate this to reliable data on the investment environment and the ways it enables or stifles investor interest.
- **Market performance data:** This needs to be segmented by target market, housing type or investment intervention and geography. Understanding the top performing investment instruments provides a roadmap for future investors to follow as they navigate the investment environment in Africa.
- **Competitive market horizon:** In order to forecast the size, financial capacity, geographic reach and market share of participants in the housing and housing finance sectors, historical data on the mortgage, home equity, personal loan, consumer loan, microfinance and housing microfinance sectors is essential. In many African countries, this historical data is seriously lacking and presents a major barrier in modelling investment horizons.

The report forms part of The Centre for Affordable Housing's *Investor Programme* which aims at plugging in some of the above-mentioned gaps, with the intention of identifying and championing increased investment in affordable housing across the African continent. The report represents the East African Community (EAC) segment of a baseline study on the landscape of housing investment across Africa. The overall goal of this project is to quantify the breadth of investment activity with respect to housing and housing finance across Africa, and to establish a mechanism to track this on an ongoing basis.

This project has collected data and highlights gaps and opportunities in the investment landscape. With the aim of stimulating greater investment in affordable housing and connecting investors with potential investments, the report profiles investors and investment instruments with the greatest impact on the housing finance market within the EAC Region.

Within this regional community, the investment landscape has been made up of predominantly Development Finance Institutions (DFIs). The report will therefore focus on profiling these institutions and the operating environment in which they invest. However, since investment begets investment, it is important to understand how the landscape of investment assists market stakeholders in both the private, public and development finance sectors, to refocus their strategies further.

2. PROFILES OF INVESTORS IN THE EAC REGION

The investment landscape in the EAC Region, constitutes both local and foreign institutional investors. Below is a description of the two categories of investors, including their institutional type, sources of capital, and other parameters that define their investment model.

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[1] See the Tanzanian Mortgage Refinancing Company (TMRC) and the Nigerian Mortgage Refinancing Company (NMRC) established under financial sector development projects of the World Bank

[2] In late 2016, the DFCU, the third largest provider of mortgage finance in Uganda, hit its cap for the real estate sector of UGX 160 billion (20 percent of the bank's total exposure), and has since halted the provision of mortgages. What triggered the halt was the bank's benchmarks of 8% for the Portfolio at Risk and the Non-Performing Loans of 2%. It is also worth noting that loans that were booked in USD had a major effect on exposure as the dollar appreciated more than the shilling over a period of five years.

2.1 Local Institutional Investors

2.1.1 Commercial Banks

The Commercial Banking Industry in the EAC Region has shown significant improvement over the last few years. The increased efficiency in mobilizing deposits illustrates this improvement. Commercial banks have recorded significantly high asset conversion rates[3] from customer deposits, with Uganda leading at 81.8%, followed by Kenya and Tanzania at 80%. Rwanda and Burundi follow at 78.2% and 74% respectively.

Customer deposits, through savings and fixed deposits accounts, are the main source of internal funds available to banks in the region. On average, deposits account for 80% of internal bank funds. Most EAC banks identify 15% of all deposits as "core" deposits, considered sufficiently stable to intermediate into very long term and illiquid assets. As a result, banks have developed new products to fuel savings or household equity contributions in the mortgage market.

Box 1: Local Saving Schemes – Long-term Horizons

Lenders in both the formal and informal sector have crafted innovative ways of mobilising savings for financing developments in the housing sector. For banks, holding long term deposits greatly enhances their funding base and is the cheapest source of funding. A conventional way of doing this has been to the creation of savings groups with the purpose of building houses or developing savings products designed specifically for housing.

The Kenyan market has several such schemes, most notably the 1stHop scheme, offered by the country's Housing Finance Company, for first time home buyers. The 1stHop account allows customers to save for as long as 10 years. It is an open scheme without restrictions as long as the account-holder is saving for his/her first property. It targets younger home buyers with regular income and a regular savings capacity. Savings up to KES 3 million is exempt from withholding tax and customers are entitled to tax rebates if deposits of Kes.4000 per month or Kes 48 000 per year are made.

Source: Housing Finance Group (2017)

Presently, bank deposits in the EAC region are estimated at about US$ 8 billion. This translates to about US$ 1.2 billion in core deposits. However, based on the regions average mortgage and housing deficit, there is a funding gap of US$ 42.2 billion The core deposits, available for long-term mortgage finance, therefore makes up only 3% of the total funding gap. Local governments aim addressing this funding gap with a mix of local and foreign funds, as discussed below. However, these are often sourced along terms which generally favour lending to middle and high income earners.

2.1.2 Capital Markets

The development of capital markets, both bond and stock, is strongly associated with greater access to long-term finance. A developed and liquid capital market plays a key role in creating and aggregating information about economic activity and key characteristics of the private sector. Accordingly, stock prices aggregate information from several participants in the market. This information is useful for firm managers and capital providers in making reasonable investment decisions. Stock markets have facilitated access to credit by reducing information asymmetries between capital providers and firms. However, In the EAC Region capital markets, are still underdeveloped, though efforts are underway by the EAC member states[4] to boost investor confidence in their respective stock markets.

With the exception of Kenya, member states have struggled to raise long-term funds in the capital market. Since 2010, the Nairobi Stock Exchange (NSE) has been able to raise (through the issuance of local currency bonds) over US$ 70 million, with long-term horizons (over 10 years) for developments in the residential real estate market. Part of these funds were used to finance over 10,000 housing development projects in Nairobi, at an average rate of 16.5%. This rate is however high and unaffordable to low income earners because it carried a fixed high interest rate of 13% to attract a sizeable number of retail and institutional investors. In addition to the NSE offering local currency housing finance through bonds, several products including shares in real-estate finance and developer companies as well as Real Estate Investment Trusts (REITs) have been used to mobilize long term finance for mortgage lending. Over US$ 10 million has been raised through REITs. A high return on investment (ROI) plays a critical

[3] Ernest and Young (2014) Eastern Africa Banking Sector. Strong economies stimulate asset growth, but lower interest rates squeeze profits.

[4] Mid June 2017, Uganda launched a Capital Markets Development Master Plan, with several objectives, including (i) simplifying capital markets regulatory processes and procedures to encourage companies to list on the securities exchange, and (ii) increase the size of domestic savings, improve efficiency and effectiveness of regulation for securities exchange operators, expand issuance, boost public awareness, as well as launch national savings products

role in making shares in REITs attractive to investors. For this reason, there is a strong impetus for REITs to invest in commercial real estate and luxury rental apartments which have a high ROI of around 20%, instead of affordable housing.

In Uganda, the Securities exchange has only recorded a few debt transactions of which only two are directly related to the housing finance sector. These included a Ugx 30 billion corporate bond issued by Housing Finance Bank in 2010 and a UGX 125 billion AfDB bond issued to finance housing developments (in 2015). However, only one tranche amounting to UGX 25 billion has been issued out of the Ugx 125 billion, leaving Ugx 100 billion outstanding. End-user affordability remains a key challenge in the issuance of these bonds. While subscribers are readily available, off-taking of bond proceeds, through bank issued mortgage finance, has been slow due to their high interest rates (14.5 percent). In Rwanda, the transactions on the stock exchange have been few and distant, including a Rwf 1 billion (US$12 million) 10.5 fixed rate bond issued by I&M bank, to support to long-term finance for the housing sector.

Overall, capital markets in the EAC Region are still being developed, and a lot of work needs to be done before they can meet funding deficits. Indeed, several financial institutions have been reluctant to issue capital market instruments as a way of raising long term debt. The high pricing of bonds - in a bid to attract investors – is the main reason for this reluctance. Some companies have incurred huge losses as a result of taking on highly priced bond proceeds. Home Afrika in Kenya is one such example. These experiences have made the stock exchange an unattractive option for fundraising initiatives towards development of the housing sector.

2.1.3 Pension Funds

In all the EAC member states, pension funds have been drawn on to fund long-term investments in the housing and housing finance sectors. Pension funds typically involve contributions made over many years and provide funding for other long-term financial instruments. Pension schemes hold deposit accounts with banks to administer contributions. These banks have utilized pension funds as a source of long-term liquidity for the housing sector. Pension schemes in Burundi, Kenya, Rwanda, Tanzania and Uganda command between 6 and 9 percent of deposits in their respective banking industries.

In addition, through medium term loans (some up to 10 years), pension funds have provided finance (over US$ 100 million) to commercial banks seeking to extend mortgage lending. However, the loan costs of these funds are often high (above 12%) due to high domestic borrowing rates. In order for EAC governments to raise the necessary funding for their budget, they must issue treasury bills and bonds at relatively attractive rates for investors (between 10 and 12%). Making these rates attractive necessarily offers a new investment opportunity for both bank and non-bank institutional investors. There is therefore a crowding out effect where funds tend to flow to the relatively secure government paper instead of private investment instruments. In order to continue lending to the private sector, commercial banks increase the interest rate. This practice pushes interest rates upwards. The situation is reversed when government reduces domestic borrowing.

Recent provisions in pension regulations for both Kenya (2009) and Uganda (2017) have paved the way for pension-backed mortgages. Kenyan law allows for pension fund beneficiaries to use up to 60% of their accumulated pension savings as collateral in a home loan. In Uganda, 50% of pension savings can be used for these purposes. This legislation has been premised on the fact that housing provides a key social function and can therefore be backed by social security funds.

Box 2: Impact of New URBRA Regulations on Housing Sector

NSSF, Uganda is the main source of long-term funds in the country. NSSF collects Ugx 40 billion per month. However, with the establishment of the Uganda Retirement Benefits Regulatory Authority Act (URBRA) 2011, access to this local pool of long-term funds has been restricted. The Act established URBRA as the regulatory authority to govern activities of Pension Sector players including determining the classes of investments for pension funds. New defined limits emerged that excluded direct loans to commercial banks and other institutions. Before this period, NSSF had loaned over US$ 25 million to commercial banks.

The objective of legislation was to protect pension member contributions from being invested in highly risky assets. Pension and provident funds are now restricted to investments in fixed deposits, treasury bills and bonds, corporate paper, listed securities within the East African region. The fund is therefore legally confined to investments in these classes and cannot make direct loans to commercial banks, unless the banks issue marketable instruments such as corporate bonds.

Source: Housing Finance Group (2017)

However, some of the regulatory initiatives and provisions, have limited the use of pension funds to support housing sector developments in the region. The regulatory framework in both Kenya and Uganda restricts pension funds from making direct loans to commercial banks. This implies that financial institutions have no access to long term pension assets which could provide long-term finance for housing sector developments. In addition, Pension schemes in Kenya and Tanzania have a regulatory limit of 30 percent for investments into real estate assets. This is meant to ensure that pension scheme have sufficient liquid assets to meet members payments at any given time. The impact of this limitation is that fewer housing establishments are realized from pension scheme assets thereby leaving a growing deficit of housing units. Of further concern is that over 95% of investments undertaken by Kenya and Tanzania pension funds in real estate, focus on rentals and target middle and high income earners, because of their ability to raise a constant stream of rental income from such properties. The focus is the return on investment with minimal risk. Commercial rental properties are therefore seen as a source of quick cashflow. Additionally, the Funds are not in the business of property trades. They may therefore not be keen on buying, developing and selling off property, since this calls for a lot of market awareness, targeting and involvement. NSSF in Uganda, is both a property developer and a source of medium term finance to commercial banks. However, as a developer the scale at which the fund delivers residential housing has been very low, in comparison to the amount of land (1,300 acres) it has allocated for residential real estate.

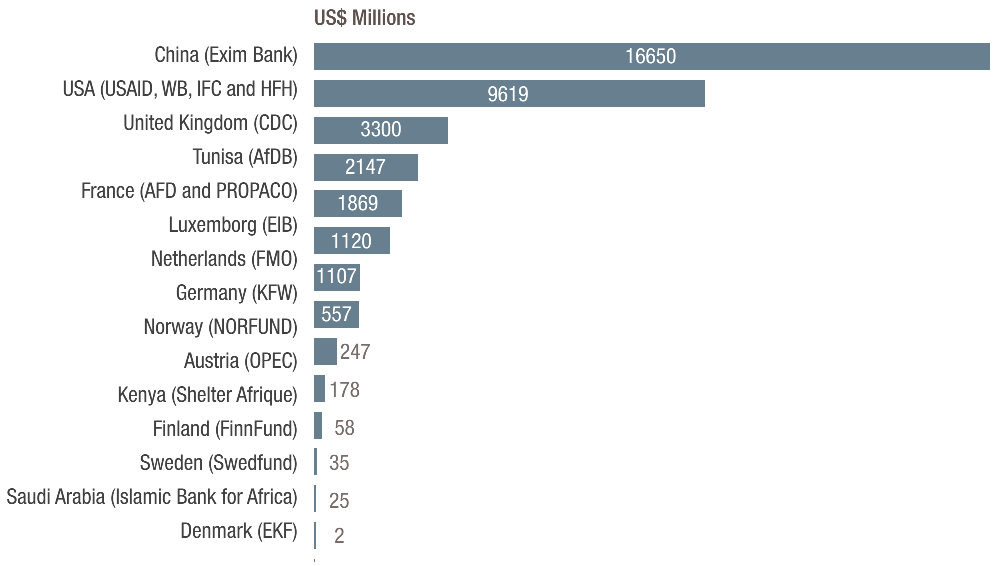
2.2 Foreign Institutional Investors in the EAC Region

2.2.1 Overview

In the period 2000 to 2017, the EAC housing and housing finance sector has attracted 20 foreign institutional investors, thanks to a politically and economically secure common market of 150 million people, in demand of new and innovative housing finance products, at affordable terms. IFC, EIB, AfDB and AFD have all established regional offices in Nairobi to coordinate their regional activities.

The majority (99%) of the foreign institutional investors that have, directly and/or indirectly contributed to the development of the EAC region's housing and housing finance sectors, are Development Finance Institutions (DFIs). DFIs are government-backed institutions that invest in private sector projects in low and middle income countries[5]. DFIs are structured as either multi-lateral or bilateral organizations that seek to invest in commercially sustainable projects often alongside private investors. DFIs operate under two types of ownership structures, either fully government owned or partially government owned with private shareholders (e.g. Dutch FMO). These ownership structures influence how the entities are regulated and funded. For example, Dutch FMO is structured with the same regulatory framework as commercial banks and must meet requisite capital requirements.

Institutional Investor, Location and Total Asset Allocation to EAC Region (2000 – 2017)



Source: various DFI Annual Reports (2000 – 2020)

From the figure above, China is home to the biggest investor in the EAC Region. Through Exim Bank, China invested close to US $ 17 billion, in the period 2000 to 2017. The second biggest source of investment (close to US$ 10 billion) was from the World Bank (WB), the International Finance Corporation (IFC), USAID and Habitat for Humanity International (HFH). Collectively, the funds sourced from Europe (FMO, CDC, NORFUND, FINNFUND, SWEDFUND, PROPARCO, KFW,

[5] CSIS (2016): Development Finance Institutions come of Age; Policy Engagement, Impact and New Directions

AFD, EIB, OPEC and EFK), match those from the USA. Emerging DFIs on the African continent represent the smallest share of investment in the region. Through the African Development Bank, US$ 2.6 billion, was invested in the EAC, in the period 2000 t0 2017 and US$ 178 million was sourced through Shelter Afrique.

The DFIs intermediate their funds through commercial banks (over 50 banks in the EAC); with whom they have built business trust and good working relations, some of which date back to the 1960s. Commercial banks are the institutions of choice, because of their good corporate governance, though plans to engage with SACCOs are in the pipeline, as part of efforts to extend housing finance to modest and lower middle-income households.

The sources of funding for DFIs range from direct capital injections by their sponsor governments (which is hugely subsidized) and securitization on the capital markets. These are often at very competitive rates (as low as 4%, payable between 15 and 25 years) due to government backing. The European Investment Bank (EIB), for example, has 28 European Union member states as shareholders and uses its financing operations to bring about European integration and social cohesion. The Bank uses a mix of shareholder capital and bonds to raise capital for on-lending to financial institutions, Private Equity Funds and projects in various currencies. In the EAC region, the Bank has largely focused on financing development projects in agriculture, manufacturing, education, health, tourism, transport and related sectors. EIB does not particularly provide funding for residential housing units but finances projects aimed at offering furnished apartments for the tourism sector. The African Development Bank (AfDB) is funded by a mix of share capital from African member states and long-term bonds, to fund Africa's budding housing industry. AfDB provides funding for both property development and homeownership through several commercial banks. Other DFIs with the mandate to finance the housing sector include Agence Française de Développement (AFD) and PROPARCO, IFC, USAID, Habitat for Humanity, CDC and the World Bank among others).

Box 3: DFIs – Mobilization of funding from the Capital Markets

DFIs also mobilize (or leverage) additional capital for the projects they invest in from private sector sources. In 2010, AFDB and Housing Finance Bank Uganda (HFBU) signed an agreement wherein the AFDB would provide local currency funding to HFBU to support housing sector developments. Since AFDB in Uganda holds only USD and therefore mostly advances loans in that currency, a corporate bond in UGX was issued by AFDB and listed on Uganda Securities Exchange. Total amount of the bond is UGX 100 billion of which UGX 25 billion has been drawn-down. To AFDB, this was the second local currency transaction structured for a client after a successful attempt to issue on in Malawi.

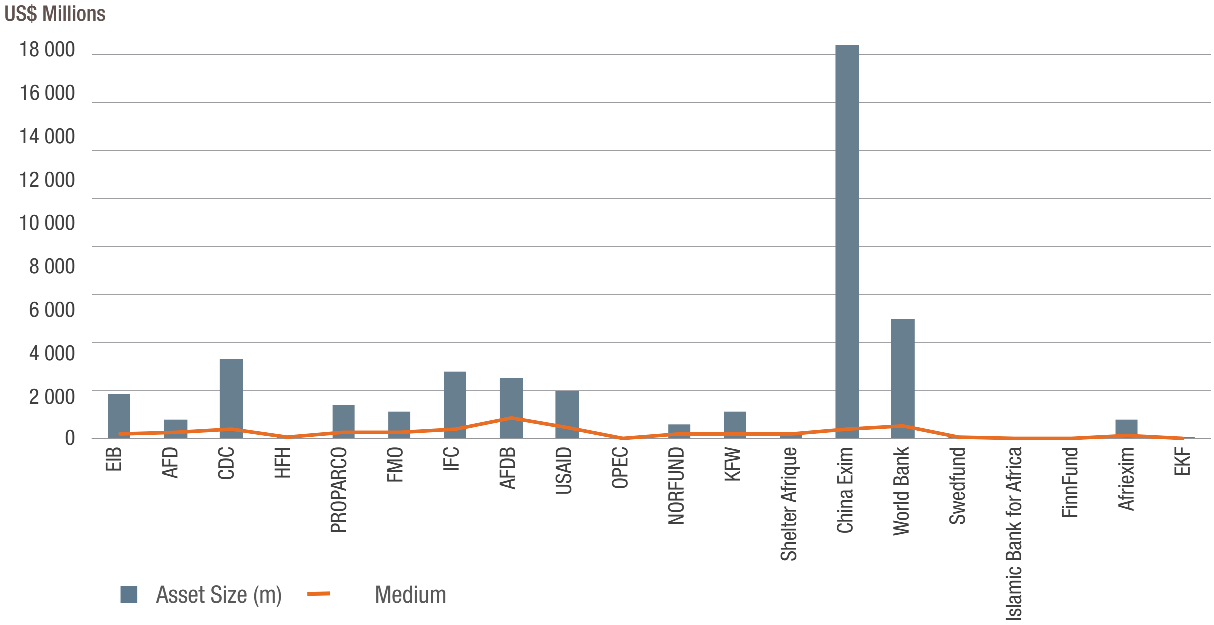
2.2.2 Total assets versus assets allocated to housing and housing finance related activities

Institutional investors (DFIs) have traditionally viewed real estate as a way of diversifying their portfolio to reduce risk. In the real estate sector, the administration of the funds (or the performance of funder investments) is largely divorced from the end-users. Financial intermediaries (commercial banks) put a lot of effort into insulating themselves, and therefore their funding sources, from credit risk. In as much as investors take comfort in taking note of the sub-projects funded by the line of credit, the ultimate risk of default is borne by the borrowing Financial Institution. This ensures that the investment performs at anticipated levels, unless there is a surprising shock closure or run on the bank.

However, this study, and earlier studies[6], established that most institutional investors allocate only a very small fraction of their portfolio to real estate (between 2 and 18%), much smaller than might otherwise be expected.

[6] Stephen A. Lumpkin (OCED): Institutional Investors and Housing Finance; 4th Housing Finance Workshop

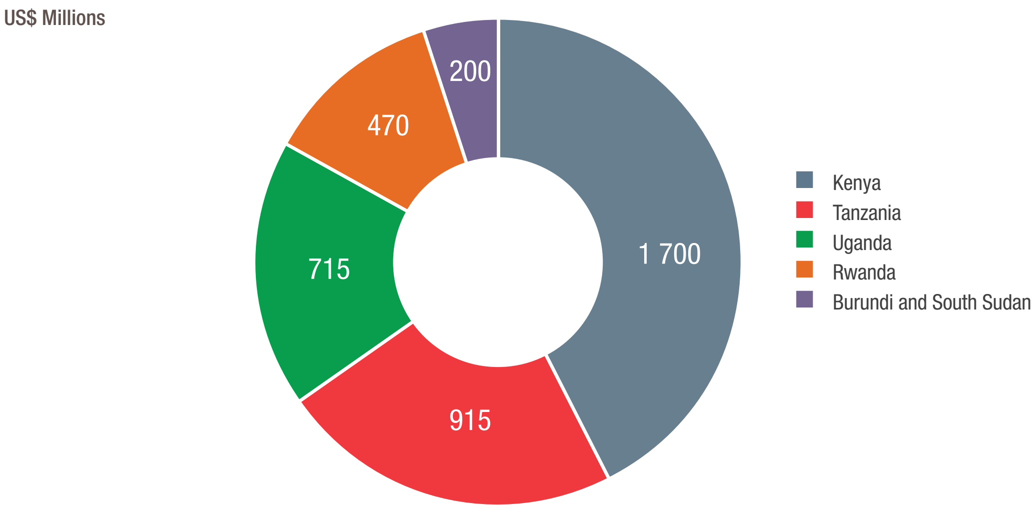
Total Asset vs. Assets to Housing Allocation to EAC Region (2000 - 2017)



Source: Institutional Investors' Annual Reports (2000 – 2020) and Consultant's Estimation

In the period 2000 to 2017, 10% of the total asset portfolio (US$ 4 billion out of the 40 billion) was allocated to investments that have a direct impact on the housing and housing finance sector in the EAC.

Assets Allocated to Housing by EAC Country (US$ millions)



This translates to about US$ 222 million per year, for the whole region. This includes equity, lines of credit to expand mortgage books, construction finance for developers, feasibility studies for down-ward market penetration, credit guarantees, technical assistance, and boosting investor confidence in capital markets. Because of a lack of readily available data, this study could not estimate how much funds are allocated to every investment activity.

Kenya, drew the biggest assets to housing (US$, 1.7 billion) in the Region, followed by Tanzania (US$ 915 million, Uganda (US$ 715 million), and Rwanda (US$ 470 million). The balance (US$ 200 million) was shared between Burundi and South Sudan.

3. INVESTMENT ACTIVITY IN HOUSING

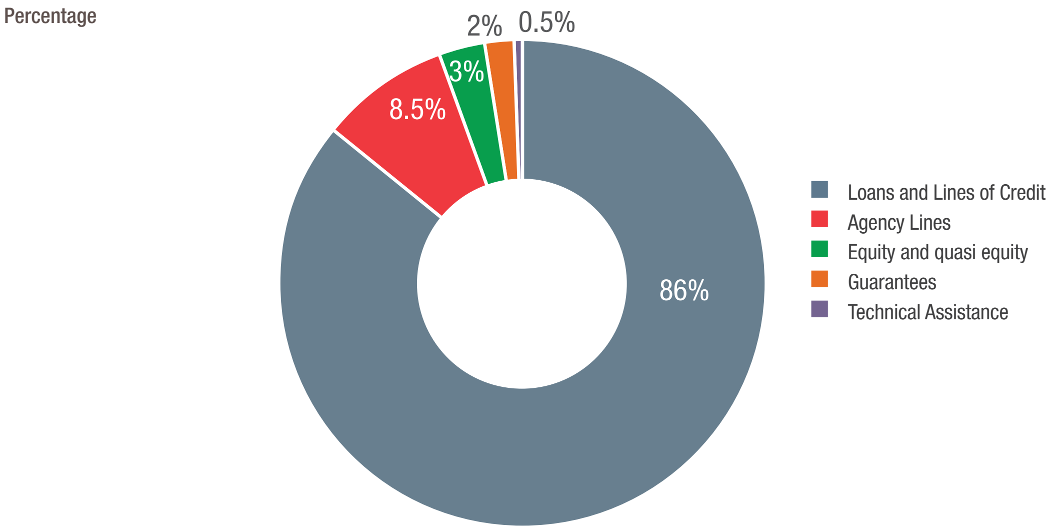
This section analyses the different investment instruments targeting the housing and housing finance sector in the EAC, their investment horizon and the period of investment

3.1 Investment instruments (Top Performing)

The overarching task of DFIs is to combine considerations of development impact and financial sustainability. They are demand driven in that each investment stems from a request made by private sector sponsors that offers the prospect of positive financial returns. PROPACO, for example, avails funds that are largely business oriented (with some allocations to housing), at market rates commensurate with local market conditions. However, PROPARCO's lines of credit are medium-term (up to 10 years) in nature, and not entirely supportive of the long-term funding required to make housing finance packages affordable to low and middle-income earners.

The most common (86%) investment tools by DFIs, are loans and lines of credit, because of the relatively high ROIs. Credit guarantees constitute 2%, pioneered by USAID, under its DCA program. USAID's strategy is to support credit taken with a partial guarantee called on in case of repayment failure.

Top Investment Tools for Housing



It targets borrowers and sectors that are constrained by a variety of factors such as the lack of formal collateral, lack of financial literacy, and inadequate property registry systems. In the EAC region, USAID credit enhancement and guarantee schemes, have been able to relax the requirements for accessing housing finance loans and also lengthen loan terms from 3 to 5 years. Technical assistance is the least invested instrument.

Equity or quasi equity made up only 3% of investment instruments. Notably, in 2007 I&M Bank (Kenya) attracted both equity and credit support from PROPARCO. This included equity support and a US$40M to the I&M group (See Kenya country report for more details on this investment).

Box 4: Technical Assistance from DFIs

AFDB, EIB, AFD and other lenders have provided Technical Assistance, on a number of capacity development issues. EIB has packaged its Technical Assistance programme to include strategies for improving bank operational efficiency through improvements in credit management procedures and customer relationship management.

The programme also extends credit to customers of financial institutions with tailored sessions that enables them improve cash handling and credit management skills aimed at reducing rates of loan defaults for the lenders.

The challenge here has been the absence of a housing sector focussed programme. To benefit the housing sector, Technical Assistance programmes need to be tailored to the needs of housing and housing finance sector, with particular focus on the design of affordable products, underwriting of non-formal sources of credit to secure housing finance.

Source: Interviews with key investors (2017)

CDC has equity worth US$ 15.1 million with DFCU Bank (the third largest provider of mortgages in Uganda) to finance long-term projects and added an additional US$ 10 million as a subordinated loan to further deepen the long-term financing agenda which caters for the housing projects particularly. Presently, CDC's shareholding in DFCU is 15%, compared to 60% in the 1990s and early 2000s. The new shareholders in DFCU, to whom CDC sold 45% of its shares, do not focus on housing investment.

In Uganda, a proposed housing project which partners the National Housing and Construction Company (NHCC - Uganda) and Zhongding International Engineering Company (ZIEC - China) is designed using the shared equity ownership concept as a means to promote affordability of housing in Uganda. The proposed Shared Equity initiative is a result of Government efforts to create affordable housing for low and middle income households through market incentives. Under this arrangement, ZIEC will source funding from a Chinese bank as a soft loan. The Chinese bank will provide a soft loan equivalent to 85% of the total cost of the project as per bank guidelines and the balance of 15% will be contributed by either NHCC. Under this arrangement, NHCC will be expected to identify a suitable institution to provide a marketing take-out guarantee – acceptable to the Chinese bank and private investor for the development of the housing units. Such guarantees will include either a local or international bank guarantee.

Social investors do not feature in EAC investment landscape. In Kenya, for example, it is the government that is raising funds, with support from institutions such as AFD, to upgrade slums and offer housing units at subsidized rates. Social investors would participate directly in building social houses, for very low-income households (less than US$ 150 per month) or even lend to SACCOs at concessional rates. In South Sudan, UN-Habitat, though a keen social investor, has since 2006 only managed to construct about 5 000 houses.

3.2 Investment Activity, Horizon and Period (Timeframe)

In the period 2000 – 2017, the average horizon for top performing investment instruments targeting the EAC housing and housing finance sector, was about 10 years (with a grace period of 1 to 2 years). This is less than the average tenor for mortgages on the market (15 years). Funding risks have therefore arisen out of the need to match the liability and asset period. There is a strong impetus among commercial banks to secure additional funding sources to cover the maturity gap of the facilities, much of which are drawn from customer deposits, as illustrated above.

Investment Asset, Investment Instrument, Activity, Horizon and Period

Investor	Assets in the Housing Sector (in US$ millions)	Investment Instrument and Activity	Horizon (years)	Period
EIB	179.4	Lines of credit to Commercial Banks for on-lending to SMEs including those in Housing Industry. Includes TA	10	2005 - 2017
AFD	245.3	Funding for residential real estate mortgages.	7	2000 - 2016
CDC	396.0	Funding across business sectors including residential real estate mortgages	12	2000 - 2017
HFHI	27.0	Loans though established microfinance institutions targeting home loan development funding. Includes TA	5	2000 - 2017
PROPARCO	225.2	Equity investments in financial institutions and a few lines credit lines	10	2010 - 2017
FMO	255.4	Credit lines for financing home loans and trade through intermediary financial institutions	7	2005 to 2017
IFC	385.5	Long term funding, boosting the lending ability of several banks to the housing sector (A mix of debt (senior loans and subordinated loans), guarantees and equity holdings	7	2008 - 2016
AFDB	868.3	Mortgage and other term loans to developer companies. Includes TA	12	2002 - 2017
USAID	420.8	Credit guarantee for the housing sector. Includes some TA	7	
OPEC	19.4	Extend long-term finance and leasing products to SMEs (some in housing)	8	2011 - 2016
NORFUND	180.5	Mortgage loan book support and infrastructural developments	7	2012 - 2016
KFW	219.2	Funds to commercial banks engaged in microfinance and SMEs, including those in housing. Includes TA	7	2011 - 2016
Shelter Afrique	178.0	Lines of credit, corporate loans and credit guarantees to financial institutions and specialized housing institutions for on-lending	10	2000 - 2016
China Exim	419.8	Infrastructure projects that have a direct impact on housing	10+	2012 - 2017
World Bank	517.6	Grants to address market failures and Institutional weaknesses to long-term financing; Technical Assistance and Studies for Housing Industry	10+	
Swedfund	21.0	Syndicated loan with other partners like FMO and PROPACO, to banks to fund SMEs in housing related activities	5	2010 - 2017
Islamic Bank for Africa	5.0	Lines of credit to support the development of affordable housing and real estate sector	5	2002 - 2017
FinnFund	14.5	Credit Information Bureaus and Infrastructure projects (solar power for homes) that have a direct impact on housing	5	2012 - 2017
Afriexim	123.0	Lines of credit to financial institutions (multi-sectoral, including housing)	5	2002 - 2017
EKF	0.5	Provision of working capital guarantee to SMEs	2	2010 – 2017
Development Banks	300	Provision of mortgage finance and production of bankable housing	5-20	2000 – 2017
Pension Funds	100	Term loans of up to 10 years to finance the mortgage loan book	3-10	2005 – 2017
Securities Markets	150	Through equity or debt, investors are able to obtain financing for their construction projects	10	2002 - 2017
Mortgage Liquidity Facility	50	supporting banks to do mortgage lending by refinancing banks' mortgage portfolios	10	2012 - 2016

Source: KII with Banks and Annual Reports of Investors

4. IMPACT OF INVESTMENTS ON EAC HOUSING INDUSTRY

This section analyses the different investment instruments targeting the housing and housing finance sector in the EAC, their investment horizon and the period of investment

4.1 The Breadth and Depth of Housing and Housing Finance Products

Mortgages

From the table below, the total portfolio that has been directly invested in the residential housing and housing finance sector (intermediated through the main mortgage providers in member states), was estimated at US$ 700 million, by the end of 4th quarter of 2016. The number of housing finance loans generated from this portfolio was estimated at slightly less than 32,830 in the same period. This represents only 0.76% of individuals in formal employment in the EAC. This clearly indicates that the breadth and depth of institutional investments has been significantly shallow, and indeed, calls for more innovation in which long-term funds are sourced and utilized to broaden their impact, particularly among modest income earners.

Characteristics of the Housing Finance Market (Estimates from Main Mortgage Lenders)

Component	Kenya	Uganda	Tanzania	Rwanda	Burundi	South Sudan
HF Product	P, CO, HL	P, CO, HL	P, CO, HL	P, CO, HL	P, CO, HL	P, CO, HL
Total Portfolio Size ('000) USD	330,000	198,700	154,700	23,300	2,900	1,670
Number of HF Loans	18,240	5,000	7,000	3,700	1500	800
Average Loan Size (USD)	47,170	52,500	54,790	73,000	24,627	5,000
Max Loan Size (M)	Up to US $10	Up to US $1.5	Up to US $1.5	Up to US $1.5	US$ 0.4	US$ 0.04
Loan Term	20 years	20 years	20 years	20 years	20 years	5 years
Pricing	16%	20%	21%	18%	19%	24%
Implied Monthly Income	US$ 1,640	US$ 2,300	US$ 2,400	US$ 2,900	US$ 1,000	US$ 400

Source: Compiled by Consultant from the main providers of mortgage finance
Key: HF – Housing Finance, P – Purchase, CO – Construction, HL – Home Loans

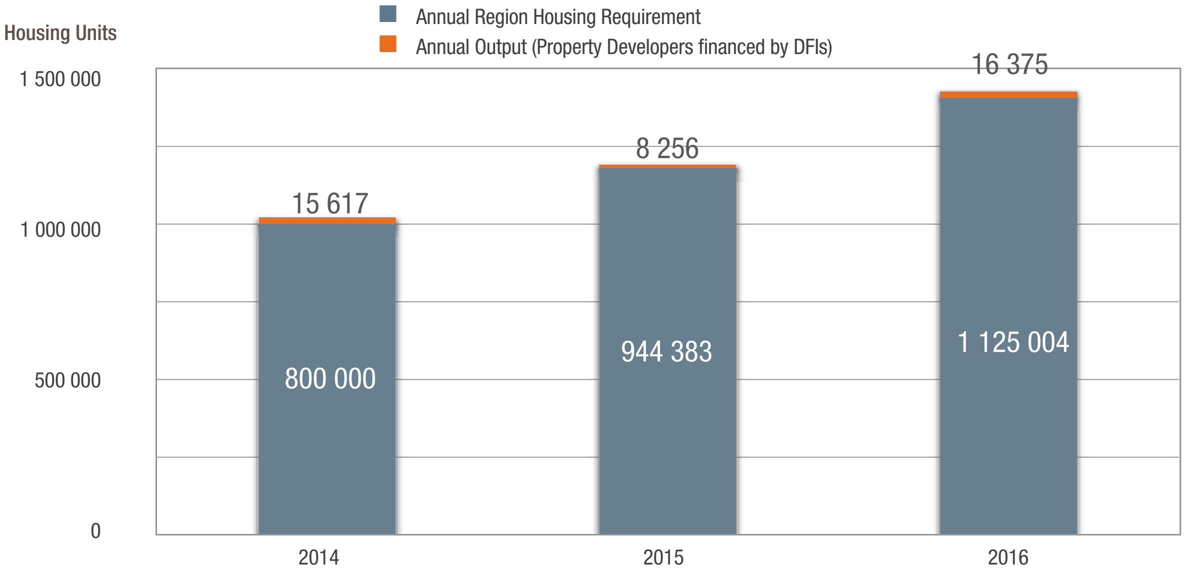
Property Developments (Housing Units)

In addition to reporting on financial rates of ROI, Institutional investors also examine their direct contribution to other enterprises (other than commercial banks) supported by their financial activities. However, a survey of the property developers supported by their financial activities, suggests that their investment have had a marginal impact on the housing industry in the EAC Region.

The figure below analyses the output of the residential housing units, during the period 2014 to 2016. In 2014 property developers (in the whole of the EAC) were only able to reduce the annual housing requirement by less than 20 000 units, against an annual requirement of 800 000 units for the whole region. Output in 2015 reduced to less than 10 000 units and increasing to 20 000 units in 2016.

The low levels of housing and housing finance sector investment calls for urgent and innovative investment approaches that will have a significant impact on the housing backlog in the short-term. The industry clearly lacks large scale investors which has resulted in the low levels of affordable residential real estate development.

Output vs. Annual Housing Requirement in the EAC Region



Source: Consultant's mini-survey of Property Developers in the EAC Region

4.1 The Breadth and Depth of Housing and Housing Finance Products

4.2.1 High Cost of Investor Funds thrusts High the Interest Rate on Mortgages

The relatively high cost at which commercial banks source long-term funds from DFIs results in high interest rates for end-users wishing to access housing finance products from these intermediaries. To safeguard risk in pricing, all foreign investments are benchmarked on Libor[7] (London Interbank Offered Rate). US$ funds are normally obtained from international funders who benchmark their ROIs on the LIBOR. Since alternative investments in developed markets, tend to fetch returns of up to the LIBOR rate, justification for investing in the more volatile East African region are based on an average return of LIBOR + 2.25%, over a period of 6 to 10 years.

Benchmarking International Funds

Credit Lines Available	Benchmarking	Cost	Tenor (Years)
ICD	Fixed	4.12%	7
USAID DCA	LIBOR+2.25%	4.21%	5
NORFUND	LIBOR+2.25%	4.23%	7
World Bank	LIBOR+	4.25%	10+
KFW	LIBOR+3.1%	4.51%	7
IFC	LIBOR+2.25%	4.57%	10+
AFDB	LIBOR+3.65%	4.65%	12
OPEC II	LIBOR+2.25%	4.87%	8
CDC	LIBOR+3.8%	4.89%	10
EIB	Fixed	5.21%	6-10
OPEC I	LIBOR+2.25%	5.33%	8
PROPARCO I	LIBOR+2.25%	5.77%	8
FMO	LIBOR+3.50%	5.82%	7
Norfund	LIBOR+2.50%	5.89%	8
PROPARCO II	LIBOR+2.25%	6.13%	8
Shelter Afrique	LIBOR+3.50%	6.2%	10
DANIDA Investments	Fixed	8% on Local Currencies	4

Source: Compiled by Consultant using several on-line sources

Once converted into local currency, the funds are benchmarked on the yield of local treasury bonds. These yields are calculated on inflation plus the "risk free" rate. In practice, the funds are benchmarked to the 182-day Treasury bill rate regardless of the tenor[8].

[7] Libor, the London inter-bank lending rate, is considered to be one of the most important interest rates in finance, upon which trillions of financial contracts rest. Libor is a global benchmark interest rate used to set a range of financial deals worth an estimated $ 450 trillion (September 2012). As well as helping to decide the price of other transactions, it is also used as a measure of trust in the financial system and reflects the confidence banks have in each other's financial health.

[8] This is because the 182 day Treasury bill is the most liquid in the market and therefore provides the most accurate benchmark.

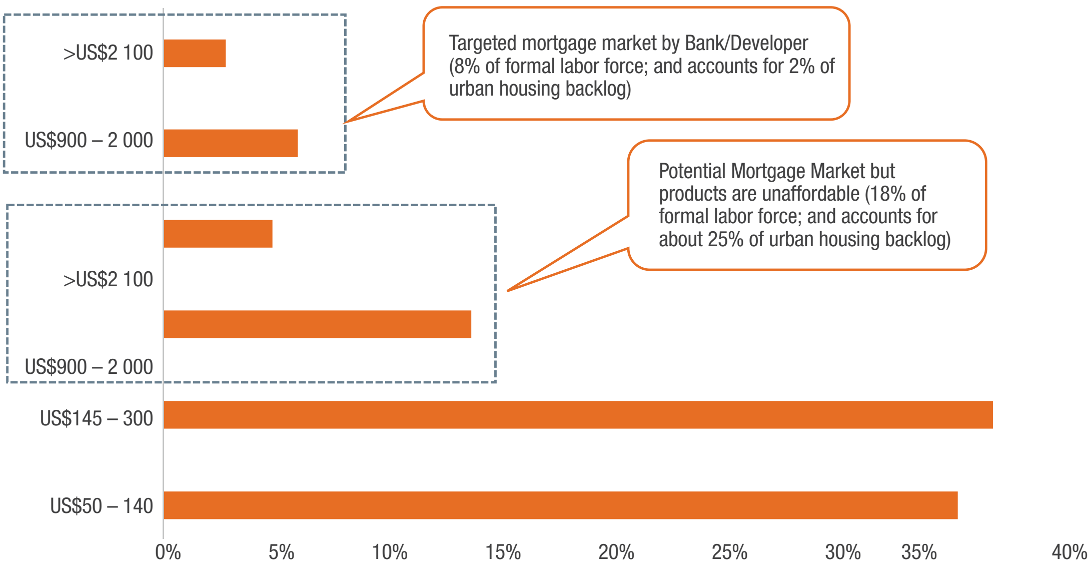
However, given the fact that member states suffer twin deficits on the national budget and the Balance of Payment, borrowing rates (for Treasury bills) are usually high (>10%) leading to steep pricing of all loans tagged to treasury security pricing. In addition, these loans are re-priced every 6 to 18 months based on movements on the treasury securities rates. This creates a re-pricing risk for banks as they are faced with new prices on the loans which may not easily be passed on to the end-consumer. Therefore, in calculating the effect of the risk free government security rates on mortgage interest rates, a consideration has to be made that as rational investors, banks have to minimize the risk of investment while getting the highest return. The result of this is that a 15-year mortgage interest rate, would automatically be pegged against an alternative investment such as 15-year government treasury bond, which is already perceived to be a risk free investment[9].

4.2.2 Information Asymmetry in EAC Housing Finance Markets

There is a growing bias in the analysis of housing finance markets in the EAC which focuses primarily on the middle and high-income households in the region. This is largely due to the lack of adequate affordable long-term investments[10]. The experts argue that the data on the housing industry is not collected in a way that differentiates the housing finance sector to adequately cater for the needs of all income groups, particularly those in the lower-middle and low income categories.

As illustrated in the figure below, a prominent developer and a housing finance institution in the EAC Region, do not plan to include low income earners (between US$ 300 and 600) among their target customers for the next five years (2018 -2023), because the prices at which the developer intends to deliver the houses (US$ 35,000 and 120,000), can only practically be afforded by middle and high-income earners (US$ 800 and above per month). The targeted households represent only 8% of the formal workforce, and account for 2% of the urban housing backlog, while the excluded represents 18% of the formal workforce and 25% of the urban housing backlog.

Asymmetrical Analysis on Potential Customers/clients of Housing Finance in a Bank



Source: Compiled by Consultant

In 2011, the World Bank[11] summed up the profound impact of the increasing information asymmetries on the delivery of affordable housing and housing finance products in East Africa, as follows,

"readily available information on the inter-active process that links income and affordability with specific house designs and specific preferences…so as to develop "a package that links prospective home owners (in this case low-middle income earners) to an affordable loan product to procure a modestly priced house, of an appropriate design"

The World Bank concluded that there is need for better and more innovative ways in which data is captured, analysed and interpreted, to make the housing and housing finance markets in Africa work better for all market participants, including the poor.

[9] If the government's 15 year borrowing rate is 16 percent, the mortgage rate has to be calculated in a number of ways; (I) Risk free rate + risk premium = 16% + 2-4% (depending on the risk associated with the borrower). (2) Cost of funds (15 year fixed deposits/savings) + risk premium. The ultimate impact is a higher rate of interest for the final borrower. Indeed, mortgages are financed at rates as high as 17% per annum on average. This further compounds affordability.

[10] WorldBank(2015) Shortage of Long-Term Finance Blunts Progress in Developing Countries.

[11] World Bank (2010): Expanding Access to Housing Finance : Design of Pilot Projects for Modest and Lower Income Households

5. INVESTMENT OPPORTUNITIES FOR THE EAC HOUSING SECTOR

The question of affordability could be approached from different points involving multiple stakeholders in the housing value chain. From the financing perspective, financial intermediaries need to find new avenues for raising long-term funds. Relying on customer deposits as a low cost source of funds is insufficient because of the short-term nature of such deposits. This would create a maturity gap and expose the intermediary to liquidity challenges and probable penalties from a regulatory point of view. There is a need to focus on making both local and foreign based financing structures affordable so as to improve both affordability and accessibility of the low-income households to mortgage finance. These structures need to target both developer finance home-owner finance. Funds should be availed at a lower cost (about 10%) to housing developer companies to reduce the cost of residential units. For customers, a lower interest rate (about 15%) would enhance the affordability of residential units.

Local funding structure could involve sourcing low-cost funds the pension schemes and other social security funds. This could be done through structuring corporate bonds at lower interest rates (less than 10%) to support the sector. A subsidy could help bring down the interest from 13% to less than 10%. Foreign funding arrangements need to incorporate a conversion mechanism in to the local currency without necessarily exposing the financial intermediary to exchange risks. For this to materialize, low-cost currency hedges must be identified to shoulder the exchange risk.

From the underwriting perspective, financial intermediaries would also need to develop capacity to credit-evaluate those in less formal employment, since they constitute the majority of modest and low-income households in the EAC Region. Without regular formal incomes, such clients cannot comfortably access or afford housing finance from commercial banks. There is therefore need to better the bank's understanding of the client segment's operations and structure suitable repayment plans under the affordable housing finance programmes.

Provision of concessional funding will go a long way in boosting delivery of housing solutions for the affordable segment. As observed, the need for affordable residential housing in the EAC Region is enormous and yet available solutions do not address the challenge due to the prevailing high interest rates (between 16 and 24%). Mortgage lenders have not had much room in pricing to bring down the interest rates. Solutions aimed at diversifying the lines of credit to mortgage lenders will bring a notable impact on pricing and aid affordability in the sector.

Credit guarantee schemes for the housing sector will also increase affordability for low income earners. Most financial institutions in the sector require at least 30% down payment on a new house. Almost entirely, this down payment has to come from savings. The average annual household income in the EAC Region is about US$ 300, which is a monthly income just above USD30. Given such statistics on household incomes, saving towards down payments is an uphill task for over 70% of households in the EAC. There is therefore need to provide guarantees in support of the down payments. Stakeholders in the financing value chain need to explore financing solutions that play a catalytic role in stimulating the supply and demand of affordable housing, and create momentum for other underlying reforms. Such solutions have been used in other emerging markets, including the creation of Mortgage Refinance Companies (MRCs) and the provision of Housing Finance Guarantees.

Elsewhere in Kenya, an enabling regulation was made in the Retirement Benefits Act of 1997 allowing for pension contributors to use up to 60% of their pension contributions as collateral for a home loan. This provision has increased affordability to the extent that some banks are now able to offer home loans to borrowers who not being considered due to inadequate collateral. This regulation should be embraced in the whole of the EAC Region.

Increasing access to affordable funding for banks and SACCOs: The narrow affordability gap in the housing market has restricted financing for both developers and users. The inaccessibility of affordable housing finance is highlighted by the fact that there are fewer than 40,000 mortgages outstanding. Commercial banks have limited access to long-term funding and few institutions have accessed capital markets to fund mortgages. It is therefore important for lenders to explore the role of SACCOs and other micro mortgage lenders to help bridge the gap in the housing finance market.

ACRONYMS AND ABBREVIATIONS

AFD	Agence Française de Développement
AfDB	Africa Development Bank
CDC	Common Wealth Development Corporation
DFI	Development Finance Institutions
EAC	East African Community
EIB	European Investment Bank
EU	European Union
IFC	International Finance Corporation
KCB	Kenya Commercial Bank
HFB	Housing Finance Bank
HFHI	Habitat for Humanity International
LIBOR	London Inter-Bank Lending Rate
MFI	Microfinance Institution
NHCC	National Housing and Construction Company
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
REITS	Real Estate Investment Trusts
RSSB	Rwanda Social Security Board
TMRC	Tanzania Mortgage Refinance Company Limited
URBRA	Uganda Retirement Benefits Regulatory Authority Act
USA	United States of America
WB	World Bank
ZIEC	Zhongding International Engineering Company

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