PRACTICE NOTE: REASONS FOR REJECTION

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The Open Access Initiative (OAI) aims to address information asymmetries in Africa's affordable housing market by harnessing the collective experiences and learnings produced by investors and developers through their investments in affordable housing. This Practice Note shares the experiences of OAI contributor International Housing Solutions in Kenya, on the reasons for rejecting project proposals to the Kenyan fund.

AFFORDABLE HOUSING DELIVERY IN KENYA: FINDING THE RIGHT PROJECTS TO FINANCE

International Housing Solutions (IHS) is a real estate fund manager with an established fund for investment in affordable housing in Kenya of $85million (Kshs 11.9 bn)[1]. With the fund having reached the first close in 2021, IHS expects to finance the construction of approximately 5,000 affordable housing units over the next 9 years, by 2032. However, a key challenge facing IHS is project eligibility, as a result of the many issues uncovered during due diligence on potential investments.

In its first two years of operations in Kenya, IHS undertook a review of over **50** projects and considered them for its pipeline. The evaluation of potential investment involves a detailed due diligence assessment of the entire project among other features. The due diligence is categorized into (I) **Legal Due Diligence, which includes the landowner's entities**; (II) **Land Due Diligence, which reviews the current and historical ownership of the land, title verification, the existence of encumbrances, caveats and charges**; (III) **Environmental, Social and Governance (ESG) Due Diligence, which assesses an organization's or developer's business practices and performance on various sustainability and ethical issues**; and (IV) **Market Due Diligence**.

To date, proposals for **29** projects within the Nairobi Metropolitan Area (specifically Nairobi, Kiambu and Machakos counties), involving more than **3,000 proposed housing units**, have been rejected. At the heart of these rejections, broadly, are not problems with developer capacity but rather **problems with the enabling environment and the local context impacting upon the development**. The reasons for rejection span the value chain, with the bulk of issues revolving around land, the most important factor of production.

Land

Land is a contested resource and as such, land challenges are not new to Kenya. Issues relating to land development impact all projects, whether residential, commercial, or industrial, whether for high value or affordable market investments. The move to digitize the land registry by the Ministry of Lands seeks to create transparency in the way land transactions are undertaken, while also automating processes such as land searches. While positive results are anticipated, the process has had teething problems and is thus slowing down current land registrations, transactions, and the entire development process, and hampering investment into affordable housing. The digitization process started in 2018 and was initially set for completion at the end of 2024, across all of Kenya. It is now widely accepted that these timelines are not feasible given the minimal progress that has been

[1] Some of IHS Fund investors include; EIB, UKCI, Counties Pension Fund and FSDAi.

made so far: the process is only underway in Nairobi County – that is, in only one of the 47 counties in Kenya.

In Nairobi County, the central lands registry was shut permanently in June 2021 after its operations were migrated to an online platform, *Ardhisasa*. The digitization process has however experienced delays, largely attributed to the conversion and verification process. Conversion is basically the process of migrating records so that they align with the Land Registration Act of 2012. Once this process is completed and the land data has been validated and cleaned, the property owners themselves must verify the land data captured on the system to allow it to go live. This involves a property owner registering an account on Ardhisasa and "adding" their property by uploading documents, to be listed under their account. Where the account is not opened, the property owners still can't access the land. The law allows the Ministry 90 days for conversions following the publishing of the conversion list. During this time, no one can transact on that parcel. The 90 days allow landowners to raise any issues which can then be corrected to allow for transactions. However, these timelines are not being kept.

Titles considered incomplete don't go live. Being considered 'incomplete' could mean that the records have missing files, the land parcels are missing in the official land cadastre, some parcels are unauthenticated and others have registration issues. Unless the parcel is live on the system, the owner is not allowed to transact in the land parcel. This conversion and verification process has been very slow. A key stumbling block is the lack of knowledge on how the system operates and the government's capacity. Notably, there is growing evidence of a need for a hybrid system where the older manual system can continue to operate while the new system is fully implemented.

According to reports by the media, the most affected are players in land conveyancing and registration, those seeking loans from banks and professionals who facilitate various land transactions. In 2021, the Kenya Bankers Association CEO Habil Olaka, noted that the transition had affected normal transactions such as consent, registration of transfer and charging of securities. He continued to state that the new system had blocked at least Kshs 104 billion in credit for the private sector, due to problems facing about 2,000 transactions. The relevant files were at different stages but the money could not be released because there needed to be a perfection of the securities[2].

Earlier this year, the Ministry of Lands defended the digitization which has come under heavy criticism with lawyers protesting delays in land transactions. The Ministry of Lands reported that it had adopted measures[3] to ensure continued operations, including creating modules and interfaces on the current land digital platforms to allow professionals transact land issues with ease. In spite of this, the transition continues to be a complex and slow process.

As is the case across Sub-Saharan Africa, land in Kenya has been subject to conflict, conquest, expropriation and exploitation[4]. Therefore, land-related challenges also exist outside the digitization process. Some of the other land-related challenges crippling investment in affordable housing include corruption and which may take the form of forgery, missing files, land grabbing, illegal allocation or double land registration; high land prices based on speculation; community or family disputes on land ownership; land encroachment and cultural heritage issues. Though some of these such as corruption can be resolved through strong governance systems, others such as resettlement

[2] AllAfrica. Kenya: Land Records Digitisation Hitches Block Sh100 Billion in Credit to Kenyans. https://allafrica.com/stories/202108200309.html (Accessed 23rd February 2023)
[3] Mbaka, J. The Star. *Lands ministry defends digitisation process*. 22 January 2023. https://www.the-star.co.ke/news/realtime/2023-01-22-lands-ministry-defends-digitisation-process/
[4] Bob, U. (2011). Land-related conflicts in Sub-Saharan Africa. https://www.researchgate.net/publication/265225778_Land-related_conflicts_in_Sub-Saharan_Africa

can be quite expensive and time-consuming for the landowner to resolve or correct to allow for development.

Of the 50 project proposals reviewed by IHS, 12 of them had land-related risks that undermined the feasibility of the initiative. The various land-related challenges are discussed below:

Land related challenges
• **Titling**: The existence of legal titles through land tenure and property rights encourages investment in land, as does improving its access to infrastructure. Unavailability of undisputed land, with clean title for new developers cripples implementation of the project as this hinders transactions. Key to note, housing will never be adequate if its occupants do not have a degree of tenure security which guarantees legal protection against forced evictions, harassment and other threats. IHS intends to revisit some of the rejected projects, should the land title issues be resolved.
• **Resettlement / Forced Eviction Risk**: With the rising cases of land encroachment in Kenya, developers continue to struggle with the process of resettlement aimed at freeing land for development mainly due to resistance of the inhabiting community and/or non-availability of a mutually agreeable resettlement process or plan. In other cases, investors restrict institutions from financing projects that could trigger forceful evictions as this is considered violation of human rights, in addition to the process of resettlement being time-consuming and expensive, and requiring legal expertise to expedite. This leads to delayed project commencement, financial loss in the resettlement and in the worst-case scenario inhibits project implementation. In this case, the projects had settlers who had to be resettled to allow access to the project site by the developer.
• **Community Disputes:** In some cases, despite the availability of a clean title, there is a risk of community disputes. Some communities may fear that a large-scale project will densify the area, such that privacy, security, existing infrastructure, and property values are compromised. "Nimby" (not in my backyard) is a common factor in many countries.
• **Cultural Heritage Concerns:** Cultural heritage is a collection of important assets of a culture that are preserved from generation to generation, and this may include land, buildings, or certain projects. Cultural heritage concerns may limit development activities within a given area or neighbourhood, and such activities may result in community resistance to housing projects for the fear of interference with the preserved assets
• **High Land Cost:** Land is central to achieve adequate housing as it defines at least three of its dimensions: tenure, affordability and location. Where the land is highly priced, it has a direct impact on the affordability of the housing units as the cost incurred in acquiring the land is recovered by the developer through the pricing of the housing units, and hence reduces viability. Additionally, high land price may compromise the viability of the project, as in the case of 2 projects reviewed by IHS. In Kenya, the cost of land is significantly high driven by high demand in infill and urban areas supported by good infrastructure. According to a Housing Development Cost Benchmarking Study commissioned by CAHF in 2022, land makes up the third highest percentage (after construction costs) of the development cost at 10% of a 44 square metre, 2-bedroom home in an apartment block in Nairobi[5]. This issue also relates to overall market dynamics as set out below.

[5] Pienaar, J., Open Access Initiative (2022) CAHF. Housing Development Cost Benchmark Report for Kenya 2022. https://housingfinanceafrica.org/documents/housing-development-cost-benchmark-report-for-kenya-2022/

- **Encumbrances and Caveats:** An encumbrance is when a claim is made against a property by someone who is not the property owner. This can affect the transferability of the property and restrict its free use, and typically requires a legal process to resolve. Encumbrances in the form of liens, leases, mortgages, restrictive covenants or deed restrictions can cripple the use of land for development purposes until the subject issue has been resolved. The resolution process can be lengthy, time consuming and costly thus making the proposed project undesirable by the investor. Additionally, the use of the property may remain restricted thus challenging the utilisation of the land. The subject projects were rejected due to the existing encumbrances on the land.

The legal and policy framework with respect to land is cumbersome and complex with the multiple legal regimes. This was partly resolved in 2012, when these were consolidated into the Land Act of 2012 and the Land Registration Act of 2012 thus simplifying the legal regime. Nevertheless, according to a policy review by FSD Kenya, the framework is still complicated by the fact that some legislation has not been operationalized with regulations. Additionally, it fails to engage productively with the notion of land value, and the impact this has on land use choices and affordable housing. The 2009 National Land Policy has important implications on affordable housing given its impact on the availability and price of land, however, it is out of date and under review. Other aspects of the law that require review include the operationalization of the Land Acquisition Tribunal to enhance conflict resolution and support land transactions, and the streamlining of the foreclosure process to promote mortgage lending. Currently, the process takes approximately 6 months thus restricting lenders from recovering their monies upon default, thereby discouraging lending, especially for high-risk clients[6].

Infrastructure

Bulk infrastructure in the form of roads, water, electricity and sewer systems is inadequate or unavailable in many parts of Kenya and especially in satellite towns. This has hindered the development of these areas even though they often have relatively affordable land in bulk. For the few who can shoulder the cost, they later pass this on to the end buyer in a bid to recover costs thus compromising housing affordability.

Of the 50 project proposals reviewed, IHS established that six of them had infrastructure-related risks that undermined the feasibility of the investment. The areas lacked adequate bulk infrastructure which could include sewerage, roads, and/or water. For the area to be feasible for housing, the developers would then need to invest in availing this infrastructure to support the project. This means an additional burden on the development cost. A Housing Development Cost Benchmarking Study[7] commissioned by CAHF in 2022 revealed that infrastructure makes up approximately 10.5% of the development cost a 44 square metre, 2-bedroom house in an apartment block in Nairobi[8]. Notably, one of the government incentives under the affordable housing program is a 25% tax exemption for investors in commercial housing properties, who spend on social infrastructure such as power, water,

[6] Murungi, M., Shah, S, (2022). Legal, policy and institutional review of affordable housing sector in Kenya. https://www.fsdkenya.org/wp-content/uploads/2022/11/Legal-policy-and-institutional-review-of-affordable-housing-sector-in-Kenya.pdf

[7] Open Access Initiative (2023) CAHF. Housing Development Cost Benchmark Report for Kenya 2022. https://housingfinanceafrica.org/documents/housing-development-cost-benchmark-report-for-kenya-2022/

[8] The CAHF cost benchmarking study assumes that the house to be constructed had basic level service in a capital city: paved access roads, storm water drainage, a waterborne sanitation system, access to an internal potable water supply and an energy system. It is assumed that if such a house cannot be connected to municipally provided bulk services, then these services must be provided on-site. One of two elements of servicing costs is therefore considered in the benchmarking cost. First, the costs of internal services (linking the house to bulk infrastructure networks), or alternatively the cost of on-site services (such as a septic tank in place of municipal sewer, a well in place of a water connection, and a generator in place of an electricity supply connection from an energy service provider).

sewer lines, and roads to allow recovery of their expenses within four years[9]. Unfortunately, just like with the other affordable housing incentives, this tax exemption is still inaccessible to developers.

The economic viability of affordable housing projects is highly dependent on availability of serviced land. There is therefore need for the government to set up measures to increase the supply of serviced land, through increased investment in physical and social infrastructure especially on peri-urban land and in satellite towns. The government could also encourage the construction of infrastructure by private developers by enhancing access to the relevant incentives. Picking a lesson from South Africa, the South African government has increased available serviced land for government housing projects by making it easier for municipalities to rezone land for housing purposes, and by financing the infrastructure necessary to develop serviced land through the Housing Development Agency (NHDA)[10]. This therefore opens up areas for development and relieves developers of the additional cost they would otherwise have to incur.

Management / Operational Issues

Operational issues in an organization can take different forms from having poor management structures, to conflicting interests or priorities. Business conflict management is often complicated by organizational leaders' resistance to formal dispute resolution processes. This often results in poor performance of the institution, low morale, employee turnover, reduced profits, disrupted activities and stalled projects. In their review, IHS established that two of the 50 projects presented to them for evaluation, were experiencing operational issues. One of the projects had in-fighting within management, while the other could not agree on the deal structure. This scenario often cripples the origination, implementation, and running of the subject project thus posing a significant risk to the investor. To support developers, IHS is working on upskilling emerging developers but at an additional cost, with the aim of ensuring projects are delivered within the set timelines and are developed to the required standards.

Operational issues in some cases also manifest as deal malfunctions. Forging a partnership to undertake the project can be an uphill task where parties fail to agree to certain fundamental aspects of the project such as unit prices, target returns and the management structure. This ultimately hampers efforts to undertake the project due to lack of synergy among key stakeholders.

Conflict within institutions is common and a majority can be resolved internally with the right leadership and systems in place. However, in the case where conflict is within the management team, the dispute may take longer to resolve and could be a financially expensive affair. This may affect project scope and timelines and thus a risk factor for investors resulting in the lack of confidence in the success of the project.

Market Dynamics, Performance and Affordability

In some cases, projects have been ruled out as "unviable for investment" which means investors do not believe they will be able to meet their targeted return. The constraint in this regard could be attributed to an unfavourable operating environment and market dynamics - relatively low unit pricing within the market, unhealthy competition or low purchasing power of the target consumers. Other hurdles may include security concerns within the proposed project site.

[9] Cytonn (2020). Accelerating Funding to Affordable Housing. https://cytonn.com/topicals/accelerating-funding-to-1
[10] Housing Development Agency. http://www.thehda.co.za/

On the legal end, gaps in the legal framework and subsequent administrative arrangements can undermine developers' performance, and this comes down to the effectiveness of county governments and the National Housing Corporation. In certain instances, therefore, it is the performance of these public bodies that impact on investment decision-making.

An existing large housing supply in an area often prompts the investor to reconsider investment in the area. The oversupply may be fuelled by forecasted demand in the area, ease of access and proximity to key business nodes or facilities, improved infrastructure thus attracting developers into the area and/or availability of development land. Large incoming supply sometimes outstrips demand leaving the market with a surplus. This therefore makes the area less attractive for further investment as the demand has already been met and further supply may result in dead stock. Key to note, this is generally not the case in the low-income market segments despite this part of the market having the bulk of the deficit.

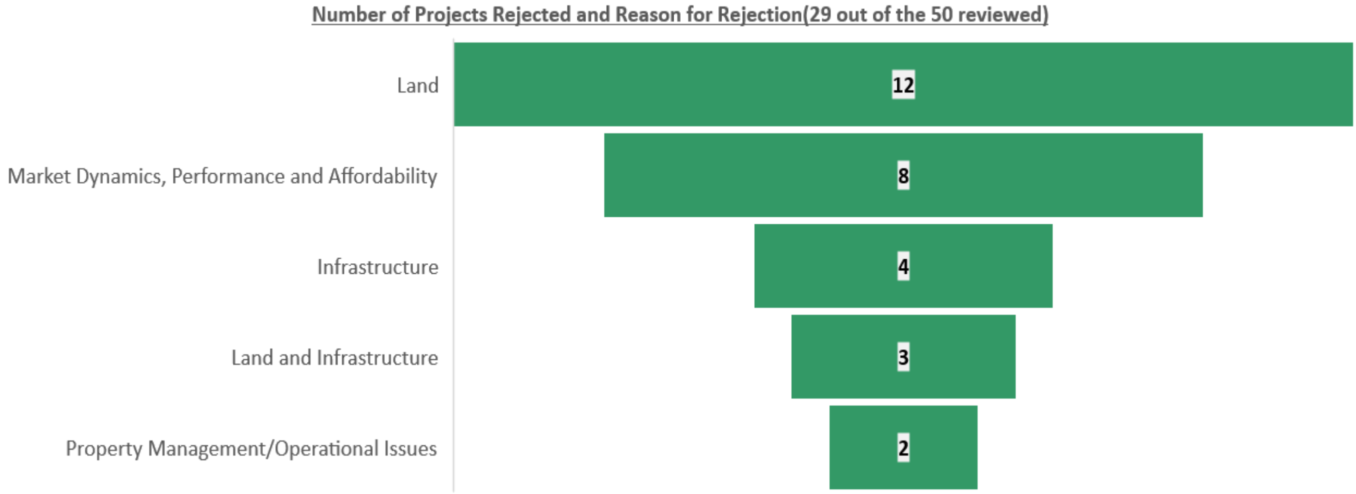
Development cost is a key determinant of housing unit pricing coupled by market performance, and target returns. High project development costs attributable to high cost of inputs, the need to invest in infrastructure and tax burdens often result in high unit pricing by developers as they seek to maintain their margins: noting that construction alone makes up approximately 53.4% of the development cost[11]. This pricing may put off a potential financier especially in the case where they are keen on housing affordability.

In the case of IHS, the unit prices within four of the proposed projects they evaluated were relatively high, outside the fund's target bracket, another three projects were deemed to be situated in an unfavourable market, and then the proposed area for one of the projects had an oversupply. IHS thus declined to invest in these projects.

Conclusion

The IHS exercise involved a review of 50 projects, 29 of which had the potential to bring to the market more than 3,000 housing units on completion, but have since been rejected by the financier. In some cases, the rejection related to the capacity of the developer, however, as mentioned earlier IHS is developing a programme to upskill emerging developers to ensure that projects are delivered within the set timelines and are developed to the required standards. In far many more, however, the rejection related to matters beyond the developer's control, such as titling, market dynamics and inadequate infrastructure. It is clear that investment into affordable housing will require addressing multiple blockages along the value chain. Investors are naturally reticent about the constraints they can see, even before the development is underway. The most dominant constraints relate to land availability. The various issues that can be bundled together under the category of "market dynamics" are also significant in undermining project success, as shown below:

[11] Open Access Initiative (2023) CAHF. Housing Development Cost Benchmark Report for Kenya 2022. https://housingfinanceafrica.org/documents/housing-development-cost-benchmark-report-for-kenya-2022/



For many of these issues, the resolution depends on the government's input. Understanding the array of factors that impact on each distinct, proposed affordable housing development, is critical as government seeks to promote the affordable housing pillar of the Big Four Agenda.

As market players explore these issues, there is an additional argument for Development Finance Institutions (DFIs) to play a role in the areas of research and innovation, and in building the government's capacity to undertake its mandate more efficiently with a key focus on the legal and regulatory framework. According to the report prepared by FSD Kenya[12], interventions required to address the above blockages include;

- **a review of land values and property price dynamics**, and the development of measures to leverage these in support of affordable housing, the provision of insights into the development of a land banking policy, and the provision of inputs into the Idle Land Taxation Policy,
- **an impact assessment of the current professional fee structure in the construction sector** to provide the Competition Authority of Kenya with the evidence needed to grant exemptions in support of affordable housing and facilitate the achievement of affordable housing units through lower professional costs,
- **support to county governments, municipalities and towns throughout the country in developing and expediting their urban area plans** to enable orderly physical development as provided in the Urban Areas and Cities Act 2011 and the County Governments Act 2012[13],
- **specific training in the legal and regulatory framework** to ensure that members of staff for the various institutions involved in the building approval processes, as well as developers and contractors are each aware of their responsibilities,
- **a wide scale assessment of human resource capacity in the building industry**, both in the public and private sectors- including training plans of the National Construction Authority[14], county officials and Competency Based Training Assessment for building contractors and construction workers,

[12] Murungi, M., Shah, S.(2022). Legal, policy and institutional review of affordable housing sector in Kenya. https://www.fsdkenya.org/wp-content/uploads/2022/11/Legal-policy-and-institutional-review-of-affordable-housing-sector-in-Kenya.pdf
[13] Kenya Law. http://www.parliament.go.ke/sites/default/files/2017-05/UrbanAreasandCitiesAct_No13of2011.pdf
[14] National Construction Authority. https://nca.go.ke/

- **advocacy for the preparation of standards for alternative building/construction materials** by the Kenya Bureau of Standards (KEBS)[15] which will enable the lowering of construction costs and therefore enable achievement of affordable housing,
- financial institutions need to create **pools of financing to support investment in infrastructure and offtake for affordable housing** in line with Kenya Affordable Housing Programme Development Framework Guidelines drafted in 2018[16]. Though the Guidelines are specifically dedicated to affordable housing agenda, and are quite progressive, they are largely yet to be implemented in scale to have desired impact.

To sum up, contrary to the "word on the street", finance is only one of the dominant constraints to the delivery of housing in Kenya. As outlined in this review, there are a myriad of other bottlenecks across the value chain which hinder investment despite the availability of finance. Property management and operational issues depict the incapability of the developers involved, while titling, land values and infrastructure lean towards the government's responsibility in creating an enabling environment. On the latter, there is a need for deliberate interventions by the government to enhance the delivery of affordable housing especially by the private sector players, which will contribute significantly to the achievement of the government's goals under the Big Four Agenda.

This Practice Note was written by Beatrice Mwangi, Research Manager at the Centre for Affordable Housing Finance in Africa. For more details on the Open Access initiative and its principles, contact Allan Mutuma, Programme Manager, on allan@housingfinanceafrica.org The full Concept Note and a brief Fact Sheet provide further details. Open Access data providers can use these Guidelines to understand and fill out the Data Template. Also explore the Nairobi Metropolitan Area Dashboard of housing developments (BETA version), and the Online Portal: Kenyan literature and documents dashboard , which were developed as part of the Open Access Initiative.

[15] Kenya Bureau of Standards. https://www.kebs.org/

[16] Kenya Affordable Housing Programme Development Framework Guidelines drafted in 2018. https://www.housingandurban.go.ke/wp-content/uploads/2018/11/Development-Framework-Guidelines-Release-Version.pdf