The East African Community

Overview

The East African Community (EAC) economy achieved significant growth in 2017 and the first half of 2018. The average GDP growth rate of 5.9 percent for the region in 2017 was forecast to continue into 2019.[1] This was significantly higher than the Sub-Saharan Africa growth performance of 1.6 percent average GDP growth recorded in 2017.[2] This growth has been attributed to the macro-economic stability driving accelerated public and private investment in several sectors including public infrastructure, oil and gas, agriculture and the financial sector. Kenya is the first country in the region to produce oil exports. The country's production unit was commissioned in June 2018 and the first 2 000 barrels were shipped to Mombasa port for export. Uganda is steadily investing in public transportation infrastructure and an airport construction project is already underway in the oil-rich region of Hoima where a US$4 billion (Ush15.12 trillion) refinery project is planned. Commencement of commercial oil extraction is likely to trigger large-scale developments in several sectors including housing and housing finance to cater for the accommodation needs of a growing, oil-linked labour force.

The region also noted a considerable decline in inflation rates in 2017, largely attributable to a good harvest and stable exchange rates. Headline inflation declined in the fourth quarter of 2017 from 7.5 percent to 5 percent in Kenya, 5.4 percent to 4 percent in Uganda, 5.1 to 4.5 percent in Tanzania, 3.9 to 2.2 percent in Rwanda and from 14.3 percent to 14.2 percent in Burundi. The relative decline in inflation resulted in a reduction in lending rates across the banking sectors with the exception of Burundi and South Sudan, where supply-side challenges continued to plague their financial sectors, due to fragile political contexts. Declining inflation rates have resulted in significant housing sector development in Uganda, Kenya and Tanzania. Low interest rates have also resulted in a rising demand for housing units. Central banks in the region have consistently reduced the benchmark Central Bank Rate (CBR) to illustrate their commitment to private sector-led growth in the region. The central banks of Rwanda, Kenya, Tanzania and Uganda maintained their policy rates at 6.0 percent, 10 percent, 12 percent and 10 percent respectively in the fourth quarter of 2017. 2018 saw further decreases in interest rates to 5.5 percent in Rwanda, 9.5 percent in Kenya, 9 percent in Tanzania and 9 percent in Uganda.[3]

Across the region, financial institutions continue to rely on customer deposits as their main source of funding. In Kenya, customer deposits accounted for 72.7 percent of the banking sector's total liabilities and shareholders' funds at the end of the fourth quarter of 2017, an increase from 71.9 percent recorded in the third quarter of 2017.[4] Although still strong, the total loan-to-deposit liability value for Uganda declined to 64.1 percent in December 2017 from the four-year average of 74.2 percent.[5] This was the result of subdued demand for credit arising out of slow growth in economic activities for the larger part of 2017, except the last quarter in which there was rebound economic activity across the region.

Access to finance

The six-member states of the EAC are generally well-served by formal financial institutions including commercial banks and microfinance institutions. In addition, large sections of both the rural and urban populace are members of savings and credit co-operatives (SACCOs). An important component of the improving levels of financial inclusion across the region relate to the development of mobile money services. Safaricom in Kenya, Vodafone in Tanzania as well as MTN in Uganda and Rwanda have introduced initiatives that enable subscribers to transfer funds, save and access small loans from their cellphones. In addition, the agent banking model recently implemented in Uganda, has gained momentum, with over 2 000 bank agents now in operation. Commercial banks, with approval from the Bank of Uganda, now appoint bank representatives from existing local businesses such as supermarkets, pharmacies, fuel stations and mobile money outlets to provide banking services in unserved areas of the country.[6] With the implementation of such initiatives, the proportion of the region's population accessing financial services will most likely increase from 44 percent in 2011 to 75 percent by 2022.[7]

In Uganda, banks faced a challenging business environment with low credit growth in 2017, which rose by only 1.5 percent,[8] far lower than the 6.1 percent growth recorded in the previous year. This marginal growth is attributable to slow economic recovery following the 2016 general elections. However, in the second half of 2017, indicators showed that domestic economic activity started to pick up, driven by an enabling monetary policy, public investments, increasing growth in consumption and improved agricultural productivity. There has been a notable rise in private sector credit (PSC), largely driven by a drop in interest rates. Credit growth by sector indicated that mortgage, construction and real estate, trade and commerce, household, agriculture and manufacturing continue to account for the bulk of private sector credit, constituting more than 70 percent of the total loan stock. The growth in credit also followed a period of general improvement in loan performance as evidenced by the reduction of the non-performing loan ratio from 10.5 percent in December 2016 to 5.6 percent in December 2017.[9]

Similarly, the banking industry in Kenya recorded a 2.6 percent rise in lending activities, from Ksh2 390.4 billion (US$23 904 million) in the third quarter of 2017 to Ksh2 452.7 billion (US$24 527 million) in the fourth quarter of 2017. The increase in gross loans and advances was largely attributable to growth in the real estate, manufacturing, trade, household, energy as well as building and construction sectors of the economy.[10]

Despite posting marginal growth figures for the larger part of 2017, the majority of commercial banks in the region remained adequately capitalised during the year. In Burundi, the return to relative stability in the political arena culminated in a marginal 8.2[11] percent rise in total loans by BIF795 480 million (US$454 million) for the period to December 2017 compared to BIF735 126 million (US$420 million) rise for the one-year period to December 2016. This marginal rise in private sector credit was recorded on the back of an 18.2 percent rise in total banking sector assets to BIF2 164.7 billion (US$1 236 million) in December 2017 from BIF1 834.9 billion (US$1 048 million) in 2016, highlighting the banks' preference for low-risk government securities as opposed to the highly risky private sector in an era of a fragile investment climate.

In Tanzania, the mortgage market registered a growth of 6 percent for the year 2017, compared to a growth rate of 16 percent in 2016. The market also witnessed the entry of three new mortgage lenders increasing the total number of lenders to 31. The new entrants in 2017 were Letshego Bank (T) Limited, Yetu Microfinance Bank PLC, and Mufindi Community Bank Ltd. The aggregate mortgage loan portfolio grew by a marginal 6.4 percent to TZS 344.84 billion (US$152 million) in December 2017, up from TZS 324.08 billion (US$142 million) in December 2016. The mortgage market in Tanzania is still dominated by five top lenders, who together command approximately 60 percent of the mortgage portfolio. Stanbic Bank commands 18 percent of the mortgage market share, followed by Bank M (16 percent), CRDB Bank (11 percent), Azania Bank (8 percent) and Commercial Bank of Africa (7 percent).[12]

Affordability

Housing affordability continues to be a challenge across the region, with three to four-bedroom housing units priced at approximately US$50 000 (Ush200 million in Uganda,[13] Ksh5 million in Kenya[14] and Tzs115 million in Tanzania[15]), far out of reach of the majority. In Rwanda, Burundi and South Sudan, the average price of housing units is above US$60 000 due to a high reliance on imported construction materials. These figures make housing inaccessible to the large majority of East African households.

Despite the slow growth rates posted by key trading partners in the East African region, attempts have been made in Uganda, Kenya, Tanzania and Rwanda to increase affordability of housing units. Burundi and South Sudan have made marginal, to no progress towards improving affordability, largely as a result of persistent political instability. However, a general reduction in the policy interest rates across the region should result in a reduction in the interest rate costs of housing finance over the medium term. Interest rates on mortgages have tended to be sticky and less affected by improvements in the reduction of NPL-driven costs. Most lenders consider the AAA mortgage loans' portfolio as relatively low risk and therefore not a key contributor to the general performance of the loan book. Additionally, because of the low risk grading for the portfolio, the pricing of mortgage loans is usually at the bottom of the bank's loan pricing tariff guide, leaving relatively less room for adjustments even in the face of general reductions in the central banks' policy rate.

In Uganda, the July 2017 amendment of the Income Tax Act provided for tax breaks on interest payments towards mortgages. Mortgage interest payments have been established as a tax deductible, incentivising investment in housing.

In Kenya, small and medium enterprises have been disproportionately affected by the law on interest rate capping. This is believed to be a consequence of tight lending criteria, with banks gravitating towards so-called safer borrowers who ordinarily attract low interest rate charges. This includes government officials and large corporations rather than small, ostensibly riskier individual borrowers. Interest rate caps have affected the profitability of commercial lenders with some experiencing a drop in revenue of up to 25 percent.[16] As a reaction to this shortfall, several banking institutions in Kenya have resorted to cost reduction measures including closing branches and cutting jobs to offset the decline. Prior to the introduction of the cap, Kenyan banks charged an average 18 percent on loans.[17] This has now declined to an average of 14 percent.

Housing supply

Across the region, housing backlogs are growing. The government in Kenya has estimated an urban housing need of 150 000 dwellings a year, against formal production of about 30 000 units annually.[18] In Tanzania, the annual housing deficit is estimated at 200 000 units.[19] Uganda, has a housing deficit of 1.6 million units, comprising an estimated 1.4 million units in rural areas and 210 000 units in urban centres.[20] Rwanda's annual housing deficit is estimated at 34 000 units.[21] The capital cities of Nairobi, Kampala, Kigali and Bujumbura have each embarked on slum upgrading projects to provide decent residential housing estates, clean water and sanitation.

Against this background, there are some noteworthy efforts towards better targeted, affordable housing delivery. In Uganda, companies such as Comfort Homes and Universal Multipurpose Enterprises launched their first one-bedroom apartment projects at Ush70 million (US$18 667) per unit. For both developers, the projects were highly successful, and all units were sold before construction was complete. They have since established the second phase of the two projects with a 23 percent increment in offer price at Ush86 million (US$22 933). Most of the purchasers of these residential units appear to be investors, however, who offer the units for rent. Rental charges for one-bedroom apartments is approximately Ush400 000 (US$105) per month. Additionally, developers are delivering two-bedroom apartments at a sale price of Ush165 million (US$44 000) and three-bedroom apartments at Ush200 million (US$53 333).[22] Most of these projects are situated within a radius of 10 kilometers from Kampala city centre. Comfort Homes Uganda delivered their first phase of low-cost homes in Gayaza (16 kilometres from Kampala City) at Ush47 000 000 (US$12 434) per unit and all apartments were sold out within six months of launching the project. Buyers are increasingly relying on home loan finance to fund the purchase of housing, illustrated in the rise in lending in the sector.

In Kenya, the Ministry of Transport, Infrastructure, Housing and Urban Development announced plans to enable the construction of 500 000 affordable housing units over the next five years as part of the government's four flagship projects. Phase I includes the delivery of 30 000 units in Nairobi using government land to reduce the delivery cost and boost affordability.[23] Eighty percent of the units will be priced between Ksh800 000 (US$8 000) and Ksh1 million (US$10 000). The remaining 20 percent of the units will be demarcated for social housing, consisting of urban slum upgrades and costing an average of Ksh650 000 (US$6 500). Government-owned land in the five urban areas of Nairobi, Nakuru, Eldoret, Kisumu and Mombasa have been targeted for developments under various public private partnerships.

The Rwandan government has financed the delivery of housing through the Development Bank of Rwanda (BRD). The Rwandan government plans to deliver 15 000 housing units by 2024 with an investment of US$250 million through BRD for project development and an additional US$150 million for end-user finance from the World Bank for on-lending through commercial banks to support mortgages.[24] These banks will offer housing loans at a concessional rate of 10 percent as opposed to the market rate of 19 percent per annum. The Rugarama project in Nyarugenge is a 2 674 housing unit project which will be developed on 42 hectares of land, at a cost of US$131 million. The Kimisangea project will consist of 150 housing units and cost US$60 million. There are an additional 800 housing units in Busanza-Kicukiro district being delivered by Community Housing Limited (CHL). BRD is partnering with Bank of Africa to kick-start construction of the Ndera project by the fourth quarter of 2018. At a cost of US$68 million and an area of 18.6 hectares, the project is planned to take a phased approach with the first phase costing US$12.4 million. About 15 kilometres from Kigali in the Gasabo district, the project is expected to be completed by September 2019. The units will include two and three bedrooms apartments, constructed in several four story apartment blocks. The project targets households with an income of between Rwf261 000 (US$301) and Rwf1.2 million (US$1 398) a month. To achieve this, the project will have a strict screening process to ensure that the project units are not taken over by high income earners. Additionally, only 5 percent downpayment will be required from qualifying buyers. Eighty percent of the units will be delivered at a relatively affordable price range of between Rwf27 million (US$31 468) and Rwf35 million (US$40 792), while the remaining 20 percent will be priced higher for middle and high income earners.[25]

In Tanzania, the National Housing Company (NHC) has several major projects in Dar-es-Salaam. This includes the Mwongozo Housing Estate located in Gezaulole Kibamboni which consists of 216 two to three bedroom houses. The NHC has also been involved in the sale of undeveloped land to prospective developers. The corporation has offered over 300 serviced plots for sale in the Mateves area close to Arusha catalyst for the development of satellite cities.[26]

Property markets

Prices of residential properties in the EAC region have continued to rise, and in some cities, doubled after a five-year period. In Tanzania, new residential neighborhoods have emerged around Dodoma when the country's administrative capital shifted to the area in 2017. Similarly, new areas have developed from the Kanombe airport towards the administrative capital of Kigali. In Kampala the construction of the Entebbe - Kampala highway has had a direct impact on the spatial growth pattern of the area.

A notable trend in Kampala has been the transformation of the formerly residential neighborhoods of Kololo, Nakasero, Ntinda, Bugolobi, Kamwokya, Makerere, Nakawa, Kireka and others into commercial areas. Residential houses in these neighbourhoods have been modified and converted into office buildings and eateries.

Policy and regulation

A number of key regulatory reforms have affected housing and housing finance in the region. In Kenya, President Uhuru Kenyatta set affordable housing as one of key focus areas with a promise to deliver 500 000 new housing units by 2022. Towards this, the President signed an amendment to the Income Tax Act to establish an Affordable Housing Relief set at 15 percent of the gross emoluments. Prospective first-time home owners of affordable housing are now exempted from paying 15 percent tax on emoluments up to Ksh 108 000 (US$1 080). The amendment also doubled the tax deduction for depositors investing in Home Ownership Savings Plan (HOSP) schemes from Ksh48 000 (US$480) per annum to Ksh96 000 (US$ 960) per annum. In the same vein, the Stamp Duty Act[27] was amended to exempt first-time home buyers under the affordable housing scheme from stamp duty. The tax is charged on the market value of the property at the rate of four percent in urban areas and two percent in rural areas and must be paid to the Kenya Revenue Authority (KRA) within 30 days of concluding the property sales and transfer agreement.

Uganda has also amended its Income Tax Act to allow for tax relief on mortgage interest payments. It is hoped that such initiatives will enhance affordability of housing and housing related finance. Additionally, a 2016 amendment to the Financial Institutions Act (2004) created a regulatory environment for agent banking, Islamic banking, and bank assurance. It is hoped that such initiatives will support the financial inclusion agenda. More specifically, agent banking now enables borrowers to access disbursed loans at agent outlets nearest to their premises and also enables them repay installments through the same agent outlets. In less urban environments where the average distance to the nearest financial services point is 12 to 22 kilometers, the introduction of agent banking regulations is a welcome addition to the expansion of financial services.

Opportunities

All six countries in the EAC have similar challenges relating the supply of affordable housing. Demand for housing and appropriate housing finance products remain extremely high, but affordability is constrained by inadequate supply, and high interest rates on housing-related facilities. While the monetary authorities in the respective countries have achieved strong gains in reducing interest rate cost of housing finance from 22 – 25 percent in 2011 to the current 15 – 19 percent, these rates are still high. The reliance on bank deposits creates an opportunity for long-term investors to partner with financial institutions for increased affordability of loan products. Additionally, the establishment of mortgage refinance facilities would go a long way in encouraging commercial banks to enter the mortgage space by providing liquidity to these institutions. Within the region, the Tanzania Mortgage Refinance Company has been instrumental in growing the mortgage market, increasing the number of mortgage lenders from three to 31 over a six-year period. A similar "Kenya Mortgage Refinance Company" is being developed in Kenya, and discussions have also been held in Uganda and Rwanda along these lines. These initiatives signal Central Bank attention to the housing sector in the region, and very real opportunities for growth.

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