Centre for Affordable Housing Finance in Africa

Kenya's Affordable Housing Program

Unlocking delivery of housing in Kenya: the need for construction finance

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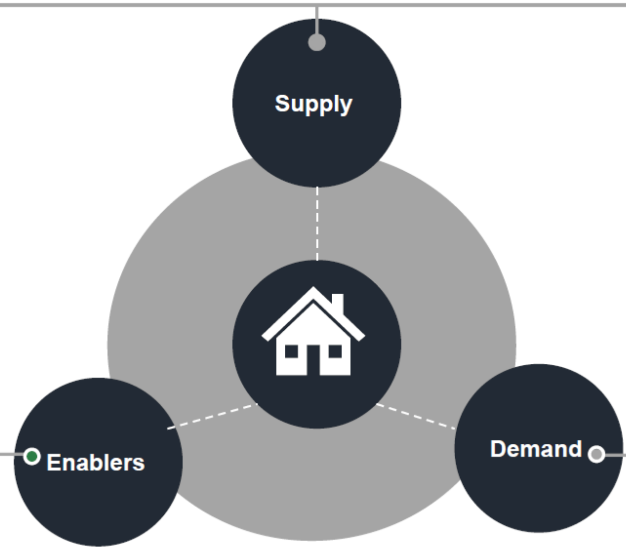
Contents

All figures in KES. Conversion rate is KES 100: $1

1.0 AHP key interventions

The AHP interventions are intended to stimulate both supply and demand.

- ☑ proven demand master plan and mega city approach
- ☑ mixed use developments with provision of social infrastructure and amenities
- ☑ affordable developer financing



- ☑ Provision of land and bulk infrastructure
- ☑ Infrastructure funding under K.U.S.P
- ☑ Tax incentives
- ☑ Tax breaks (Zero rating of Stamp duty for first time home owners
- ☑ Standardised designs and/or processes

- ☑ Tenant Purchase Schemes (TPS)
- ☑ KMRC (extending Mortgages tenures)
- ☑ Housing Portal to assist in identifying the end buyer

Source: Page 7, AHP Delivery Framework Presentation, Nov 2018.

1.0 AHP framework for supply

Developer provided with **offtake agreement: price of KES 50,000 psm**

Developer contributes land, designs, builds and finances units

Government provides offtake **on completion**

90% on verification, 10% after defects liability

CAHF Paper reviews viability for local developers to participate

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2.0 Small vs Large Developers

Developer Size	Product	Construction Methodology	Volume	Capital injection	Ave const cost psm	Ave sale price psm	Examples local developer
Small	Bungalow (1 storey)	Buys materials and hires labour on a daily basis, acts as developer and contractor	< 50 units pa	Limited capital from developer, projects funded largely by purchaser instalments	KES 20,000	KES 35,000	Mahiga Banda Sierra
Large	Apartments (4 stories +)	Employs a contractor for delivery of project	>100 units pa	Raises significant equity and debt in addition to purchaser instalments	KES 31,500	KES 65,000	Karibu Suraya Greenspan Unity Riruta Chigwell Natureville

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2.1 Small vs Large Developers costs

Description	Factor	KES psm	Explanation
Base construction cost for Small Developers		**KES 20,000**	Input resulting in average sale price psm of KES 35,000
Structure	25%	KES 25,000	Additional steel etc for building high rise versus single storey: structural frame, stairs, intermediate floor slabs
Labour	5%	KES 26,250	Pay all regulatory dues on labour (NSSF, NHIF, PAYE)
Margin	20%	KES 31,500	Add profit margin for contractor
		KES 31,500	Resulting cost per buildable sqm from contractor to large developer
Area adjustment	15%	KES 36,225	Circulation space of apartments (corridors, staircases) is an additional cost factored onto sellable space.
VAT	16%	KES 42,021	16% VAT is an additional tax on final contractor price
Corresponding construction cost for Large Developers		**KES 42,021**	Input resulting average sale price psm of KES 65,000

VAT on construction is a big barrier to affordability

3.0 Pilot Project

Unit Typology	2 Bedroom apartments, 40 sqm net
Land	Well located, serviced to boundary, KES 20 m per acre
Gross to Net	1.15, Total built 6,900 sqm
Density	Ground plus 3 stories, FAR 1.7
Onsite infrastructure	KES 6 million per acre
Construction	KES 31,500 psm before VAT
Soft costs	12% of hard construction and infrastructure costs
Debt to Equity	Debt funds 60% of hard construction cost only
Timeframe	Month 1-3: Land contribution, finalize designs Month4-6: Approvals, arrange financing Month 7-24: Construction over 18 months Months 27: First offtake payment of 90% Month 39: Final offtake payment of 10%
Required return	Developer IRR of 25%

3.1 Pilot Project Financials

Project Costs	150 units	1 unit	1 sqm	
Land value	**20,000,000**	**133,333**	**3,333**	**6%**
Infrastructure cost	6,000,000	40,000	1,000	2%
Construction @ KES 31,500 psm	217,350,000	1,449,000	36,225	68%
VAT on Infra + Construction	35,736,000	238,240	5,956	11%
Total Hard Costs	**259,086,000**	**1,727,240**	**43,181**	**81%**
Soft Costs (Prof / Mkg/ Appr)	**26,802,000**	**178,680**	**4,467**	**8%**
Interest on debt @ 15%	**13,757,466**	**91,716**	**2,293**	**4%**
Total Project Cost	**319,645,466**	**2,130,970**	**53,274**	100%
Financed by				
Debt	**155,451,600**	**1,036,344**	**25,909**	**49%**
Equity:				
Land	20,000,000	133,333	3,333	6%
Soft Costs	26,802,000	178,680	4,467	8%
Hard Costs (40% of total)	103,634,400	690,896	17,272	32%
Interest during construction	13,757,466	91,716	2,293	4%
Total Equity	**164,193,866**	**1,094,626**	**27,366**	**51%**
Total Sources	**319,645,466**	**2,130,970**	**53,274**	100%
Offtake price offered by AHP	**300,000,000**	**2,000,000**	**50,000**	

Key Conclusions

- **Land & Infrastructure not prohibitive due to density**
- **Construction cost continues to be most limiting factor. VAT on construction is a big barrier.**
- **Delivery cost without contingency, close to offtake price**
- **Debt finance difficult to access and expensive despite offtake**
- **Developer to raise significant equity**
- **Offtake price not viable for developer risk undertaken, particularly bearing T Bond Rate**

4.0 Recommendations

- **Construction Finance**
  - Milestone payments within the offtake agreement
  - Setting up a separate construction financing
  - Increase debt: equity proportions

- **Improve viability for developers**
  - Zero rated VAT, Offtake price, construction finance rate

4.1 Offtake price and equity required sensitivities

Scenario	VAT	Interest Rate	Debt: Equity	Equity required KES, per 2 BR unit	Viable offtake price KES, psm
1, Current	16%	15%	50:50	1,155,770	65,000
2	0%	15%	50:50	1,039,390	57,500
3	0%	9%	50:50	986,679	56,000
4, Proposed	0%	9%	60:40	715,235	55,000

4.2 The rationale for concessions to developers

Project Costs	Scenario 1 Per Unit	Scenario 4 Per Unit	Key Changes Sc 4 - Sc 1	% saving
Land value	**133,333**	**133,333**		
	-	-		
Infrastructure cost	40,000	40,000		
Construction @ KES 31,500 psm	1,449,000	1,449,000		
VAT on Infra + Construction	238,240		-238,240	
Total Hard Costs	**1,727,240**	**1,489,000**	-238,240	**-14%**
Soft Costs (Prof / Mkg/ Appr)	**178,680**	**178,680**		
Interest on debt @ 9%	91,716	105,421	13,705	**15%**
Total Project Cost	**2,130,970**	**1,906,435**	**-224,535**	**-11%**
Financed by				
Debt	1,036,344	1,191,200	154,856	15%
Total Equity	**1,094,626**	**715,235**	**- 379,391**	**-35%**
Total Sources	**2,130,970**	**1,906,435**	**- 224,535**	**-11%**
	-	-		
Required offtake price	**2,600,000**	**2,200,000**	**- 400,000**	**-15%**

Key Conclusions

- Zero Rated VAT reduces cost by 14%
- Interest cost increases but higher debt amount
- **Total subsidy: KES 224k**
- **Reduction in house price: KES 400k.**

4.3 Subsidy multiplier

Subsidy to developer (zero VAT, lower debt cost)	-KES 224,535	
		Subsidy multiplier
Reduction in house price	KES 400,000	**1.78**
Reduction in TPS subsidy	KES 521,831	**2.32**

4.4 Key Conclusions

- Kenya has a class of credible local developers
  - Eager to participate in delivery of affordable housing
  - Have access to land
- Volume of finance to build houses is very high, even for 150 unit project need approximately KES 160m of developer equity
  - Providing construction finance through milestone payments or via a separate financing vehicle will unlock delivery
- Currently offered offtake price of KES 50,000 psm is not viable
  - Without concessions, require offtake price of KES 65,000psm
  - With concessions (Zero rated VAT and 9% construction financing), require offtake price of KES 55,000 psm
- Construction risk can be managed well with proper risk mitigation framework and project governance
- Supply subsidy described has a 2.3 times positive multiplier

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5.0 Reinvestment Fund: www.reinvestment.com

- Founded in 1985, non-profit lending agency
  - **Community Reinvestment Act**
  - Focused on reviving distressed neighbourhoods
  - Intermediary between banks & developers for private capital
  - Intermediary between state governments & developers for tax credits
- Fund raised own capital
  - Impact bonds issued in $1,000 denominations,
  - **880 investors, $2 billion in capital, AA-S&P Rating**
- Product range:
  - Housing, schools, supermarkets, commercial, renewable energy

The Fund's success if based on:

- Strong market knowledge and local networks, GIS Mapping platform, **www.policymap.com**
- Skilled workforce and investment oversight
- Risk alignment (on book lending)
- Strong commercial discipline: 90 days deal closing, 5 days drawdown

5.1 Risk Management

Risk Area	Avoid / Mitigate / Manage Measure
Product	Consultant vetting and contract documents, Consultant Professional Indemnity, Decennial (Inherent Defects) Insurance, Independent time, quality and cost monitoring
Construction Delivery	Independent developer vetting, performance bond and monitor retention amounts Technical interrogation of the procurement documentation Manage ground risks with a separate ground work contract Independent program monitoring by aligned construction professionals Independent Certification of Milestone payments Contractors insurances assigned to financier
Market	Offtake agreement based on proven end user market acceptance of product Offtake payment credibility proven and accepted by supply chain Allow access to savings from middle to higher income population to invest in housing (eg. Accessing partial pension contributions)
Payment Default	Drawdown Conditions Precedent include, construction permits, progress and equity first Build in similar milestones for balance debt funding relative to developer Cash Equity Overall risk lower as limit debt to 60% of project cost which equates to 55% of sale price
Dispute and Litigation	Strong and simple contracts with intelligent Alternative Dispute Resolution Adjudication in 40 days as first course of dispute resolution and prescribed adjudicator
Project Management	Upfront due diligence of whole project delivery team Invest in capacity building to ensure systems are in place, Regular independent monitoring
Developer insolvency	Liquid asset rich security, Bond coverage Step in provisions to realise completion

Project Governance

Recurrent issues in Kenya to be avoided…

Design issues to get right in high rise…