The Role of Special Purpose Vehicles (SPVs) in Finance and Investments in Kenya, and Cytonn Weekly #04/2025

Executive Summary:

Fixed Income: During the week, T-bills were oversubscribed, with the overall subscription rate coming in at 136.7%, higher than the overall subscription rate of 78.6%, recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 16.8 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 419.8%, significantly higher than the undersubscription rate of 84.6%, recorded the previous week. The subscription rates for the 182-day decreased to 38.2% from the 54.5% recorded the previous week, while the subscription rates for the 364-day papers increased to 122.0% from the 100.3% recorded the previous week. The government accepted a total of Kshs 32.8 bn worth of bids out of Kshs 32.8 bn bids received, translating to an acceptance rate of 100.0%. The yields on the government papers were on a downward trajectory, with the yields on the364-day, 182-day and 91-day papers decreasing by 1.0 bps, 0.2 bps and 4.0 bps respectively to 11.29%, 10.03% and 9.53% from the 11.31%, 10.03% and 9.56% recorded the previous week;

In the primary bond market, the government is looking to raise Kshs 70.0 bn through the reopened two infrastructure bonds; IFB1/2022/14 and IFB1/2023/17 with a tenor to maturity of 11.8 years and 15.1 years respectively. The bonds will be offered at fixed coupon rates of 13.9% and 14.4% respectively. The period of sale opened on Thursday, 23rd January 2025, and will close on 12th February 2025. Our bidding range for the reopened bonds are 12.85%-13.55% and 12.95%-13.65% for the IFB1/2022/14 and IFB1/2023/17 respectively;

During the week, the global ratings agency, Moody's announced its revision of Kenya's credit outlook to positive from negative, while maintaining the credit rating at Caa1, on the back of a likelihood of an ease in liquidity risks and improved debt affordability;

We are projecting the y/y inflation rate for January 2025 to increase to within the range of **3.1% - 3.4%** mainly on the back of: a rise in fuel prices in January and the decrease in the Central Bank Rate (CBR) by 75.0 bps to 11.25% from 12.00%.

Equities: During the week, the equities market was on an upward trajectory, with NSE 10 gaining the most by 3.0% while NSE 25, NSE 20 and NASI gained by 2.9%,1.8% and 1.3% respectively, taking the YTD performance to gains of 6.2%, 5.7%, 3.3% and 3.2% for NSE 20, NASI, NSE 10 and NSE 25, respectively. The equities market performance was driven by gains recorded by large-cap stocks such as EABL, KCB and DTBK of 7.2%, 6.6%, and 5.3% respectively. The gains were however weighed down by losses recorded by large-cap stocks such as Bamburi, Stanbic and BAT of 3.5%, 1.6%, and 0.5% respectively;

Real Estate: During the week, Kenya Bureau of Statistics (KNBS) released 2023/24 Kenya Housing Survey Basic Report that provides a comprehensive analysis of the housing sector in Kenya. The survey aims to gather information and generate estimates for key housing indicators, and real estate indicators in the country. The report provides detailed insights into housing conditions, affordability, and tenure across the country. Conducted by KNBS in collaboration with government agencies, the survey aimed to inform evidence-based housing policies aligned with national and global development goals.

Also during the week, Kenya Bureau of Statistics (KNBS) released 2023/2024 Real Estate Survey Report which highlighted significant growth, regulatory challenges, and market dynamics. The market has grown by 33.7% from 2019 to 2023, driven by urbanization, infrastructure, and initiatives like the Affordable Housing Program. However, gaps in reliable housing data hinder effective decision-making. The report indicates that in 2023, about 34.4% of advertised office space remained unoccupied due to low demand.

During the week, Hass Consult, a Kenyan consulting and Real Estate development firm, released its Property Index Q4'2024 Report, focusing on the residential Real Estate sector's performance in the Nairobi Metropolitan Area (NMA).

Also during the week, Hass Consult released Land Price Index Q4'2024 Report which highlighted the performance of the Real Estate land sector in the Nairobi Metropolitan Area (NMA).

During the week, a private developer, GulfCap Real Estate broke ground on a Kshs 120.0 bn housing project in Kisumu marking a significant development in Kenya's real estate sector. Spanning 285 acres, the project aims to address the growing demand for housing in Kisumu, a city experiencing rapid urbanization and population growth. The initiative is expected to create thousands of jobs, both directly and indirectly, through construction activities and the establishment of supporting services. This employment boost is anticipated to stimulate the local economy and improve livelihoods in the region.

During the week, an investor, The View by the Park Limited, has proposed a Kshs 1.3 bn hotel development overlooking Nairobi National Park, aiming to capitalize on the park's unique proximity to the city center. The proposed hotel is expected to offer panoramic views of the park, providing guests with a distinctive experience of urban and natural landscapes. The hotel's location is advantageous, situated near key transport routes and close to Nairobi's central business district. This strategic positioning is anticipated to attract both international tourists and business travelers seeking convenient access to the city's amenities while enjoying the tranquility of the park's surroundings.

During the week, the Local Authorities Pensions Trust (Laptrust) revised its plans for the Ugatuzi Tower project in Nairobi, reducing the proposed 50-storey office building to 34 floors. This adjustment comes in response to a surplus of office space in the market and escalating construction costs. The revised project is estimated to cost approximately Kshs 3.1 bn. Originally, Laptrust intended to construct a 50-storey tower at an estimated cost of Sh5 billion. However, legal challenges from some of its members delayed the project's commencement, leading to the current revision. The proposed building will occupy 1.3 acres at the intersection of Argwings Kodhek and Chaka Road in the Hurlingham area. Laptrust plans to complete the project within 24 months after obtaining the necessary licenses and beginning construction.

On the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 25.4 and Kshs 22.2 per unit, respectively, as per the last updated data on 17th January 2025. The performance represented a 27.0% and 11.0% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. Additionally, ILAM Fahari I-REIT traded at Kshs 11.0 per share as of 17th January 2025, representing a 45.0% loss from the Kshs 20.0 inception price;

Focus of the Week: A Special Purpose Vehicle (SPV), sometimes known as a Special Purpose Entity (SPE), is a legally separate and independent entity formed for a specific, defined purpose, typically to isolate financial risk. SPVs are widely utilized in securitization, project finance, structured finance, and asset-backed transactions. They are intended to be bankruptcy-resistant, meaning that their operations and liabilities are separate from the parent or sponsoring organization. SPVs can be established as either limited liability companies (LLCs) or limited partnerships, trust or even a subsidiary of the originator. Since they operate as independent entities, they remain off the sponsor's or parent company's balance sheet. We chose to focus on SPVs given their limited understanding in the local market, yet they are crucial to bringing much needed capital to fund businesses and projects;

Investment Updates:

- Weekly Rates: Cytonn Money Market Fund closed the week at a yield of 16.5% p.a. To invest, dial *809# or download the Cytonn App from Google Play store here or from the Appstore here;
- We continue to offer Wealth Management Training every Tuesday, from 7:00pm to 8:00 pm. The training aims to grow financial literacy among the general public. To register for any of our Wealth Management Trainings, click here;

- If interested in our Private Wealth Management Training for your employees or investment group, please get in touch with us through wmt@cytonn.com;
- Cytonn Insurance Agency acts as an intermediary for those looking to secure their assets and loved ones’ future through insurance namely; Motor, Medical, Life, Property, WIBA, Credit and Fire and Burglary insurance covers. For assistance, get in touch with us through insuranceagency@cytonn.com;
- Cytonn Asset Managers Limited (CAML) continues to offer pension products to meet the needs of both individual clients who want to save for their retirement during their working years and Institutional clients that want to contribute on behalf of their employees to help them build their retirement pot. To more about our pension schemes, kindly get in touch with us through pensions@cytonn.com;

Hospitality Updates:

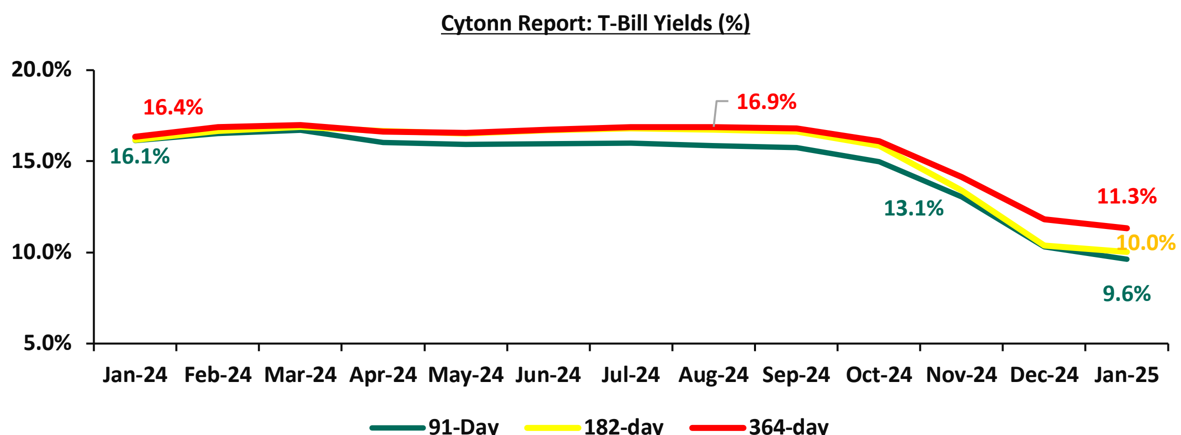
- We currently have promotions for Staycations. Visit cysuites.com/offers for details or email us at sales@cysuites.com;

Fixed Income

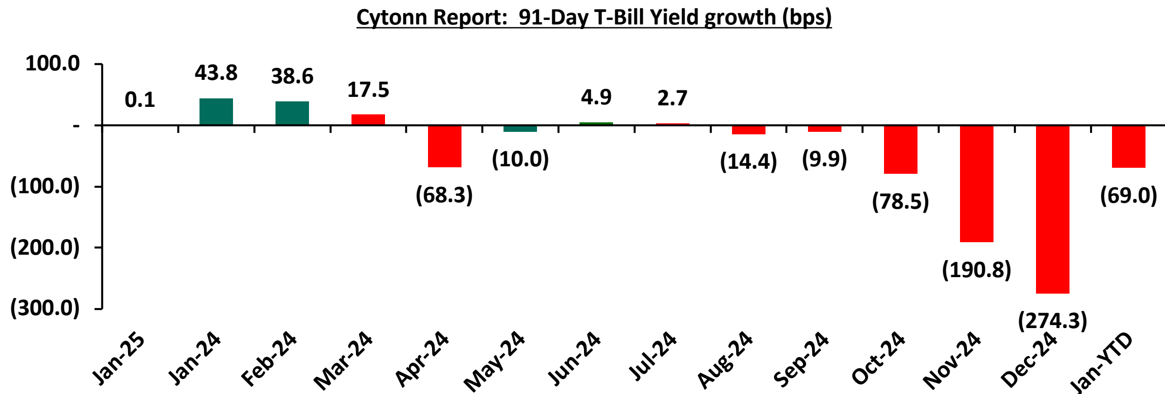
Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed, with the overall oversubscription rate coming in at 136.7%, higher than the overall undersubscription rate of 78.6%, recorded the previous week. Investors’ preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 16.8 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 419.8% significantly higher than the undersubscription rate of 84.6%, recorded the previous week. The subscription rates for the 182-day decreased to 38.2% from the 54.5% recorded the previous week, while the subscription rates for the 364-day papers increased to 122.0% from the 100.3% recorded the previous week. The government accepted a total of Kshs 32.8 bn worth of bids out of Kshs 32.8 bn bids received, translating to an acceptance rate of 100.0%. The yields on the government papers were on a downward trajectory, with the yields on the 364-day, 182-day and 91-day papers decreasing by 1.0 bps, 0.2 bps and 4.0 bps respectively to 11.29%, 10.03% and 9.53% from the 11.31%, 10.03% and 9.56% recorded the previous week.

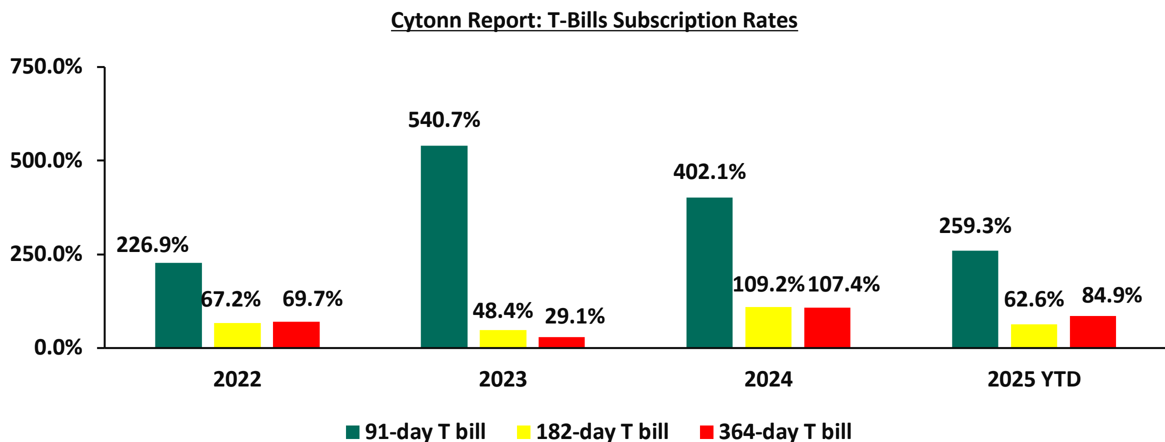
The charts below show the performance of the 91-day, 182-day and 364-day papers from January 2024 to January 2025:



The chart below shows the yield growth for the 91-day T-bills:



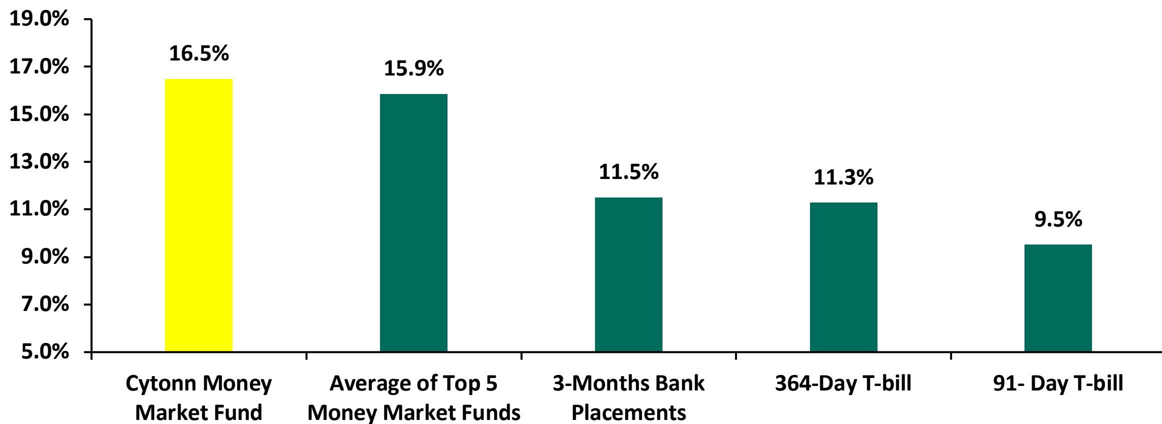
The chart below compares the overall average T-bill subscription rates obtained in 2022,2023, 2024 and 2025 Year-to-date (YTD):



In the primary bond market, the government is looking to raise Kshs 70.0 bn through the reopened two infrastructure bonds; IFB1/2022/14 and IFB1/2023/17 with a tenor to maturity of 11.8 years and 15.1 years respectively. The bonds will be offered at fixed coupon rates of 13.9% and 14.4% respectively. The period of sale opened on Thursday, 23rd January 2025, and will close on 12th February 2025. Our bidding range for the reopened bonds are 12.85%-13.55% and 12.95%-13.65% for the IFB1/2022/14 and IFB1/2023/17 respectively.

Money Market Performance:

In the money markets, 3-month bank placements ended the week at 11.5% (based on what we have been offered by various banks), and yields on the government papers were on a downward trajectory, with the yields on the 364-day and 91-day papers decreasing by 1.0 bps and 4.0 bps respectively to 11.29% and 9.53% respectively, from the 11.30% and 9.56% respectively recorded the previous week. The yield on the Cytonn Money Market Fund decreased by 6.0 bps to close the week at 16.5%, from the 16.6% recorded the previous week, while the average yields on the Top 5 Money Market Funds decreased by 20.0 bps to close the week at 15.9% from the 16.1% recorded the previous week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 24th January 2025:

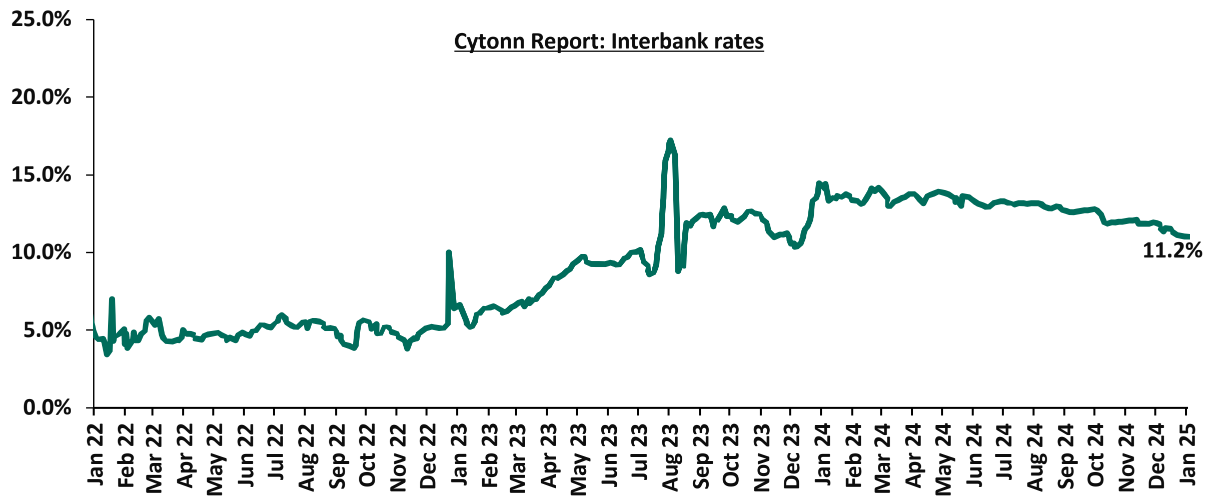
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 24th January 2025		
Rank	**Fund Manager**	**Effective Annual Rate**
1	Cytonn Money Market Fund (Dial *809# or download the Cytonn app)	16.5%
2	Gulfcap Money Market Fund	16.3%
3	Lofty-Corban Money Market Fund	15.7%
4	Ndovu Money Market Fund	15.5%
5	Kuza Money Market fund	15.3%
6	Etica Money Market Fund	15.3%
7	Mali Money Market Fund	15.2%
8	Dry Associates Money Market Fund	13.7%
9	Orient Kasha Money Market Fund	13.6%
10	Sanlam Money Market Fund	13.5%
11	Jubilee Money Market Fund	13.2%
12	GenAfrica Money Market Fund	13.1%
13	Genghis Money Market Fund	13.0%
14	British-American Money Market Fund	13.0%
15	Madison Money Market Fund	12.8%
16	Faulu Money Market Fund	12.8%
17	CIC Money Market Fund	12.6%
18	Co-op Money Market Fund	12.6%
19	ICEA Lion Money Market Fund	12.4%
20	Old Mutual Money Market Fund	12.2%
21	Absa Shilling Money Market Fund	12.1%
22	Enwealth Money Market Fund	12.0%
23	Nabo Africa Money Market Fund	11.9%
24	KCB Money Market Fund	11.9%
25	Ziidi Money Market Fund	11.7%
26	Apollo Money Market Fund	11.5%
27	AA Kenya Shillings Fund	11.2%
28	Arvocap Money Market Fund	10.8%
29	Mayfair Money Market Fund	10.3%
30	Stanbic Money Market Fund	10.0%
31	Equity Money Market Fund	6.9%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets marginally eased, with the average interbank rate decreasing by 0.5 bps, to remain relatively unchanged from the 11.3% recorded the previous week, partly attributable to tax remittances that were offset by government payments. The average interbank volumes

traded decreased by 22.7% to Kshs 23.1 bn from Kshs 29.9 bn recorded the previous week. The chart below shows the interbank rates in the market over the years:



Kenya Eurobonds:

During the week, the yields on Kenya's Eurobonds were on an upward trajectory, with the yield on the 10-year Eurobond issued in 2018 increasing the most by 20.2 bps to 9.0% from 8.8% recorded the previous week. The table below shows the summary performance of the Kenyan Eurobonds as of 23rd January 2025;

Cytonn Report: Kenya Eurobonds Performance						
	2018		2019		2021	2024
Tenor	10-year issue	30-year issue	7-year issue	12-year issue	13-year issue	7-year issue
Amount Issued (USD)	1.0 bn	1.0 bn	0.9 bn	1.2 bn	1.0 bn	1.5 bn
Years to Maturity	3.1	23.1	2.3	7.3	9.4	6.1
Yields at Issue	7.3%	8.3%	7.0%	7.9%	6.2%	10.4%
02-Jan-25	9.1%	10.3%	8.5%	10.1%	10.1%	10.1%
16-Jan-25	8.8%	10.1%	8.2%	9.8%	9.8%	9.8%
17-Jan-25	8.8%	10.1%	8.3%	9.8%	9.9%	9.8%
20-Jan-25	8.8%	10.1%	8.3%	9.8%	9.9%	9.8%
21-Jan-25	8.7%	10.1%	8.2%	9.7%	9.8%	9.7%
22-Jan-25	8.9%	10.1%	8.3%	9.8%	9.9%	9.9%
23-Jan-25	9.0%	10.2%	8.3%	10.0%	10.0%	10.0%
Weekly Change	0.2%	0.1%	0.1%	0.2%	0.2%	0.2%
MTD Change	(0.1%)	(0.0%)	(0.1%)	(0.1%)	(0.1%)	(0.1%)
YTD Change	(0.1%)	(0.0%)	(0.1%)	(0.1%)	(0.1%)	(0.1%)

Source: Central Bank of Kenya (CBK) and National Treasury

Kenya Shilling:

During the week, the Kenya Shilling appreciated against the US Dollar by 23.7 bps, to close the week at Kshs 129.3, from 129.6 recorded the previous week. On a year-to-date basis, the shilling has appreciated by 3.4 bps against the dollar, a contrast to the 17.4% appreciation recorded in 2024.

We expect the shilling to be supported by:

i. Diaspora remittances standing at a cumulative USD 4,945.0 mn in 2024, 18.0% higher than the USD 4,190.0 mn recorded in 2023. The United States remained the largest source of remittances to Kenya accounting for 51.0% in the period, and,
ii. The tourism inflow receipts which came in at USD 352.5 bn in 2023, a 31.5% increase from USD 268.1 bn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 14.9% in the 12 months to October 2024, compared to a similar period in 2023.

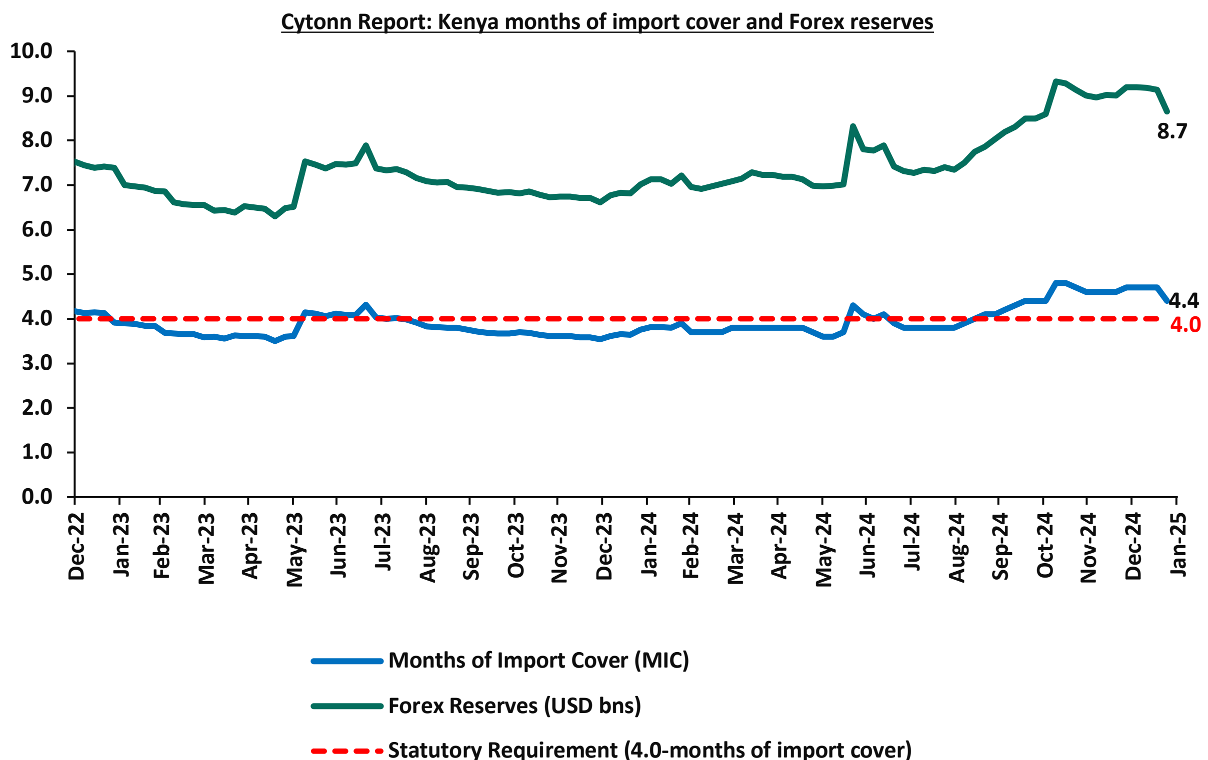
iii. Improved forex reserves currently at USD 8.7 bn (equivalent to 4.4-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover but below the EAC region's convergence criteria of 4.5-months of import cover.

The shilling is however expected to remain under pressure in 2025 as a result of:

i. An ever-present current account deficit which came at 4.0% of GDP in Q3'2024 which remained relatively unchanged from Q3'2023 and,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.2% of Kenya's external debt is US Dollar-denominated as of June 2024.

Key to note, Kenya's forex reserves decreased by 5.4% during the week, to USD 8.7 bn, from the USD 9.1 bn recorded in the previous week, equivalent to 4.4 months of import cover and above the statutory requirement of maintaining at least 4.0-months of import cover. During the week the months of import cover decreased by 6.4% to 4.4 months from 4.7 months recorded the previous week. The recent decrease in forex reserves is primarily attributed to increased demand of foreign exchange in the week which marginally outpaced inflows from remittances and the tea sector.

The chart below summarizes the evolution of Kenya's months of import cover over the years:



Weekly Highlights

I. Moody's Revises Kenya's Credit Negative Outlook to Positive and Affirms Caa1 Rating

On January 24th 2025, the global ratings agency, Moody's announced its revision of Kenya's credit outlook to positive from negative, while maintaining the credit rating at Caa1, on the back of a likelihood of an ease in liquidity risks and improved debt affordability. The improved debt affordability is largely attributable to the reduction in domestic borrowing costs, evidenced by the sharp decline of yields for short-dated papers. Given the low inflation rates in the country, the stability of the exchange rate, and the ease in the monetary policy stance, domestic borrowing costs are expected to continue decreasing over the short-medium term.

Inflation remained within the CBK's preferred target range of 2.5%-7.5% throughout 2024, with the average inflation rate for 2024 coming in at 4.5%. As of December 2024, inflation came in at 3.0%, a slight increase by 0.2% points from the 2.8% recorded in November 2024, nearing the lower end of the target range. The low inflation coupled with a stable exchange rate has led to an expansionary monetary stance by the Central Bank of Kenya, improving domestic liquidity and reduced short-term interest rates. Since July 2024, the government's domestic borrowing costs have significantly decreased with the average yields on the 91-day treasury bill decreasing by 6.4% points to 9.6% by January 2025 from 16.0% in July 2024. While yields on longer-term Treasury bonds have also declined, the drop has been more gradual. Bonds with maturities exceeding five years saw yields decrease from 16.5% six months ago to between 14.0% and 15.0% in recent auctions.

The affirmed Caa1 credit rating shows that the high credit risks remain due to the high debt-service to revenue ratios, which stood at 56.3% as of December 2024, 26.3% points above the IMF threshold of 30.0%. Additionally, the lower borrowing costs could feed into a more positive debt trajectory for the government. In addition, Kenya's local currency (LC) ceiling remains at B1, maintaining a three-notch gap with the sovereign rating. The foreign currency (FC) ceiling was also remains at B2, one notch below the LC ceiling, reflecting Kenya's relatively low external debt and moderately open capital account, which, while not completely eliminating, do reduce the need for transfer and convertibility restrictions during periods of financial stress.

This moves positions Kenya alongside emerging economies like Nigeria and Egypt. The revision comes after the rating agencies downgraded Kenya's credit rating in late 2024, after the withdrawal of Finance Bill 2024. Notably, S&P Global Ratings announced its revision of Kenya's long-term sovereign credit rating, downgrading it to B-, and a stable outlook from a credit rating of B and a negative outlook, on 23rd August 2024. Additionally, the global ratings agency, Fitch Ratings announced its revision of Kenya's credit score, downgrading it to B- from a credit rating of B while also revising the outlook to stable, from a negative outlook on 2nd August 2024. Below is a summary of the credit rating on Kenya by various rating agencies;

Cytonn Report: Kenya's Credit Ratings						
Rating Agency	**Previous Rating**	**Previous Outlook**	**Current Rating**	**Current Outlook**	**Meaning**	**Date Released**
Moody's Rating	Caa1	Negative	**Caa1**	Positive	Substantial credit risks	24th January, 2025
Fitch Ratings	B	Negative	**B-**	Stable	Highly Speculative	2nd August 2024
S&P Global	B	Negative	**B-**	Stable	Extremely high risk, very vulnerable to default	23rd August 2024

Source: Fitch Ratings, S&P Global, Moody's

Going forward, Kenya's government faces the challenge of managing a fiscal strategy that relies on revenue-driven expenditure through a broadened tax base. The agency noted that Kenya's rating could be upgraded if domestic financing conditions improved, fiscal reforms succeed in lowering liquidity risks, and the debt burden starts to decline sustainably. Strong external reserves and reliable access to affordable external funding would also support an upgrade. However, if financing conditions worsen or fail to improve,

leading to higher liquidity risks and poor debt affordability, the outlook would shift to stable. A downgrade is unlikely in the near term but could occur if rising liquidity risks limit funding access and weaken fiscal and debt metrics.

II. January Inflation projection

We are projecting the y/y inflation rate for January 2025 to increase to within the range of **3.1% - 3.4%** mainly on the back of:

i. **A Rise in Fuel Prices in January**– In their last fuel prices release, EPRA announced that the maximum allowed price for Super Petrol, Diesel and Kerosene increased by Kshs 0.3, Kshs 2.0 and Kshs 3.0 respectively. Consequently, Super Petrol, Diesel and Kerosene is now retailing at Kshs 176.6, Kshs 167.1 and Kshs 151.4 per litre respectively, from Kshs 176.3, Kshs. 165.1 and Kshs 148.4 per litre respectively, representing increases of 0.2%, 1.2% and 2.0% for Super Petrol, Diesel and Kerosene respectively. This rise in fuel prices is likely to increase pressure on consumers' purchasing power as well as business operational costs, since fuel is a major input cost for businesses, and,

ii. **The decrease in the Central Bank Rate (CBR) by 75.0 bps to 11.25% from 12.00%** – In 2024, the CBK Monetary Policy Committee began reducing the Central Bank Rate (CBR) with a 25.0 bps cut in August, lowering it to 12.75%. In their final meeting on 5th December 2024, they implemented a more significant reduction, cutting the CBR by 75.0 bps to 11.00%. This reduction in the CBR is likely to increase the money supply through lower borrowing costs, which may cause a slight rise in inflation rates as the effects of the CBR gradually take hold in the broader economy.

We, however, expect that inflation rate will, be supported by:

i. **Stability of the Kenya Shilling against the US Dollar** – The Kenya Shilling has recorded a slight 3.4 appreciation as of 24th January 2025 to remain relatively unchanged at Kshs 129.3 recorded at the beginning of the month. and,

ii. **Reduced electricity prices –** In January 2025, electricity prices decreased marginally on the back of a drop in fuel cost charges and forex adjustment charges. EPRA set the fuel cost charge at Kshs 3.55, down from Kshs 3.57 in December 2024, while the forex adjustment was lowered to Kshs 0.83 from Kshs 1.1 in December 2024. With electricity being one the major inputs of inflation, this decrease is expected to reduce production costs for businesses as well as decrease electricity costs for households and thus easing inflation.

Going forward, we expect inflationary pressures to remain anchored in the short term, remaining within the CBK's target range of 2.5%-7.5% aided by the stable fuel prices, decreasing energy costs and stability in the exchange rate. However, risks remain, particularly from the potential for increased demand-driven inflation due to an accommodative monetary policy. The CBK's ability to balance growth and inflation through close monitoring of both inflation and exchange rate stability will be key to maintaining inflation within the target range.

Rates in the Fixed Income market have been on a downward trend due to high liquidity in the money market which allowed the government to front load most of its borrowing. The government is 137.3% ahead of its prorated net domestic borrowing target of Kshs 235.6 bn, and 36.9% ahead of the total FY'2024/25 net domestic borrowing target of Kshs 408.4 bn, having a net borrowing position of Kshs 559.1 bn. However, we expect a continued downward readjustment of the yield curve in the short and medium term, with the government looking to increase its external borrowing to maintain the fiscal surplus, hence alleviating pressure in the domestic market. As such, we expect the yield curve to normalize in the short to medium-term and hence investors are expected to shift towards the long-term papers to lock in the high returns.

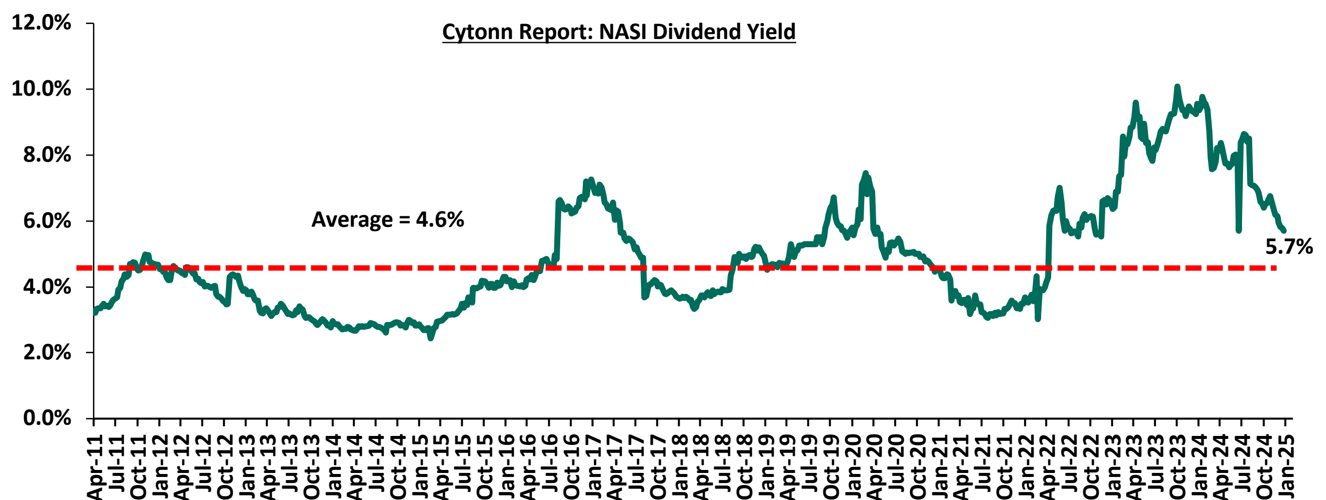
Equities

Market Performance

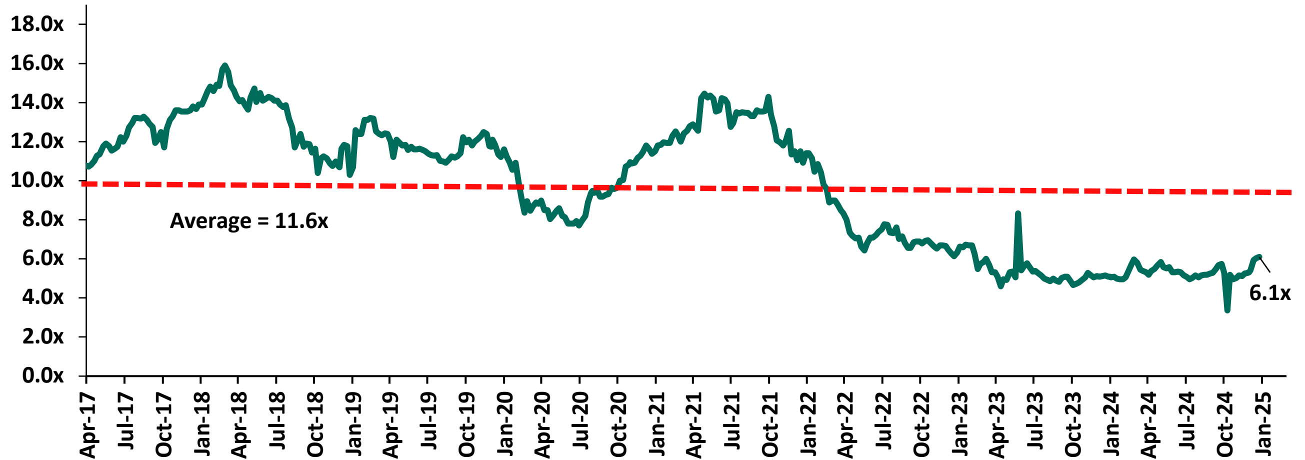
During the week, the equities market was on an upward trajectory, with NSE 10 gaining the most by 3.0% while NSE 25, NSE 20 and NASI gained by 2.9%,1.8% and 1.3% respectively, taking the YTD performance to gains of 6.2%, 5.7%, 3.3% and 3.2% for NSE 20, NASI, NSE 10 and NSE 25, respectively. The equities market performance was driven by gains recorded by large-cap stocks such as EABL, KCB and DTBK of 7.2%, 6.6%, and 5.3% respectively. The gains were however weighed down by losses recorded by large-cap stocks such as Bamburi, Stanbic and BAT of 3.5%, 1.6%, and 0.5% respectively;

During the week, equities turnover increased by 31.3% to USD 18.6 mn, from USD 14.2 mn recorded the previous week, taking the YTD total turnover to USD 56.7 mn. Foreign investors became net sellers for the first time in two weeks, with a net selling position of USD 1.0 mn, from a net buying position of USD 0.7 mn recorded the previous week, taking the YTD foreign net selling position to USD 5.8 mn.

The market is currently trading at a price-to-earnings ratio (P/E) of 6.1x, 47.7% below the historical average of 11.6x. The dividend yield stands at 5.7%, 1.1% points above the historical average of 4.6%. Key to note, NASI's PEG ratio currently stands at 0.8x, an indication that the market is undervalued relative to its future growth. A PEG ratio greater than 1.0x indicates the market is overvalued while a PEG ratio less than 1.0x indicates that the market is undervalued. The charts below indicate the historical P/E and dividend yields of the market;



Cytonn Report: NASI P/E



Universe of Coverage:

Cytonn Report: Equities Universe of Coverage										
Company	Price as at 17/01/2025	Price as at 24/01/2025	w/w change	YTD Change	Year Open 2025	Target Price*	Dividend Yield***	Upside/ Downside**	P/TBv Multiple	Recommendation
Jubilee Holdings	194.3	203.3	4.6%	16.3%	174.8	260.7	7.0%	35.3%	0.3x	Buy
Equity Group	48.5	48.7	0.4%	1.5%	48.0	60.2	8.2%	31.8%	1.0x	Buy
Co-op Bank	16.2	16.2	0.0%	(7.2%)	17.5	18.8	9.3%	25.3%	0.7x	Buy
NCBA	47.7	49.1	2.9%	(3.8%)	51.0	53.2	9.7%	18.1%	0.9x	Accumulate
Stanbic Holdings	140.3	138.0	(1.6%)	(1.3%)	139.8	145.3	11.1%	16.4%	0.9x	Accumulate
ABSA Bank	17.2	17.9	4.4%	(5.0%)	18.9	19.1	8.7%	15.4%	1.4x	Accumulate
CIC Group	2.5	2.6	2.8%	21.5%	2.1	2.8	5.0%	12.7%	0.8x	Accumulate
Standard Chartered Bank	280.3	286.5	2.2%	0.4%	285.3	291.2	10.1%	11.8%	1.9x	Accumulate
KCB Group	43.0	45.8	6.6%	8.0%	42.4	50.3	0.0%	9.8%	0.7x	Hold
Diamond Trust Bank	66.3	69.8	5.3%	4.5%	66.8	71.1	7.2%	9.1%	0.3x	Hold
I&M Group	33.2	34.9	5.1%	(3.1%)	36.0	32.3	7.3%	(0.1%)	0.7x	Sell
Britam	7.5	8.4	13.1%	45.0%	5.8	7.5	0.0%	(11.1%)	1.0x	Sell

*Target Price as per Cytonn Analyst estimates
**Upside/ (Downside) is adjusted for Dividend Yield
***Dividend Yield is calculated using FY'2023 Dividends

We are "Bullish" on the Equities markets in the short term due to current cheap valuations, lower yields on short-term government papers and expected global and local economic recovery, and, "Neutral" in the long term due to the adverse operating environment and huge foreign investor outflows.
With the market currently trading at a discount to its future growth (PEG Ratio at 0.8x), we believe that investors should reposition towards value stocks with strong earnings growth and that are trading at discounts to their intrinsic value. We expect the current high foreign investors sell-offs to continue weighing down the economic outlook in the short term.

Real Estate

I. Industry Report

a) Kenya housing survey basic report 2023/2024

During the week, Kenya Bureau of Statistics (KNBS) released 2023/24 Kenya Housing Survey Basic Report that provides a comprehensive analysis of the housing sector in Kenya. The survey aims to gather information and generate estimates for key housing indicators, and real estate indicators in the country. The report provides detailed insights into housing conditions, affordability, and tenure across the country. Conducted by KNBS in collaboration with government agencies, the survey aimed to inform evidence-based housing policies aligned with national and global development goals. In a nutshell the report found that 85.5% of rural households own homes, while urban homeownership stands at 22.8%. Renting rates in the urban areas were recorded at 72.3%, 63.4% points higher than rural areas which recorded 8.9% renting rate. Nationally, 58.9% of dwellings use durable construction materials, and 73.5% of households access improved drinking water. Additionally, 53.5% of the population is aware of the Affordable Housing Program, but only 7.7% are aware of stamp duty exemptions for first-time buyers. Technological adoption in housing processes is growing, with 20.5% of counties digitizing building plan applications and 23.3% georeferencing land records. The report underscores the importance of sustainable planning and enhanced access to housing utilities. The survey established the below key finding:

i. **Household Demographic and Economic Characteristics:** The report surveyed on the demographic characteristics of households to provide a background for determining the socio-economic status of household members and to provide the information necessary for development planning and resource allocations. The report found out that the total dependency ratio stood at 65.5%, with a child dependency ratio of 59.0% and an old-age dependency ratio of 6.5%. Kiambu, Kajiado, and Nakuru had higher proportions of households in urban areas, with 73.8%, 66.0%, and 54.9% respectively, compared to rural areas, while Nairobi and Mombasa were entirely urban. The most common household sizes were 1-2 persons (34.1%) and 3-4 persons (33.5%), with the 1-2-person household size more prevalent in urban areas (43.7%) than in rural areas (28.0%). Among homeowners, 41.9% had a primary level education, and 20.5% had no education. Out of the sampled households, owned homes represented a 61.3% while 34.4% were either rented or leased. The national employment-to-population ratio was 61.6%, with men at 68.1% and women at 55.1%. About 33.1% of households with individuals who have mobility challenges reported safe housing units, though few had special aids like grab bars (2.8%) or smoke alarms (0.0%). Low income was cited as the primary reason for housing inadequacy by 77.9% of households. Nationally, 53.7% of the population owned a mobile phone, and 64.9% used one. About 36.3% of households had internet access, and 8.8% owned computers.

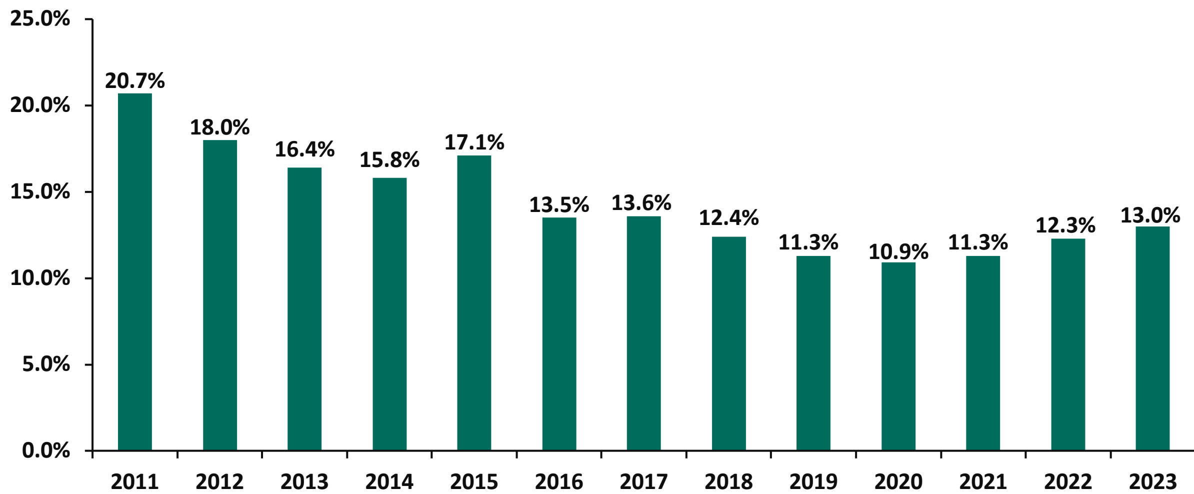
ii. **Housing accessibility, affordability and perception:** The survey highlights a growing housing deficit, especially in urban centers like Nairobi, where demand surpasses supply. More than 60.0% of urban households are renting, with many exceeding the 30.0% affordability threshold recommended by the United Nations. The report also notes disparities in housing affordability between income groups, with high-end developments benefiting wealthier individuals while the low and middle-income groups struggle to find affordable options. Proposed solutions include subsidized housing programs, expanded mortgage availability, and tax incentives for affordable housing developers. The survey highlights critical insights into housing, safety, and policy awareness. A significant 87.6% of respondents reported being comfortable in their current residences, though only 60.5% felt secure in their neighbourhoods at night. Safety remains a concern, with 15.4% having been victims of crime. Public knowledge of housing regulations is alarmingly low, with 75.9% unaware of building sector rules and 83.0% uninformed about minimum housing standards. Affordability is a pressing issue, as 45.2% believe government agencies should regulate housing loan and mortgage interest rates. While 53.5% of respondents were aware of the affordable housing program, awareness of associated incentives remains limited. Only 7.7% knew of the stamp duty exemption for first-time buyers, and 11.3% were aware of affordable housing tax relief, of whom 16.2% reported benefiting. These findings underscore

the need for stronger public awareness, improved safety measures, and more effective outreach for housing initiatives.

iii. **Housing Quality and Amenities:** The report emphasizes that a significant percentage of urban households, particularly in informal settlements, lack basic amenities such as clean water, adequate sanitation, and waste disposal. It reveals that around 40.0% of households in informal areas rely on shared sanitation facilities, contributing to health hazards. The findings call for infrastructure upgrades, including water supply systems and improved waste management, to enhance the quality of housing and living conditions. The survey highlights that 78.8% of dwelling units in Kenya were classified as being of inadequate quality. The Crowding Index showed that 68.1% of dwelling units were fit for habitation based on the number of persons per room, with an average of two persons per room, pointing to overcrowding issues. The Structure Fitness Index found that only 44.1% of dwellings used durable materials for roofs, walls, and floors, making them fit for habitation. Meanwhile, the Water and Sanitation Fitness Index revealed that 59.7% of dwellings had access to adequate facilities for drinking water and human waste disposal. The Energy Use Fitness Index indicated that 70.1% of households relied on unclean sources of energy for cooking and lighting, underscoring significant deficiencies in essential services and living conditions across the country.

iv. **Homeownership and Renting:** The report records a stark imbalance, with only about 20.0-25.0% of urban dwellers owning homes. The primary challenges cited are high property prices, limited mortgage access, and lengthy loan approval processes. Mortgages account for less than 5.0% of housing finance, emphasizing the need for innovative financing solutions. The Affordable Housing Program, despite its goals, has faced challenges such as land acquisition issues and delays in project execution. The survey reveals that bungalows are the most common type of dwelling in Kenya at 51.8%. Urban renters allocate 38.0% of their expenditure to rent, with 76.5% paying rent directly to landlords. However, 71.8% of tenants lack formal rental agreements. Notably, 87.4% of tenants have not experienced rent increases in the last five years, while 76.9% are unwilling to purchase their current dwellings. About 55.5% prefer to build their homes, with 63.1% favoring bungalows for ownership. Nairobi is the top choice for 17.1% of tenants seeking homeownership, while 52.2% cite distance from work as a primary reason for renting. Rent disputes affect 8.2% of tenants, with the highest cases reported in Nandi County (17.9%). According to the report, 84.0% of urban tenants face eviction threats and 52.5% of houses were constructed through one-off methods. Additionally, 85.5% of homes were built in under a year, with architects involved in 19.4% of housing acquisitions

v. **Housing finance**: The report aimed at finding the access to finance since it is a limiting factor to housing developments. Key trends undermining housing development with respect to access to finance include; about 33.4% of financiers offer savings products for land purchases, 20.9% for incremental building, and only 10% for mortgages. Among commercial banks, 38.9% have savings products tailored for mortgages, while 34.2% of SACCOs focus on savings for land purchases. Mortgage finance dominates housing finance products for commercial banks at 86.1%, while microfinance banks (MFBs) primarily offer construction finance for rental units at 53.8%, and SACCOs focus on land acquisition at 60.8%. As of December 2023, housing non-performing loans (NPLs) accounted for 12.7% of total housing loans, with MFBs recording the highest rate at 24.0%, commercial banks at 15.3%, and SACCOs at 3.9%. Mortgage interest rates averaged 13.0%, with commercial banks reporting 14.0% and SACCOs 12.0%. A lack of long-term capital remains the primary barrier to lending, hindering financiers' ability to expand their housing finance portfolios. The chart below shows the mortgage rates across the years from 2011 to 2023;



Source: *KMRC and KNBS*

vi. **Housing Developments and property prices:** The rapid population growth and urbanization in Kenya have significantly increased the demand for urban housing. Private sector players dominate housing supply, utilizing diverse development and financing models such as site and service schemes, incremental construction, tenant purchase arrangements, self-financing, joint ventures, public-private partnerships, and off-plan projects. Housing developers, whether companies or individuals, play a crucial role in shaping urban communities by designing, building, and selling residential properties. They provide a wide range of housing solutions, from single-family homes to large-scale apartment complexes, helping to meet the diverse needs of the urban population. The survey reveals critical insights into housing development processes, costs, and preferences in Kenya which include;

i) Delays in approvals by county governments (66.0%) and NEMA (35.9%) are a major challenge, with 56.6% of developers citing high county approval fees. However, most developers (67.9% for NEMA and 66.0% for NCA) find their processes reasonably efficient, and over 60% consider their fees reasonable,
ii) Awareness of alternative building technologies is high, indicating potential adoption,
iii) Key factors influencing site selection include land availability (94.1%), expected returns (88.2%), access to materials (82.4%), and infrastructure (64.7%),
iv) While 69.1% of developers know about VAT exemptions on construction inputs, only 10.5% benefit from the incentive.
v) Average property prices in 2023 were high, with bungalows costing Kshs 19.3–49.9 mn and maisonettes, apartments, and townhouses ranging from Kshs 19.4–23.3 mn, and,
vi) Prices were highest in Nairobi Upper, Kilifi, and Mombasa, with stand-alone properties being more expensive than apartments.

vii. **Institutional and Regulatory Framework:** The report noted that counties achieved a housing building plan approval rate of 99.6% in 2023, a significant increase from 81.2% in 2022. Applications for changing land use from residential to other purposes rose by 13%, reaching 2,300. The country has 392 slums, with 38.1% of counties reporting slums within their jurisdictions. The primary county intervention for improving informal settlements is the regularization of tenure, with 90.9% of counties indicating this measure. NEMA received 6,994 housing construction license applications, approving 5,472, a 78.2% approval rate. This was an improvement from 2022 when NEMA received 7,186 applications, approving 5,472, or 74.3%. Additionally, 142,290 land transfer applications were received nationwide, with 120,370 successfully processed, reflecting an overall processing rate of 84.6%. Samburu, Laikipia, and Trans Nzoia processed all their land transfer applications in 2023.

viii. **Land use, tenure, consumption rate and green spaces:** According the report's findings, the most prevalent form of land ownership documentation in Kenya is the title deed, held by 66.0% of

landowners, while 15.9% of parcels lack formal documentation. Land acquisition is primarily through inheritance (53.5%), followed by purchase (31.0%) and family allocation (8.6%). Land use is predominantly for agriculture (47.2%) and residential purposes (47.1%), with a small portion (3.4%) reserved for future development. These trends highlight the importance of inheritance as a primary method of land acquisition and the dual focus on agricultural and residential land use in the country. From 2016 to 2023, the four counties experienced an average increase of 34.45% in built-up areas. Nakuru County saw the highest growth at 47.1%, followed by Kisumu at 46.5%, Mombasa at 29.9%, and Nairobi City at 14.3%. In contrast, green space areas declined by an average of 21.7% across the counties. Nairobi City led this reduction with a 42.2% decrease, followed by Nakuru at 26.3%, and Kisumu at 14.6%. This shift highlights significant urban expansion, especially in Nakuru and Kisumu, coupled with a concerning loss of green spaces, particularly in Nairobi.

The real estate sector has experienced notable growth, with a 33.7% increase in sector output from 2019 to 2023. This growth is underpinned by urbanization, infrastructure development, and government initiatives such as the Affordable Housing Program, which seeks to build 200,000 housing units annually. However, the lack of consistent and comprehensive data, oversupply in the high-end market and slow uptake in affordable housing persist remains major challenges. To address this, the 2023/2024 survey was conducted to collect current market data on residential and commercial property prices, trends in housing typologies, and housing finance arrangements.

Going forward we expect significant opportunities for growth in the housing sector, driven by government initiatives, technological advancements, and private sector involvement. Areas earmarked for infrastructure projects, such as roads and commuter rail lines, are expected to see a surge in real estate developments. The report highlights the potential for green and sustainable housing developments, which can reduce costs and align with global climate goals. This can be achieved through the key recommendations from the report to address the above noted key issues. These recommendations include

i. Policy interventions: The report advocates for the implementation of policies aimed at increasing the supply of affordable housing. This includes incentivizing private sector participation, streamlining regulatory frameworks, and enhancing public-private partnerships.
ii. Financial accessibility: Improving access to affordable mortgage financing is crucial. The report suggests revisiting lending policies, offering subsidies, and developing financial products tailored to low and middle-income earners.
iii. Infrastructure development: Investing in essential infrastructure such as roads, sanitation, and water supply is imperative to improve living conditions, particularly in informal settlements.

The report provides critical insights into the current state of housing in Kenya. It underscores the pressing need for multifaceted approaches to tackle housing challenges, emphasizing that adequate housing is not only a fundamental human right but also a cornerstone for social and economic development. While the 2023/24 Kenya Housing Survey Basic Report provides a strong foundation for understanding the country's housing landscape, a concerted effort to implement innovative, sustainable, and inclusive strategies is critical for addressing Kenya's housing challenges effectively. The housing sector has the potential to be a transformative driver of Kenya's socio-economic growth, but only with comprehensive action from all stakeholders.

b) Real Estate survey report 2023/2024

During the week, Kenya Bureau of Statistics (KNBS) released [2023/2024 Real Estate Survey Report] which highlighted significant growth, regulatory challenges, and market dynamics. The market has grown by 33.7% from 2019 to 2023, driven by urbanization, infrastructure, and initiatives like the Affordable Housing Program. However, gaps in reliable housing data hinder effective decision-making. The report indicates that in 2023, about 34.4% of advertised office space remained unoccupied due to low demand.

The residential market is diverse, with three-bedroom flats being the most common. Nairobi City dominates, accounting for 66.7% of available properties. Demand is strong, with 76.2% of properties sold in 2023, but price variations are notable across regions. The rental market is competitive, with flats and apartments making up the majority, and townhouses commanding the highest rental rates. Rental yields

vary by property type, with two-bedroom townhouses offering the highest returns. On the commercial side, office buildings dominate, particularly in Nairobi, Kiambu, Mombasa, and Machakos. Despite high demand for office space, hotel properties experience slower sales.

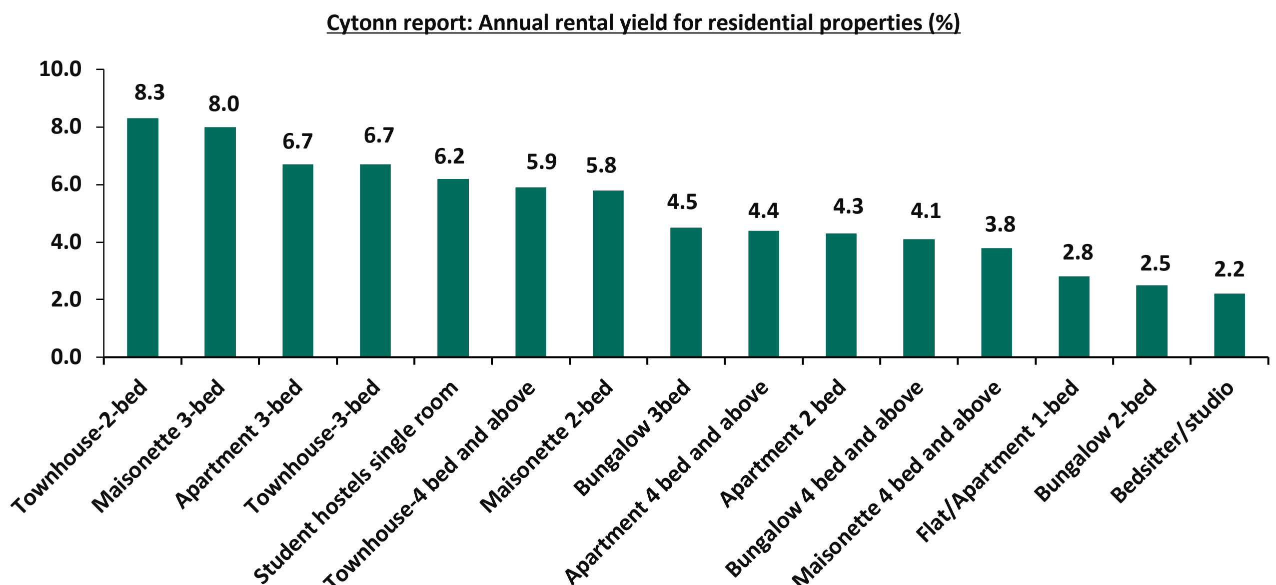
Rental prices for commercial properties vary, with industrial spaces attracting the lowest rates. The survey reveals that the majority of real estate firms in Kenya (95.1%) are privately owned, with a small proportion being cooperatives (3.4%) and parastatals (1.5%). Approximately 40.7% of firms are registered with the Valuers Registration Board (VRB), while 33.9% are affiliated with the Kenya Valuers and Estate Agents. About 10.0% of these firms offer housing finance options to buyers or renters, with 31.8% partnering with cooperatives or SACCOs, 22.7% with housing finance institutions, and 13.6% with microfinance institutions. Additionally, 63.4% of firms own the properties they manage, while 36.7% do not.

They key finding of the report are as follows

i. **Sector growth:** The real estate sector experienced a 33.7% increase in output from 2019 to 2023, growing from Kshs 946.7 bn to Kshs 1.3 tn. This growth is attributed to infrastructural developments, rapid urbanization, and government initiatives like the Affordable Housing Program, which aims to construct 200,000 housing units annually.

ii. **Regulatory compliance:** The survey reveals that 47.1% of real estate firms operate without registration from professional or regulatory bodies. Reasons for non-registration include a perceived lack of necessity and the cumbersome nature of the registration process. This lack of oversight raises concerns about consumer protection and industry professionalism.

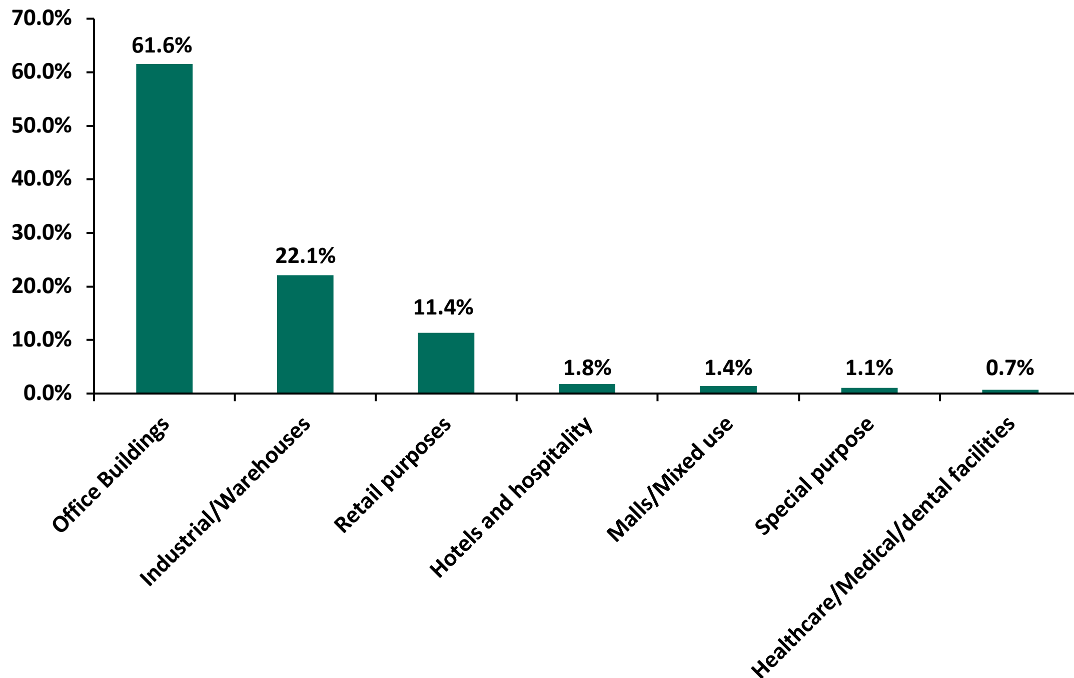
iii. **Residential property prices:** Data indicates significant variations in residential property prices across different regions and property types. Urban centers, particularly Nairobi, have higher property values compared to rural areas. The report emphasizes the need for comprehensive data collection to monitor these trends effectively. On properties rental yield, bedsitters and studio apartments recorded the lowest rental yield of 2.2% while two-bedroom town houses had the highest rental yield of 8.3% followed by three-bedroom maisonette at 8.0%. The below chart shows the residential properties yields for the different typologies as per the KNBS survey report:



Source: KNBS

iv. **Commercial property market:** The commercial property sector shows a diverse range of rental rates, with special-purpose properties and suites/condominiums attracting the highest rents at Kshs 150.0 and Kshs 140.0 per square foot, respectively. Industrial and warehousing properties have the lowest rental rates, at Kshs 40.0 per square foot. Service charges also vary, with industrial

properties incurring higher costs due to maintenance. The office buildings have the biggest proportion of 61.6% followed by Industrial/warehouse by 22.1%. The graph below shows the various types of commercial properties and their distribution.



Source: KNBS

The report gave key recommendations to ensure the Real Estate sector continues to grow. These recommendations include:

i. Enhance regulatory framework: To address the high percentage of unregistered firms, the report suggests streamlining the registration process and increasing awareness about the benefits of professional accreditation. Strengthening regulatory oversight is crucial for consumer protection and maintaining industry standards.
ii. Data-driven policy making: The report underscores the importance of consistent and comprehensive data collection to inform policy decisions. Establishing a centralized real estate data system would aid in monitoring market trends and addressing issues like housing affordability.
iii. Promote affordable housing: Given the significant growth in the sector, there's a need to focus on affordable housing solutions to cater to the low and middle-income populations. Encouraging private sector participation through incentives and public-private partnerships can help achieve this goal.

The Report provides valuable insights into Kenya's real estate sector, highlighting areas of growth and challenges. Implementing the recommendations can foster a more regulated, transparent, and inclusive real estate market, contributing to the country's socio-economic development.

We expect the Kenyan Real Estate sector market performance will be supported by; i) increased and consistently growing demand for Real Estate developments facilitated by the country’s positive demographic profile, ii) government’s continued focus on provision of affordable housing, iii) initiation and implementation of various infrastructural improvements opening up new areas for investment and boosting property prices, iv) renewed investor confidence in the hospitality sector as a result of continuous recovery, as evidenced by increased international arrivals, v) efforts by the government through the Kenya Mortgage Refinance Company (KMRC) to provide affordable home loans to buyers, vi) initiation and implementation of infrastructure projects, vi) aggressive expansion efforts by both local and international

retailers, and, vii) continued recognition of Kenya as a regional business hub, attracting foreign investments. However, rising construction costs, existing oversupply of physical space in the commercial office and retail sectors, slow delivery of affordable housing projects, recently issued travel advisories by multiple governments, impacting tourism, the deteriorating business environment and, low investor appetite for REITs is expected to hinder the optimum performance of the sector.

c) Hass Consult Land and property price index

During the week, Hass Consult, a Kenyan consulting and Real Estate development firm, released its Property Index Q4'2024 Report, focusing on the residential Real Estate sector's performance in the Nairobi Metropolitan Area (NMA). The following are the key take outs from the report;

The average selling prices for all properties posted a 0.8% increase on a quarter-on-quarter (q/q) basis in Q4'2024, an improvement from 0.7 % increase in Q3'2024. The performance can be linked to 1.5% increase in detached house prices. However, apartment units' prices registered a q/q decline in performance of 0.6% in Q4'2024. Similarly, semi-detached units registered a 0.8% decline in selling prices, undermining the overall performance. On a year-on-year (y/y) basis, property prices showed a 5.2% increase, contrasting from a 2.5% increase witnessed in Q4'2023. This significant hike further elevated the cost of financing house purchases, making it more expensive for buyers. Additionally, protests that affected the country during the year in June and July saw cautious pricing in a period of uncertainty, dampening the market that was coming off a period of strong price growth in the last quarter of 2023 and first half of 2024. Furthermore, developers are facing rising construction costs, which they are forced to pass on to homebuyers, further driving up property prices.

i. The average asking rents of housing units in the NMA during period under review increased slightly by 0.2% on q/q basis, higher compared to a 0.6% decrease recorded in Q3'2024. On a y/y basis, the average asking rent decreased slightly by 0.02% compared to the 2.5% increase recorded in Q4'2023. The decrease in performance was attributable to decreased rents in semidetached houses, registering q/q decline of 1.4% in Q4'2024, as landlords tried to hedge against a tough operating environment during the period,
ii. Apartments registered the highest y/y increase in asking rents of 2.5% in Q4'2024, a decrease from 10.2% increase in Q4'2023. In addition, detached units witnessed 0.6% increase in asking rents a decrease from 2.4% increase recorded in Q4'2024 and semi-detached units witnessed 4.8% decrease in asking rents, a further decrease from 1.4% decline recorded in Q4'2023. The rise in rental rates can be attributed to the growth of the middle class, with more people joining this income bracket and thereby increasing demand for apartments. At the same time, as some individuals transition from the middle class to higher income levels, demand for detached units has also increased, driving up prices in this segment of the market.
iii. In the Nairobi Suburbs apartments, Parklands was the best-performing region recording a y/y capital appreciation of 5.3%, due to i) Its close proximity to key commercial, social, and recreational facilities such as Sarit center and Westgate malls, among other retail outlets, ii) its accessibility to the Central Business District, supported by good road such as Limuru road and Waiyaki Way networks that reduce commute times, and iii) many developers in Parklands have embraced modern architectural designs, offering high-quality apartments with contemporary finishes and amenities, such as gyms, swimming pools, and security systems. On the other hand, Muthangari saw the highest year-on-year price correction of 8.7%, driven by reduced demand as residents favored nearby areas like Kilimani, Kileleshwa and parklands.
iv. In the satellite towns, properties in Juja posted the highest year-on-year price appreciation, coming at 12.9%. This surge can be linked to several factors: i) Excellent connectivity via the Thika Super Highway, ii) an increasing preference among the middle class to settle and raise families in this area, iii) proximity to major retail centers like Unicity Mall and Juja City Mall, and iv) access to essential amenities, including educational institutions such as Jomo Kenyatta University of Agriculture and Technology (JKUAT) and hospitals. On the other hand, Athi River recorded the lowest year-on-year price growth at

3.0%, mainly due to strong competition from similar proximity areas like Kitengela and Rongai, which are becoming increasingly favored by residents seeking a superior residential environment.

v. In satellite towns' apartments, Ongata Rongai recorded the highest y/y price appreciation of 9.9% which was supported by good connectivity through infrastructure such as the Lang'ata road, Southern bypass and Ngong' road , With rising property prices in Nairobi itself, Rongai has become an ideal alternative, offering spacious apartments and gated communities that cater to middle-income earners, and the area has seen an increase in the development of social amenities, including shopping centers, schools, and healthcare facilities, making it convenient for residents. Proximity to retail centers like Galleria Mall and nearby medical facilities enhance Rongai's attractiveness for families and working professionals alike. Conversely, Ruaka registered the lowest y/y price depreciation of 1.7% attributed to stiff competition faced from neighbourhoods such as Kiambu and Gigiri which have more access to international activities and better road networks

The findings of the report are in line with our Cytonn Annual Markets Review – 2024, highlighting that selling prices of residential properties in the Nairobi Metropolitan Area (NMA) recorded a 0.7% appreciation in FY'2024. The performance was supported by 0.4% price appreciation realized by both apartments, detached and semi-detached units the period under review.

Hass Consult also released Land Price Index Q4'2024 Report which highlighted the performance of the Real Estate land sector in the Nairobi Metropolitan Area (NMA). The following were the key take outs from the report;

i. The average q/q selling prices for land in the Nairobi suburbs grew by 1.7%, compared to a 3.3% increase recorded in Q3'2023. On a y/y basis, the performance represented 2.5 % points increase to 6.5% from the 4.0% increase recorded in Q3'2023. Consequently, q/q and y/y land prices in satellite towns of Nairobi increased by 1.9% and 10.6% respectively, compared to the 3.7% and 9.3% growth respectively recorded in Q3'2023. The tough economic conditions and increased interest rates impacted the ability of developers to finance land purchases however, the ongoing market recovery underscores the sector's resilience, with demand steadily increasing due to emerging opportunities in retail, manufacturing, and logistics, which are crucial for supporting the rapid urbanization of towns and the Nairobi CBD. This growth is further fuelled by the strategic expansion of infrastructure and businesses looking to capitalize on the expanding urban population and improving economic conditions. The convergence of these factors positions the sector for sustained growth as it adapts to the evolving needs of a dynamic urban environment.

ii. Spring Valley was the best-performing node in the Nairobi suburbs with a y/y price appreciation of 15.0%. This was attributed to; i) Its close proximity to key commercial, social, educational, and recreational facilities, including malls like West Gate, Village Market, Two Rivers mall and other retail centers ii) improved accessibility thanks to well-developed road networks such as Redhill link road, and iii) growing preference among land buyers compared to neighboring areas like Kitisuru. In contrast, Kitisuru experienced the lowest year-on-year land price depreciation at 2.0%. This can be attributed to land buyers increasingly favoring nearby areas such as Spring Valley, Loresho and Nyali, which offer a wider range of amenities, superior infrastructure, closer proximity to retail hubs, and a more established residential environment.

iii. For satellite towns, Kiserian was the best-performing node with a y/y capital appreciation of 18.1%, followed by Limuru which recorded a y/y capital appreciation of 17.2%. The improvement in performance in Kiserian was driven by; i) enhanced access provided by Ngong' road, southern bypass, and Lang'ata road, which has made the area more accessible for both residential and commercial developments ii) there has been a surge in demand for both residential and commercial land, driven by its strategic location near Nairobi. This demand has

been further boosted by infrastructure developments and the area's growing attractiveness to investors seeking high returns on their property investments. On the other hand, land prices in Limuru were bolstered by its its proximity to Nairobi and excellent connectivity via Nakuru-Nairobi highway, making it a prime location for residential and industrial developments. Conversely, Ngong' was the least performing node with a y/y price depreciation of 2.6%, attributable to increased competition from the neighboring areas which are closer in proximity to the CBD and other urban areas such as Rongai, Kiserian and Kitengela

The findings of the report are also in line with our Cytonn Annual Markets Review – 2024 which highlighted that the overall average selling prices for land in the NMA recorded a price appreciation of 2.7% to Kshs 130.9 mn from 128.9 mn. This performance was bolstered by; i) growing demand for housing which is driven by positive demographics such as high population and urbanization, which currently stands at 1.9% and 3.8%, which is relatively higher than the global averages of 0.9% and 1.6% respectively, ii) the fixed supply of land has intensified demand, particularly for residential and commercial purposes, leading to an increase in land prices, iii) there is an expanding middle class in the NMA with disposable income, willing to invest in land as a savings and investment option,iv) the government's ongoing infrastructural development projects, such as roads, sewers, railways, and water connections, are opening up more satellite towns, subsequently driving land prices upward, v) the widely held belief among the middle class that land represents a secure form of wealth has prompted many families to save specifically for land acquisition, and, vi) the government's Affordable Housing Program, under the Bottom-Up Economic Transformation Agenda (BETA), has initiated construction projects across various parts of Nairobi and the country, further increasing land values due to heightened construction activity.

II. Residential sector

During the week, a private developer, GulfCap Real Estate broke ground for a Kshs 120.0 bn housing project in Kisumu marking a significant development in Kenya's real estate sector. Spanning 285 acres, the project aims to address the growing demand for housing in Kisumu, a city experiencing rapid urbanization and population growth. The initiative is expected to create thousands of jobs, both directly and indirectly, through construction activities and the establishment of supporting services. This employment boost is anticipated to stimulate the local economy and improve livelihoods in the region. The project is also poised to enhance infrastructure in Kisumu, including roads, water supply, and sewage systems. Such improvements are essential for accommodating the new housing developments and ensuring a high quality of life for residents.

By focusing on affordable housing, the developer aims to make homeownership accessible to a broader segment of the population. This approach aligns with national objectives to reduce the housing deficit and promote inclusive growth. The project is expected to attract significant investment, both domestic and international, into Kisumu's real estate market. This influx of capital can lead to further development opportunities and economic diversification in the region. This housing project in Kisumu represents a substantial contribution to addressing housing shortages, stimulating economic growth, and improving infrastructure in the region. Its successful implementation could serve as a model for similar initiatives across Kenya.

We expect the residential sector to continue being supported by both private and government initiatives such as the Affordable Housing Programme throughout the year in an effort to boost home ownership in Kenya. We also expect the sector to be supported by the completion and expansion of various infrastructural projects which will lead to opening up of satellite areas, which were previously inaccessible consequently leading to increased property prices and values. Furthermore, infrastructural development and increased connectivity of key utilities such as water and electricity in these areas will likely boost property prices upwards. On the other hand, we expect the sector will be mainly weighed down by high cost of financing which may affect uptake and occupancy in several nodes, ultimately affecting rental yields and property prices.

III. Hospitality Sector

During the week, an investor, The View by the Park Limited, has proposed a Kshs 1.3 bn hotel development overlooking Nairobi National Park, aiming to capitalize on the park's unique proximity to the city center. The proposed hotel is expected to offer panoramic views of the park, providing guests with a distinctive experience of urban and natural landscapes. The hotel's location is advantageous, situated near key transport routes and close to Nairobi's central business district. This strategic positioning is anticipated to attract both international tourists and business travelers seeking convenient access to the city's amenities while enjoying the tranquility of the park's surroundings.

The development is projected to create numerous employment opportunities during both the construction and operational phases. This includes jobs in construction, hospitality services, and related sectors, contributing to the local economy and providing livelihoods for residents. By offering a unique lodging experience with views of Nairobi National Park, the hotel aims to enhance the city's tourism appeal. It is expected to attract visitors interested in eco-tourism and those seeking accommodations that blend urban amenities with natural beauty.

The development plans to incorporate sustainable building practices, including energy-efficient designs and waste management systems. These measures aim to minimize the environmental footprint of the hotel and align with global standards for eco-friendly construction. The proposed Kshs 1.3 bn hotel overlooking Nairobi National Park represents a significant investment in the city's hospitality sector. By leveraging its unique location, the development seeks to boost tourism, create employment, and contribute to the economic growth of Nairobi. If realized, it could set a precedent for future developments that harmonize urban growth with environmental conservation.

We expect the hospitality industry to continue growing owing to several key drivers: i) aggressive marketing campaigns promoting Kenya’s tourism, expected to boost tourist arrivals and improve occupancy rates at hospitality venues, ii) continued international recognition of Kenya’s tourism industry, enhancing its status as a leading tourist destination and drawing more global visitors, iii) strategic partnerships within the tourism sector, fostering innovation and collaboration to capitalize on new opportunities, iv) events and initiatives aimed at increasing tourism activity and improving guest experiences. However, while the sector demonstrated resilience in its overall performance in 2024, the outlook remains cautiously optimistic due to i) Kenya continues to face significant competition from neighboring markets, such as Rwanda, which employs aggressive promotional strategies, alongside Zanzibar, Tanzania, and South Africa, these regions actively position themselves as attractive alternatives, challenging Kenya's market share in the region, ii) difficulty in accessing finance as lenders demand more collateral to cushion themselves owing to elevated credit risk, and iii) occasional release of cautionary statements by governments like China and United States to their citizens advising them against travelling to Kenya due to threats like terrorism and elevated crime rates.

IV. Commercial office sector

During the week, the Local Authorities Pensions Trust (Laptrust) revised its plans for the Ugatuzi Tower project in Nairobi, reducing the proposed 50-storey office building to 34 floors. This adjustment comes in response to a surplus of office space in the market and escalating construction costs. The revised project is estimated to cost approximately Kshs 3.1 bn. Originally, Laptrust intended to construct a 50-storey tower at an estimated cost of Sh5 billion. However, legal challenges from some of its members delayed the project's commencement, leading to the current revision. The proposed building will occupy 1.3 acres at the intersection of Argwings Kodhek and Chaka Road in the Hurlingham area. Laptrust plans to complete the project within 24 months after obtaining the necessary licenses and beginning construction.

The decision to reduce the building's height aligns with data from the Kenya National Bureau of Statistics, which indicates that in 2023, about 34.4% of advertised office space remained unoccupied due to low demand. Laser Property Services, the development manager for the project, noted that the change was also informed by the need to deliver a "positive market return acceptable" to the pension scheme. The

building is planned to be certified green in line with International Finance Corporation (IFC) Edge green building standards, aiming to use at least 20% less energy or water than conventionally built buildings.

Since the project's inception, various economic factors, including the COVID-19 pandemic, have influenced office space demand. The pandemic reinforced the culture of working from home and co-sharing office spaces, leading to a gradual increase in demand, though not yet returning to pre-pandemic levels. In 2021, the Kenya County Government Workers Union challenged Laptrust's plan in court, citing high costs and the inclusion of certain workers. However, they lost the case, allowing the project to proceed. The Ugatuzi Tower project is expected to contribute significantly to Nairobi's skyline and the local economy, providing modern office space in a prime location.

Despite oversupply challenges and developers revising their building plans, We expect the sector to remain stable with a slight improvement attributable to i) the increasing presence of multinational companies in Kenya is likely to drive up occupancy levels, ii) co-working spaces are gaining in popularity in the region iii) the gradual return to "working from office" after the Covid-19 pandemic, iv) more start-ups are expected to drive demand for commercial spaces, and v) a considerable take-up of prevailing commercial office spaces after developers adopted a 'wait-and-see' approach to avoid vacancies in newly built spaces, However, the sector continues to face challenges due to a significant oversupply of office space, currently standing at 5.8 mn SQFT.

V. Real Estate Investments Trusts (REITs)

On the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 25.4 and Kshs 22.2 per unit, respectively, as per the last updated data on 17th January 2025. The performance represented a 27.0% and 11.0% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at Kshs 12.8 mn and Kshs 34.8 mn shares, respectively, with a turnover of Kshs 323.5 mn and Kshs 722.8 mn, respectively, since inception in February 2021. Additionally, ILAM Fahari I-REIT traded at Kshs 11.0 per share as of 17th January 2025, representing a 45.0% loss from the Kshs 20.0 inception price. The volume traded to date came in at 138,600 shares for the I-REIT, with a turnover of Kshs 1.5 mn since inception in November 2015.

REITs offer various benefits, such as tax exemptions, diversified portfolios, and stable long-term profits. However, the ongoing decline in the performance of Kenyan REITs and the restructuring of their business portfolios are hindering significant previous investments. Additional general challenges include:

i. Insufficient understanding of the investment instrument among investors leading to a slower uptake of REIT products,

ii. Lengthy approval processes for REIT creation,

iii. High minimum capital requirements of Kshs 100.0 mn for REIT trustees compared to Kshs 10.0 mn for pension funds Trustees, essentially limiting the licensed REIT Trustee to banks only

iv. The rigidity of choice between either a D-REIT or and I-REIT forces managers to form two REITs, rather than having one Hybrid REIT that can allocate between development and income earning properties

v. Limiting the type of legal entity that can form a REIT to only a trust company, as opposed to allowing other entities such as partnerships, and companies,

vi. We need to give time before REITS are required to list – they would be allowed to stay private for a few years before the requirement to list given that not all companies maybe comfortable with listing on day one, and,

vii. Minimum subscription amounts or offer parcels set at Kshs 0.1 mn for D-REITs and Kshs 5.0 mn for restricted I-REITs. The significant capital requirements still make REITs relatively inaccessible to smaller retail investors compared to other investment vehicles like unit trusts or government bonds, all of which continue to limit the performance of Kenyan REITs.

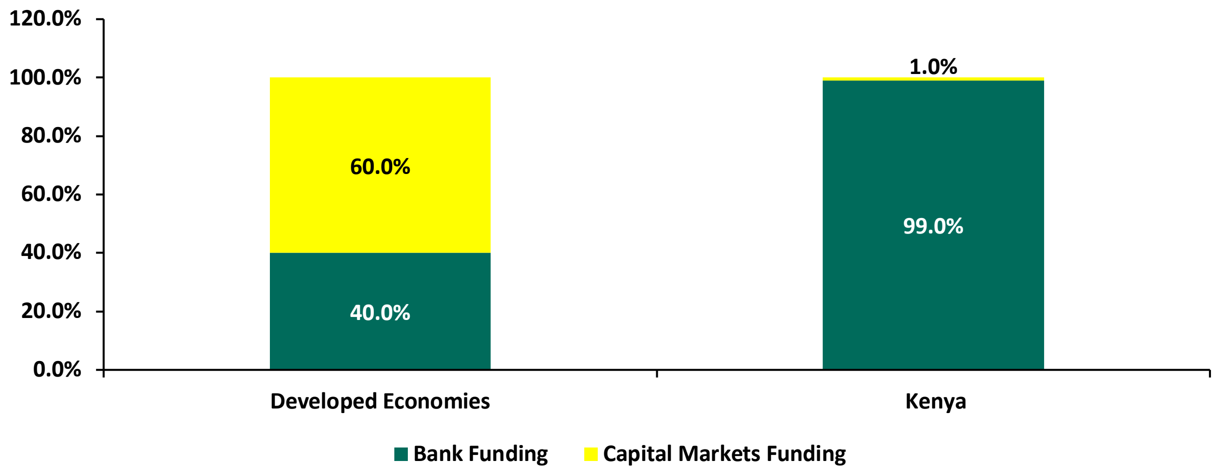
We expect Kenya's Real Estate sector to remain on a growth trend, supported by: i) demand for housing sustained by positive demographics, such as urbanization and population growth rates of 3.8% p.a and 2.0% p.a, respectively, against the global average of 1.7% p.a and 0.9% p.a, respectively, as at 2023,, ii) activities by the government under the Affordable Housing Program (AHP) iii) heightened activities by private players in the residential sector iv) increased investment by local and international investors in the retail sector. However, challenges such as rising construction costs, strain on infrastructure development (including drainage systems), high capital requirements for REITs, and existing oversupply in select Real Estate sectors will continue to hinder the sector's optimal performance by limiting developments and investments.

Focus of the Week: The Role of Special Purpose Vehicles (SPVs) in Finance and Investments in Kenya

A Special Purpose Vehicle (SPV), sometimes known as a Special Purpose Entity (SPE), is a legally separate and independent entity formed for a specific, defined purpose, typically to isolate financial risk. SPVs are widely utilized in securitization, project finance, structured finance, and asset-backed transactions. They are intended to be bankruptcy-resistant, meaning that their operations and liabilities are separate from the parent or sponsoring organization.

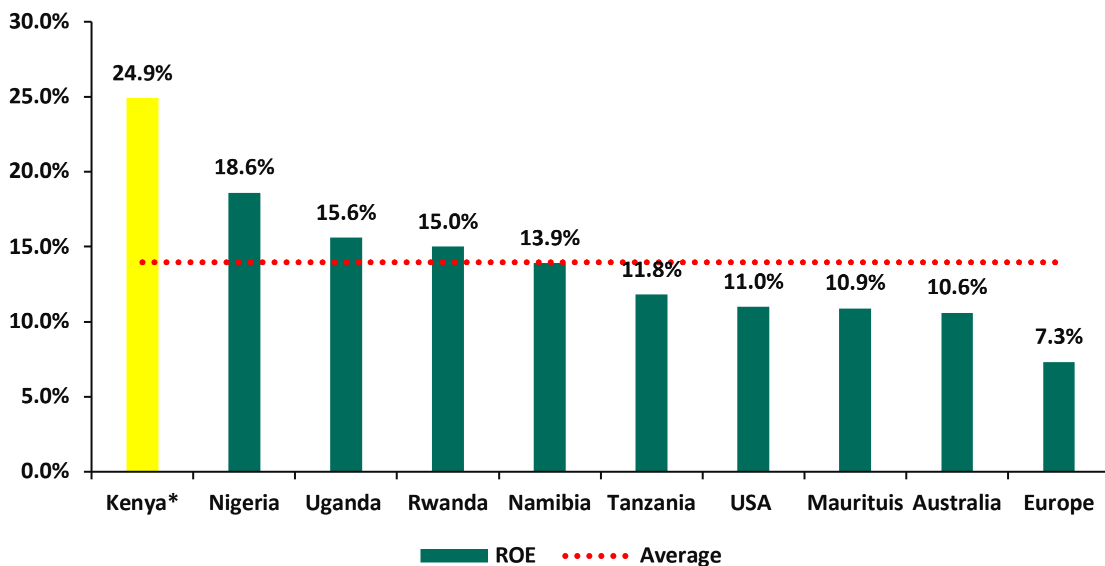
We chose to focus on SPVs for two reasons:

- First is Limited Understanding: Given their limited understanding in the local market, yet they are crucial to bringing much needed capital to fund businesses and projects. Further, the High Court in a matter for one of our associate companies, order liquidation primarily based on the fact that a Funding SPV had lent money to a project SPV without getting the typical securities a bank would get, hence calling the arrangement "a kin to a fraud". These liquidation orders over two funding vehicles, with 4,000 investors, had financed 10 real estate projects with another 20,000 investors in the 10 projects. The liquidation orders appeared to be founded on the High Court lack of appreciation on how SPVs work, and the orders have now given risk to almost 200 matters in various courts. In his recusal ruling, Justice Alfred Mabeya said, "I do not know how I should have described that arrangement." We hope that an explanation will help the market, stakeholders and even future adjudicates understand and describe arrangements around SPVs.
- Second is the Importance of SPVs in Funding businesses: In well developed economies such as the US, banks provide only 40% of funding for businesses while the majority 60% comes from capital markets funding by structures and instruments such as equity and debt instruments, SPVs, Special Purpose Acquisition Companies – SPACs, etc. However, in emerging market such as Kenya, banks provide 99% of capital with capital markets providing only 1% of capital. Essentially, there is bank dominance, and that is why funding for businesses is hard to find and when found, its prohibitively expensive making Kenya one of the most lucrative markets for banking business. The chart below shows a comparison of banks' and capital markets funding in Kenya against the funding proportions for developed economies



Source: World Bank

On a global level, the Kenyan banking sector continues to record high profitability compared to other economies in the world, as highlighted in the chart below:



Source: Cytonn Research, Kenya as of Q3'2024*

To try to improve understanding of SPVs, in this week's focus, we shall look into the following;

I. Introduction,
II. The Overview of SPVs in Kenya,
III. The Legal and Regulatory Framework for SPVs in Kenya,
IV. Misconceptions around SPVs in Kenya,
V. Case Studies,
VI. Benefits of SPVS in the Kenyan Financial Ecosystem,
VII. Challenges and Risks Associated with SPVs in Kenya, and,
VIII. Recommendations and Conclusion.

Section I: Introduction

a. The Evolution of Special Purpose Vehicles (SPVs) in Global Finance and Investments

A Special Purpose Vehicle (SPV), sometimes known as a Special Purpose Entity (SPE), is a legally separate and independent entity formed for a specific, defined purpose, typically to isolate financial risk. SPVs are widely utilized in securitization – which means turning projected cash flows from a project into an investable instrument, project finance, structured finance, and asset-backed transactions. Drawing from the settled trite law that a company is a separate legal entity and also captured in the celebrated case of **Salomon vs. Salomon and Company Limited**, SPVs are intended to be bankruptcy-resistant, meaning that their operations and liabilities are separate from the parent or sponsoring organization. It would be very messy if the bankruptcy of one entity is visited upon the other entities.

SPVs can be established as either limited liability companies (LLCs) or limited partnerships, trust or even a subsidiary of the originator. Since they operate as independent entities, they remain off the sponsor's or parent company's balance sheet.

Initially, SPVs were simple legal entities designed to address specific financial needs, but they have since become powerful tools for financial innovation, risk management, and strategic funding. Early applications were seen in real estate, infrastructure, and government projects. Developed countries like the U.S. and the U.K. provided the legal environments conducive to creating SPVs, leveraging their corporate law systems. In the 1990's SPVs became central to securitization, with financial institutions using SPVs to pool assets like mortgages, loans, and credit card receivables, and issue securities backed by these assets. This innovation led to the creation of asset-backed securities (ABS) and mortgage-backed securities (MBS). However, SPVs also began to attract scrutiny due to their misuse in some cases, such as Enron's collapse in 2001, where SPVs were used to conceal debt and inflate earnings. Notably, during the 2008 financial crisis, the Federal Reserve used an SPV to help rescue Bear Stearns by facilitating its sale to JPMorgan, invoking Section 13(3) of the Federal Reserve Act to authorize the creating of emergency lending facilities. The financial crisis highlighted the role of SPVs in opaque transactions and excessive risk-taking, leading to the establishment of regulatory reforms, such as the Dodd-Frank Act and Basel III, that increased oversight of SPVs, requiring greater transparency and stricter capital requirements.

Additionally, during COVID-19, the Term Asset-Backed Securities Loan Facility (TALF) created by the Federal Reserve, used SPVs to support the issuance of asset-backed securities and revive credit markets. Under the TALF, the Federal Reserve gave loans that didn't require repayment if the borrower couldn't pay, as long as the loans were backed by highly rated securities tied to new consumer and small business loans. The TALF was established by the Federal Reserve under the authority of Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary and ceased extending credit on 31st December 2020.

The global evolution of SPVs highlights their adaptability and enduring relevance in a rapidly changing financial landscape. From basic risk management tools to key drivers of financial innovation, SPVs continue to shape the future of global finance. Countries like India and China are increasingly adopting SPV structures for infrastructure development and public-private partnerships (PPPs).

b. The Evolution of Special Purpose Vehicles (SPVs) in Finance and Investments in Kenya

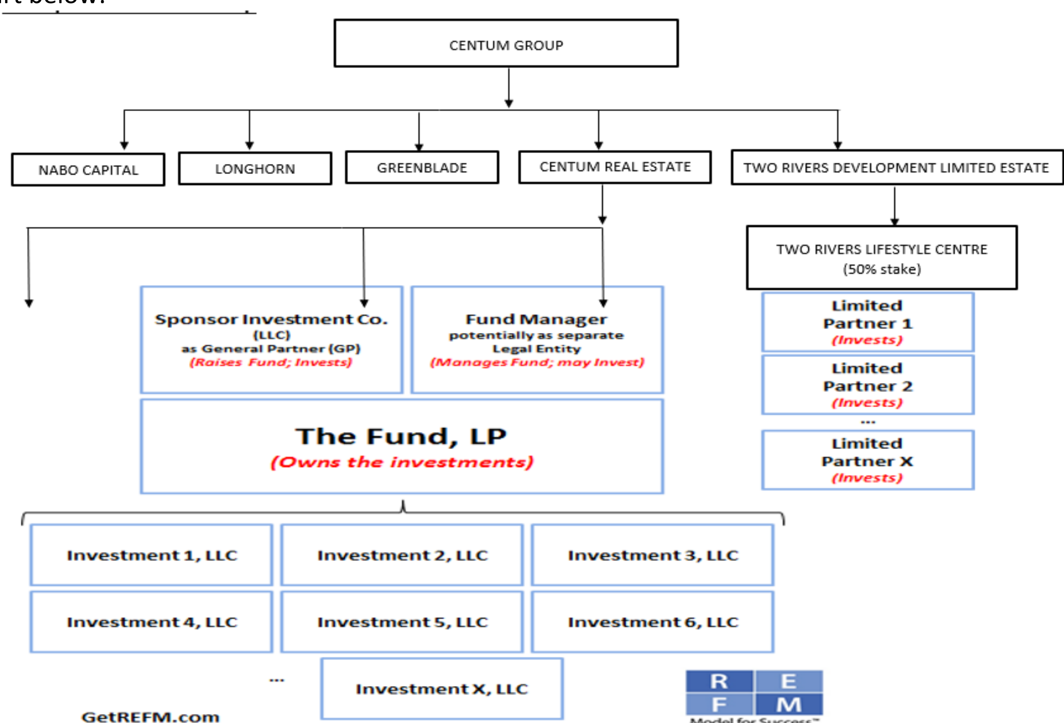
In Kenya, the adoption and development of Special Purpose Vehicles (SPVs) have followed global trends while being influenced by the country's unique regulatory, economic, and infrastructural context. SPVs were first introduced in Kenya during the 1990s, primarily as a means to finance large-scale infrastructure projects. Before the mid-1990s, the only SPVs in operation were Development Finance Institutions (DFIs) such as the Commonwealth Development Corporation (CDC) and the International Finance Corporation (IFC). These institutions also established subsidiaries like the Housing Finance Company of Kenya (HFCK) and several others. After 1995, there was an increase in involvement by Development Partners (DPs), including the United Kingdom's Department for International Development (DFID), which supported the establishment of the Private Infrastructure Development Group (PIDG), a group of institutions legally based in Mauritius. This initiative also led to the creation of organizations such as the Financial Sector Deepening (FSD) Trust in Kenya in 2005.

Recently from 2010, SPVs gained prominence in real estate developments and securitization deals. Developers used SPVs to manage specific projects, separate liabilities, and attract investors. Similarly, financial institutions began experimenting with securitization, pooling assets like mortgages for investment products. Notable examples include:

i. Cytonn Investments employing Special Purpose Vehicles (SPVs) to manage its real estate projects, ensuring proper governance and accountability. Each project is structured into an SPV, overseen by the Real Estate Projects (REP) Board, which provides guidance throughout the project's lifecycle. With notable projects such as the Alma, a comprehensive residential development located in Ruaka, featuring modern apartments and various amenities

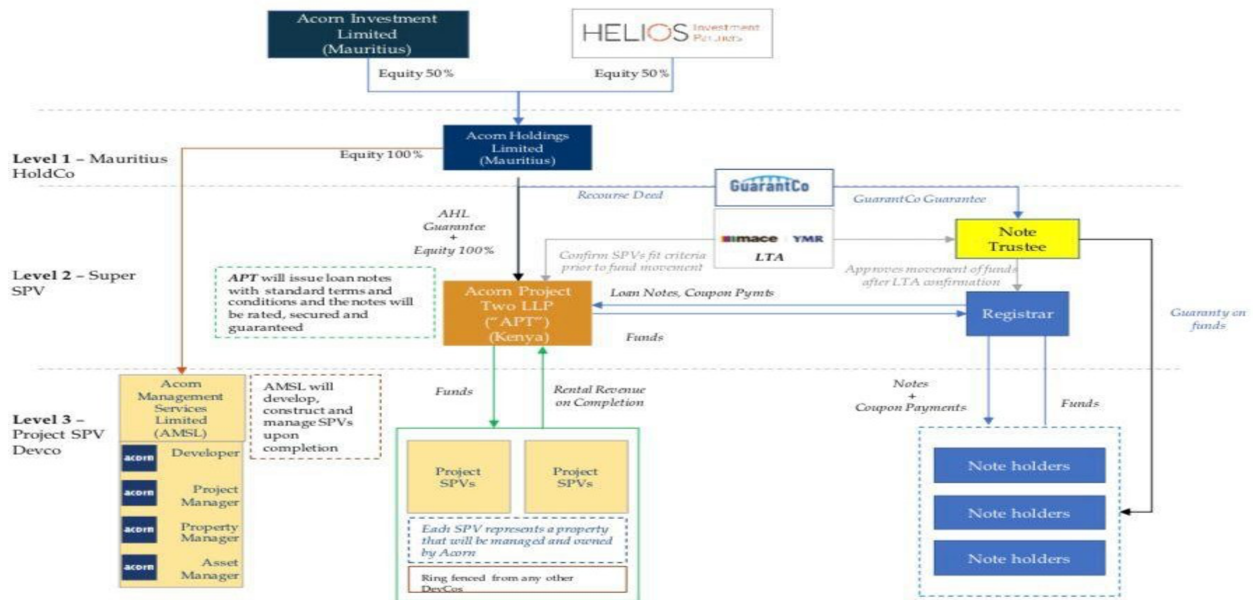
ii. The Kenya Mortgage Refinance Company (KMRC), which was established to promote affordable housing, began experimenting with the use of SPVs to securitize mortgage portfolios. By pooling mortgages from commercial banks, KMRC aimed to create mortgage-backed securities (MBS) that could be sold to investors, which would provide more liquidity in the housing market.

iii. Centum Real Estate, a subsidiary of Centum Investment Company, developed the Two Rivers Development in Nairobi, Kenya. To effectively manage and finance various components of the development, Centum utilized Special Purpose Vehicles (SPVs). One significant SPV is the Two Rivers Development Limited (TRDL), which oversees the entire Two Rivers project. Within this framework, specific projects have been initiated, including Centum Real Estate securing Kshs 2.9 bn from the International Finance Corporation (IFC) to accelerate the construction of the Edge-certified Mzizi Court Apartments at Two Rivers. Centum Group has invested in a number of Real Estate projects in the country through subsidiaries and special purpose vehicles as indicated in the chart below:



iv. Acorn, with equity backing from Helios through Acorn Investment Limited, uses Special Purpose Vehicles (SPVs) to channel funds raised from note issuances. The funds are downstreamed via Acorn Project Two LLP to individual project SPVs, which hold and manage specific real estate projects. Helios provides equity financing at the holding level, while the SPVs utilize the funds for property development, project costs, and reimbursement of pre-funded expenses, ensuring risk segregation and transparency. Upon project completion, the SPVs generate rental income to pay

noteholders, demonstrating a structured investment approach supported by Helios' capital. The figure below shows how Helios invests in Kenya through Acorn:



In Kenya, Special Purpose Vehicles (SPVs) continue to play a pivotal role in financing and developing large-scale infrastructure projects. The Central Bank of Kenya has highlighted SPVs as an effective mechanism for infrastructure development, including initiatives in low-cost housing and road construction. The enactment of Kenya's Public-Private Partnership (PPP) Act, 2021 has further facilitated the use of SPVs, particularly in the energy sector. The Act recognizes the SPV structure, enabling the establishment of project finance frameworks essential for investments.

Section II: The Benefits of SPVs & Legal Forms in Kenya

Special Purpose Vehicles (SPVs) are widely used across different sectors globally, and in Kenya, they have become a critical tool for structuring transactions, managing risks, and fostering investment.

a. Benefits of SPVs

i. **Risk Isolation:** SPVs are primarily used to separate the financial and legal risks of a project from the parent organization. By isolating liabilities, an SPV ensures that the parent company is not adversely affected in case of project failure.
ii. **Facilitation of Complex Projects:** SPVs are instrumental in executing large-scale projects, such as infrastructure development, renewable energy projects, and real estate projects. They simplify project financing by consolidating project-specific assets, liabilities, and operations within the SPV.
iii. **Access to Funding:** An SPV allows entities to attract investors by offering a structured and transparent vehicle for their investment. The distinct legal identity of the SPV often enhances investor and financier confidence. For example, for a group company such as Cytonn with many projects, a bank may not be interested in funding the group company which in turn uses the funding for development, they will be more willing to have the project in an SPV and they lend to the SPV and take securities in the SPV and the SPV's properties.
iv. **Asset Securitization:** SPVs are used to securitize assets such as loans, leases, or other receivables, enabling organizations to raise capital through the sale of these assets to investors. In other works, the projects cash flows of a project ring fenced in an SPV can be sold as an investment to investors.
v. **Asset Ownership:** An SPV allows a single asset to be owned by multiple owners, this then allows it to be able to raise funding from a larger base. Given that SPVs fund large projects, ability to attract

difference financiers is key. Without SPVS, large projects such as real estate projects would not be possible.

vi. **Isolate Financial Risk:** It would be hard to grow big companies that can do innovation, R&D and create jobs if the failure of one entity fails the entire company. SPVs are a modern finance tool to contain the financial risk of one project to that project alone.

vii. **Minimal Red Tape:** It allows the setting up of a project finance and funding vehicle without much red tape, and typically without government authorization required as it would be the case in raising funds through regulated vehicles.

viii. **Clarity of Documentation and Governance**: The parties will include exactly what they want done and how they want the SPV governed through a specific document.

ix. **Containing Legal Liability:** The liability for the sponsor is limited to the SPV in the event that the project fails it does not affect the rest of the group company, hence preserving value, jobs and tax base

x. **Public-Private Partnerships (PPPs):** In Kenya, SPVs are frequently employed in PPPs, allowing private sector entities to collaborate with the government in the development of public infrastructure and services.

b. Risks Associated with SPVs

i. **Credit Risk:** This arises if the underlying assets or counterparties (e.g. borrowers, or project sponsors) default on payments. Creditworthiness affects the SPV's ability to meet obligations, particularly in asset-backed securities or project finance.

ii. **Liquidity Risk:** SPVs often have structured payment obligations. A mismatch in cash inflows (from underlying assets) and outflows (to creditors or investors) can lead to liquidity challenges, especially if revenues are delayed or lower than expected.

iii. **Operational Risk:** Inefficiencies, fraud, or errors in the management of SPVs, such as poor documentation, oversight failures, or mismanagement of funds, can jeopardize their performance.

iv. **Market Risk:** SPVs that depend on market-linked revenues (e.g., real estate prices, interest rates, or foreign exchange rates) are exposed to fluctuations that may reduce returns or increase costs.

v. **Reputational Risk:** Negative publicity, poor performance, or disputes involving the SPV or its sponsors can undermine investor confidence, making it harder to raise funds or sustain operations.

vi. **Structural Risks:** Poorly designed SPV structures or inadequate legal arrangements (e.g., insufficient separation of the SPV from the sponsor) can expose investors to additional risks, including legal claims against the SPV.

Section III: The Legal and Regulatory Framework for SPVs in Kenya

While still fairly new, Special Purpose Vehicles (SPVs) have become an integral part of Kenya's financial and infrastructural landscape, providing mechanisms for project financing, risk isolation, and investment structuring. The establishment and operation of SPVs in Kenya are guided by a range of legal and regulatory provisions designed to ensure compliance, transparency, and efficiency.

SPVs in Kenya can take various legal forms, each chosen based on the specific needs and objectives of the project. The choice of SPV structure depends on factors such as the nature of the project, risk considerations, funding requirements, and regulatory implications. These include:

i. **Limited Liability Companies:** This is the most common form, providing a separate legal identity and limiting the liability of shareholders to their capital contributions. It is suitable for projects requiring clear ownership structures and governance frameworks. Cytonn Investments used a

limited liability company structure to establish Cytonn Real Estate Project Notes LLP, which pools investor funds for real estate projects like The Alma

ii. **Partnerships and Limited Partnerships:** These forms are often used for joint ventures where parties seek to combine resources and share profits and losses according to agreed terms. Limited partnerships allow for both general and limited partners, providing flexibility in management and investment roles. In the Amu Power Coal Plant Project (Lamu), a partnership structure was initially adopted between Gulf Energy and Centum Investment to pool resources and expertise.

iii. **Trusts:** In certain cases, especially in asset securitization, SPVs may be established as trusts to hold assets for the benefit of beneficiaries, ensuring legal separation and protection of assets. Trust-based SPVs are commonly used by REITs (Real Estate Investment Trusts) in Kenya, such as the Acorn Student Accommodation REIT, to secure assets for the benefit of investors.

iv. **Joint Ventures:** When multiple entities collaborate on a specific project, they may form an SPV as a joint venture, defining each party's rights, responsibilities, and profit-sharing arrangements. This structure is prevalent in large-scale infrastructure and real estate projects. The Standard Gauge Railway (SGR) involved a joint venture approach, with entities such as China Road and Bridge Corporation and Kenyan authorities coordinating through SPV structures.

v. **Public-Private Partnerships (PPPs):** SPVs in PPP projects are critical for structuring collaboration between the government and private investors, allowing for the financing, development, and operation of public infrastructure. The government may hold equity or participate in oversight roles within the SPV. The Nairobi Expressway Project utilized an SPV under a PPP arrangement, with China Road and Bridge Corporation taking on the development and operation roles while the government provided oversight and enabling policies.

The laws and regulations guiding SPVs in Kenya include:

a. The Limited Liability Partnership Act 42 of 2011, (CAP 30)

The Limited Liability Partnership Act, No. 42 of 2011, establishes the framework for forming and operating Limited Liability Partnerships (LLPs) in Kenya. While the Act does not specifically mention Special Purpose Vehicles (SPVs), entities can utilize the LLP structure to create SPVs for various purposes. Upon registration, an LLP becomes a body corporate with perpetual succession, possessing a legal identity distinct from its partners. This allows the LLP to own property, enter contracts, and conduct business in its own name. By leveraging the LLP structure, entities in Kenya can establish SPVs that benefit from limited liability, a separate legal identity, and a flexible management framework.

b. The Public-Private Partnership (PPP) Act, 2021

According to Section VII of the Public-Private Partnership (PPP) Act, 2021, a project company is a special purpose vehicle incorporated by a successful bidder specifically to undertake a public-private partnership (PPP) project. This incorporation ensures that the project company is a distinct legal entity, separate from the parent company, allowing for the isolation of financial and operational risks associated with the project. The Act mandates that the project company operates within the scope defined in the project agreement, adhering to the obligations and responsibilities outlined therein. The Act establishes the PPP Directorate and PPP Committee to oversee SPV operations within the PPP framework.

b. The Companies Act, 2015

While the Companies Act, 2015 does not provide specific provisions for Special Purpose Vehicles (SPVs), it offers the necessary legal structures for their creation. The Companies Act, 2015 facilitates the establishment of SPVs in Kenya by providing various company structures that can be tailored to serve specific purposes, governing the registration, operation and dissolution of SPVs as legal entities. Entities intending to establish an SPV must comply with the general requirements of the Act. This includes the incorporation process, which involves submitting requisite documents such as the memorandum and articles of association to the Registrar of Companies. Additionally, entities must adhere to corporate governance standards outlined in the Act, including appointing directors and company secretaries and

maintaining statutory records. Furthermore, they are required to prepare and file annual financial statements and reports in accordance with the Act's stipulations.

c. **The Capital Markets Authority and Capital Markets Act (Cap 485A)**

The Capital Markets Act (Cap 485A) of Kenya, along with its accompanying regulations, outlines specific provisions concerning Special Purpose Vehicles (SPVs) engaged in capital market transactions. SPVs must obtain approval from the Capital Markets Authority (CMA) before issuing securities. This requirement ensures that all securities offerings meet regulatory standards and protect investor interests. The CMA evaluates the suitability of the SPV and the proposed issuance to maintain market integrity.

The Act mandates that SPVs provide comprehensive information to investors, including detailed financial statements and disclosures of potential risks associated with the investment. This transparency is crucial for informed decision-making by investors and is enforced through regulations such as the Capital Markets (Public Offers, Listings and Disclosures) Regulations, 2023. Additionally, the CMA regulates the issuance of Asset-Backed Securities by SPVs to ensure investor protection and market stability. In 2017, the CMA issued a Policy Guidance Note (PGN) to facilitate the issuance of ABS, providing clarity on the structure and operation of SPVs in such transactions.

d. **The Tax Regulations**

The Kenya Revenue Authority (KRA) does not provide specific tax regulations exclusively for Special Purpose Vehicles (SPVs). Instead, SPVs are subject to the general tax framework applicable to all corporate entities in Kenya. This includes obligations related to corporate income tax, value-added tax (VAT), withholding tax, stamp duty, and turnover tax (TOT), depending on the nature of the SPV's activities.

SPVs are required to pay corporate income tax at a rate of 30.0% on taxable income and must file annual tax returns with the KRA. If an SPV's annual turnover exceeds Kshs 5.0 mn, it must register for VAT, which is charged at a standard rate of 16.0%, though exemptions and reduced rates may apply to certain goods and services. Additionally, SPVs are required to withhold tax on specific payments such as dividends, interest, and royalties, with rates varying based on the recipient's residency and the nature of the payment. Transactions involving property transfers, share transfers, or certain financial instruments may attract stamp duty, with rates dependent on the transaction's value and type. SPVs with an annual gross turnover between Kshs. 1.0 mn and Kshs. 25.0 mn are subject to turnover tax (TOT) at a rate of 1.0% on gross monthly sales, though some income types like rental income and professional fees are exempt from TOT.

While SPVs follow general tax regulations, the specific activities and structures of the SPV, such as those related to securitization or asset-backed securities, may influence their tax obligations.

e. **The Insolvency Act, 2015**

The Insolvency Act, 2015 provides mechanisms for handling financial distress in SPVs. As SPVs are typically incorporated entities under Kenyan law, they are subject to the general insolvency framework applicable to all companies. This includes procedures for administration, liquidation, and arrangements with creditors as outlined in the Act. Therefore, while there are no SPV-specific insolvency provisions, the standard insolvency processes and protections apply to SPVs in Kenya. The Act outlines procedures for placing insolvent SPVs under receivership or liquidation.

Section IV: Misconceptions around SPVs in Kenya

Special Purpose Vehicles (SPVs) are structured financial entities created to isolate risk and achieve specific financial objectives. In Kenya, SPVs are increasingly being adopted in areas such as real estate development, project financing, and securitization of assets. However, there are several misconceptions about SPVs that hinder their adoption and proper utilization:

a. **SPVs are only for large corporations or multinationals:** Many people in Kenya believe that SPVs are tools exclusively designed for large corporations, international organizations, or governments. In reality, SPVs are accessible to a wide range of entities, including small and medium-sized

enterprises (SMEs), partnerships, and even individual investors. For example, an entrepreneur who owns 20 matatus, instead of having them all owned in one company, they can have each matatu owned by a different company hence have 20 different companies. The risks of each matatu are contained in that specific matatu.

b. **SPVs are illegal or used to evade taxes:** Some stakeholders associate SPVs with tax evasion, fraud, or illegal financial practices. In reality, SPVs are legitimate financial tools used in compliance with existing laws. In Kenya, SPVs must adhere to the Limited Liabilities Partnerships Act, Companies Act, the Capital Markets Authority (CMA) regulations, and tax laws. Properly structured SPVs provide clarity to both regulators and investors. Any abuse arises from poor governance rather than the inherent nature of SPVs.
c. **SPVs are only for avoiding liabilities:** Many believe that SPVs are merely tools to shift liability from the parent company to avoid responsibility in case of failure. In reality, while SPVs indeed ring-fence liabilities, their primary purpose is to isolate risks tied to a specific project, ensuring the financial health of the parent company. By isolating risks, SPVs can attract more investors who may be reluctant to invest in the broader entity but are willing to back a specific, well-defined project.
d. **SPVs guarantee project success:** Some stakeholders believe that creating an SPV automatically ensures the success of a project. In reality, SPVs are tools, not guarantees. Their success depends on proper management structures and oversight, the viability of the project and proper risk management.
e. **SPVs lack transparency:** Some believe that SPVs are opaque and prone to misuse, hiding critical information from stakeholders. In reality, properly structured SPVs enhance transparency by isolating finances and governance for specific projects. Lack of transparency occurs when governance is weak or when parties misuse the SPV to obscure transactions, which is a regulatory and management issue rather than an issue inherent to SPVs
f. **SPVs are a form of tax avoidance:** There is a perception that SPVs are created solely to avoid taxes. However, SPVs are subject to the same tax laws as any other entity in Kenya. The perception of tax avoidance often arises when SPVs are misused, not because of their inherent structure.

Addressing misconceptions around SPVs in Kenya requires enhanced financial literacy, strong regulatory oversight, and public awareness of their benefits. SPVs are not inherently complex or exclusive tools for large organizations; they are flexible vehicles that can promote investment, manage risk, and enable innovation across various sectors. For SPVs to fulfill their potential, stakeholders must move beyond these misconceptions and focus on leveraging them to unlock Kenya’s economic growth.

Section V: Case Studies

a. Cytonn High Yield Solutions (CHYS)

Cytonn High Yield Solutions (CHYS) was established as a privately placed, high-return investment product, structured as a limited Liability Partnership (LLP). The primary objective of CHYS was to by pass borrowing from banks at 18% to fund real estate development, but instead borrow directly from investors and pay them the same 18% that a project would pay to bank; essentially providing investors with higher returns compared to traditional cash management options, leveraging the potential of alternative investments like Real Estate. CHYS was offered to investors as restricted private offers as defined in Regulation 21 of the Capital Markets (Securities) (Public Offers, Listings, and Disclosures) Regulations 2002 as read together with Capital Markets Act, Section 30A(3)(b). The structure enabled CHYS to pool private client funds, invest strategically and offer direct access to high yield opportunities typically unavailable to retail investors. While Investors in CHYS participated as Investment Partners, they elected a Board to represent their interests, ensuring participatory governance and transparency in decision-making.

The funding model adopted by CHYS entailed consolidating investments from clients into a single pool and investing in alternative opportunities such as Real Estate through Loan Note Instruments, which lent from the CHYS fund to the real estate projects. In comparison, the traditional way of investing involves a saver taking money to the bank and gets little to no return on their deposit; with the bank in turn lending to, for example, a developer, and charges the market rate cost of borrowing. The bank then benefits from the difference between the cost of the deposit paid to saver and the yield from the developer. In the CHYS scenario, the process remains the same as the traditional way except that the intermediary is not a bank but an investment vehicle. The saver takes money to an investment professional through an investment vehicle (CHYS), who gives money directly to the developer. The developer will still pay the usual cost of borrowing, but instead of paying to the bank, it will be paid to the Investment Vehicle in this case CHYS, which will in turn pass returns to the saver.

The CHYS investment portfolio was diversified to include a mix of real estate projects to capitalize on the robust performance of this asset class which has historically offered returns of 25.0%-28.0% outperforming traditional investment classes such as equities and fixed-income securities. For example, a portion of the funds in CHYS was invested as mezzanine notes in The Alma in Ruaka, a Kshs 6.0 bn 450-unit mixed-use development, yielding an annualized return of approximately 25.0 % per annum supported by through market research and sound risk assessments in the project. The Alma apartments in Ruaka (Cytonn Integrated Project LLP) leveraged pre-sales contracts to maintain liquidity and meet its debt obligation to investors (CHYS). In turn, CHYS offered investors returns of up to 18.0% per annum supported by the alternative investments such as real estate-backed mezzanine debt.

On governance and transparency CHYS was structured as a Limited Liability Partnership (LLP) with investors coming in as Investment Partners. For governance, the CHYS investors had their elected Board where they voted Partners among themselves to represent them in the Board which directs investment decisions. The Board was responsible for convening Annual General Meetings (AGMs), reviewing and approving audited financial statements, and making key resolutions. Additional oversight was provided by Standard Chartered as the custodian of partner assets and Grant Thornton, which conducted annual audits. This governance framework ensured accountability and transparency in managing investor funds.

List most real estate funds, CHYS ran into liquidity challenges at the onset of Covid 19 when there was mass withdrawal of funds, limited investment into the fund and limited inflows from the real estate projects it had lent to.

Key Lessons drawn from CHYS:

i. **Liquidity Management:** A key lesson from CHYS was the importance of liquidity management. The onset of the unprecedented COVID-19 pandemic in 2019 strained the liquidity of real estate funds globally and several real estate funds were hit with a surge in cash demands by investors, coupled with reduced inflows as economic uncertainty crippled markets. Consequently, many real estate funds, including CHYS, faced significant liquidity challenges leading to stalled projects. While the pandemic scenario was unforeseen, the experience highlights a great need for structured funds to develop better strategies for mitigating liquidity risks during future crisis.

ii. **Need for Public and Investor Sensitization on structured products:** The lack of widespread knowledge by the general public and potential investors on structured products created significant negative publicity for the fund which further impacted its optimal operations. Given this, there is greater need for continuous education of potential investors and general public to enhance understanding of structured products and SPVs specifically on the benefits, risks and operational framework in order to build trust and facilitate informed decision making.

iii. **Need for stake holder education:** on seeking administrative projection to restructure, the court ended up issuing liquidation orders of the fund, but also preserving, essentially crippling all the 10 projects, which made matters worse.

b. The Alma Apartments in Ruaka (Cytonn Integrated Project LLP-SPV)

Formation and Purpose of the SPV

The Alma Apartments in Ruaka is a case example of a development done through the Cytonn Integrated Project LLP, a special purpose vehicle (SPV) formed to meet the rising demand for high-quality mixed-use units while delivering attractive returns to investors in the CHYS. The Cytonn Integrated Project LLP (Special Purpose Vehicle) is a limited partnership registered under the laws of the republic of Kenya and was created specifically to manage and own The Alma Project. The SPV operates with Standard Bank of Mauritius (SBM) as the custodian and Goal Advisory as the trustee who ensure proper oversight and accountability.

Overview of the Project

The Alma is a mixed-use comprehensive lifestyle development comprising of 477 units of 1,2 and 3-bed units' typology. The project was designed to cater to the needs of middle-income families and young professionals, capitalizing on the growing demand for housing in Ruaka. The table shows the progress of the development as of 2025;

Type	Feature
Development Type	Mixed Use Development
Start Date	April 2016
Completion Status	Phase 1 – Completed Phase 2 – Completed Phase 3 – Completed Phase 4 – Still in progress
No. of Blocks	9
Number of Units	477
Amenities	Clubhouse, Swimming Pool, Gym, Kindergarten, Spa, retail centre etc.

Source: Cytonn Research

Capital Raising Mechanism

The project's funding was sourced through a combination of clients' funds raised via CHYS and mezzanine financing. The Cytonn Integrated Project LLP -SPV functioned as a trading entity, meaning it generated income and value by holding the residential units within The Alma project and earning from the receivables tied to these units. These receivables are the payments made by buyers or tenants, which serve as a primary security for the investors of Cytonn High Yield Solutions (CHYS). Essentially, instead of relying on the value of undeveloped land, the SPV'S value is based on the payments from completed residential units that it holds as assets. The project was financed by several investors. The table below shows the Alma's capital funding structure;

The Alma Capital Funding Structure				
Security Ranking	Proportion of Capital Funding (%)	Type of Capital	Description	Number of Investors
1st	12.7%	Bank Funding	The 1st ranking source of funding which entails a registered charge amounting to Kshs 700 mn against the Alma Project.	1
2nd	3.6%	The regulated Cytonn High Yield Fund (CHYF)	Consists of secured funding from the CMA regulated CHYF, with a registered security interest amounting to Kshs 200 mn against the Alma project.	20,000
3rd	36.3%	Presales contracts (Investors holding sales agreements)	This is funding amounting to approximately Kshs 2.0 bn raised from the pre-sale of a total 477 home units at Alma secured through an equitable lien on the project via the purchase agreement	477
3rd	29.0%	Mezzanine Funding from Cytonn High Yield Solution (CHYS)	Entails approximately Kshs 1.6 bn of privately raised funding in Cytonn High Yield Solutions (CHYS) from 4,000 investors.	4,000
4th	18.4%	Promoters and Equity Investors	Involves approximately Kshs 1.0 bn funding raised from promoters and Equity Investors in the Alma project.	250

Source: Cytonn Research

The above funding comes into the project through SPVs:

a) Bank Funding comes into the development SPV - 1
b) Regulated CHYF funding comes through the Trust SPV- 1
c) Presales comes into the development SPV (same as a above)
d) Mezzanine funding comes through two unregulated funding SPVs called CHYS and CPN – 2 SPVs
e) Promoters come through various SPVS
    - The project management SPV to do project management – coordinates project teams such as architect, engineers, contractor – 1 SPV
    - The development management SPV to do development management - overall responsibility for the project – 1 SPV
    - The facilities management SPV to manage the common areas facilities – 1 SPV
    - Joint venture partners contribute the land through SPVs that are party to the JV, about 3 of them – 3 SPVs

From the above, one big real estate project alone requires about 10 SPVs each playing different roles. Multiple by 5 big projects, a modern-day real estate developer would require about 40 to 50 SPVs to execute 5 projects.

Project Execution and Return to Investors

Execution of the Alma was guided by detailed market research and an enhanced project management framework. Through the SPV, the Alma development has been able to successfully hand over 301 units across three phases, which then demonstrates the power of comprehensive market research. The SPV is still focused on securing financing to complete Phase 4. The Alma currently has a potential revenue of Kshs 2.5 bn from unsold units, representing a substantial future cash inflow. In addition, Kshs 211.3 mn remains collectible from units already sold but for which payments have not yet been completed. Combined, the total direct receivables from The Alma amount to Kshs 2.7 bn. In terms of transparency Cytonn Integrated Project LLP maintained rigorous reporting throughout the project's lifecycle with regular updates provided to investors, covering progress on construction, sales performance, and financial metrics mitigating any potential risks.

Lessons Drawn from the Alma SPV:

i. **Stimulation of Capital Markets to Improve Access to Financing:** Inadequate funding opportunities remains a significant challenge for development projects, often resulting in project delays or in some cases, project suspension. Without adequate funds, developers may struggle to commence or complete construction on time, resulting in extended project timelines which can frustrate buyers, erode investor confidence, and lead to reputational damage for the developer. As such, the government should work towards further stimulation of capital markets in order to improve access to financing for developers. This can be achieved through the establishment and effective utilization of specialized Collective Investment Schemes (CIS) and Real Estate Investment Trusts (REITs) known as Development REITs (DREITs) which can further increase availability of capital for development projects, while reducing reliance on traditional financing channels such as bank loans,

ii. **Potential Delays in Construction Timelines:** Unforeseen circumstances such as company governance issues, supply chain disruptions, or regulatory issues can cause construction timelines to be extended. This can impact both buyers and developers, as buyers will have to wait longer to take possession of their properties, and developers may face increased costs in order to complete the off-plan project,

iii. **Off-plan Real Estate development:** Off-plan Real Estate development and investing in Kenya offers a promising opportunity for both investors and developers aiming to capitalize on the country's rapidly growing property market. Investors can leverage the potential for significant returns and the advantage of purchasing properties at lower prices during the construction phase. Simultaneously, developers stand to benefit from pre-sales, which provide upfront funding and in ensuring a ready market for their properties ahead of project completion.

The Impact the Alma has had on the Real Estate Market

The Alma Apartments set a benchmark for mixed-use developments in satellite towns, showcasing the potential and demand for high-quality and relatively affordable housing to address Nairobi's housing deficit. Its successful hand over of 301 units across three phases highlights the viability of alternative financing models, such as mezzanine debt and off-plan sales in driving real estate growth. The project's focus on amenities and modern living standards has continued to influence market trends encouraging similar developments in Ruaka area and beyond.

Section VI: Benefits of SPVs in the Kenyan Financial Ecosystem

In the Kenyan financial ecosystem, SPVs have grown in prominence due to their role in structuring investments, enhancing financial inclusivity, and catalyzing economic growth. Their benefits include:

a. **Efficient Risk Management**: SPVs enable businesses to isolate risks associated with specific projects. By compartmentalizing liabilities, SPVs protect the parent company's assets while ensuring targeted management of risks. For instance, in real estate development, SPVs are used to shield investors from project-specific risks.
b. **Facilitation of Large-Scale Infrastructure Projects:** Kenya's ambitious infrastructure projects, such as the Lamu Port-South Sudan-Ethiopia Transport (LAPSSET) Corridor and renewable energy projects, have leveraged SPVs to pool investments and manage project-specific finances. These projects, executed via SPVs, have boosted economic growth by creating jobs and improving connectivity.
c. **Attraction of Foreign Direct Investment (FDI):** SPVs provide a clear framework for investment, making it easier for foreign investors to participate in Kenya's economy. The use of SPVs ensures transparency, encourages investor confidence, and fosters a conducive environment for capital inflows.
d. **Enhancement of Financial Inclusion:** Through SPVs, marginalized sectors such as affordable housing and SME financing can access structured funding. The Kenyan government has established SPVs to drive affordable housing initiatives under the Big Four Agenda, thereby addressing housing deficits and contributing to social development.
e. **Diversification of Funding Sources**: By pooling resources from multiple investors, SPVs enable funding for high-capital projects. This diversifies the financial ecosystem and reduces dependency on traditional banking systems. In Kenya, SPVs have played a pivotal role in real estate crowdfunding and asset-backed securities.
f. **Promotion of Capital Markets**: SPVs issue securities such as bonds and sukuk (Islamic bonds), deepening Kenya's capital markets. For instance, green bonds issued through SPVs have financed sustainable development projects, aligning Kenya with global environmental goals and enhancing its international financial standing**.**

Section VII: Challenges Associated with Special Purpose Vehicles in Kenya

Special Purpose Vehicles (SPVs) in Kenya have gained importance in the financial and investment landscape as tools for isolating risks and facilitating structured finance transactions. However, the use and implementation of SPVs face several significant challenges and risks. Below are some of the key challenges facing SPVs in Kenya:

a. **Lack of Transparency:** One critical issue with SPVs is the potential lack of transparency, which can undermine investor confidence. In Kenya, contributors to SPVs may not have full visibility into the nature of the assets held within the vehicle, their performance, or the associated risks. This lack of clarity can create mistrust, particularly in a market where financial literacy and regulatory enforcement are still evolving. For example, Kenyan investors might be unaware of the credit quality of underlying assets in an SPV or the specific mechanisms used to generate returns, increasing perceived risk.
b. **High Leverage:** SPVs are often structured with high levels of leverage to enhance potential returns. However, this reliance on debt financing introduces significant risk, especially in a country like Kenya, where interest rates can be volatile. Poor debt management by SPV administrators can lead to substantial losses for investors. In addition, Kenya's financial markets are still maturing, and mechanisms for assessing and mitigating leverage risks are not always robust, further amplifying potential losses in the event of market shocks.
c. **High Complexity and Administrative Costs:** Setting up and managing SPVs is inherently complex, involving detailed legal, regulatory, and administrative requirements. In Kenya, this complexity is compounded by unclear and sometimes burdensome regulatory processes. Entrepreneurs and investors must navigate costs related to maintaining separate records, preparing financial statements, and filing tax returns for SPVs. For instance, the lack of a streamlined process under the Companies Act or taxation framework adds administrative overhead, making SPVs less attractive for smaller businesses or investors.

d. **Conflicts of Interest:** Conflicts of interest are another challenge, particularly when the sponsor of an SPV also acts as its manager. This dual role can lead to decisions that prioritize the sponsor's benefits over those of investors. In Kenya, where corporate governance standards are still developing, such conflicts can go unchecked, further discouraging participation in SPVs. For example, a sponsor might structure an SPV to offload high-risk assets from its balance sheet without adequately disclosing the risks to investors, leading to misaligned incentives and potential losses.
e. **Regulatory and Legal Framework Limitations:** Kenya's regulatory framework for SPVs is still evolving, which can create uncertainty for investors and sponsors alike. Ambiguities in the Companies Act and Capital Markets Authority (CMA) regulations make it difficult to structure SPVs efficiently. This lack of regulatory clarity increases the likelihood of compliance breaches, which can lead to financial penalties or even legal disputes. Additionally, there is limited case law on SPVs in Kenya, making it challenging for parties to predict how courts will interpret disputes related to these entities.
f. **Limited Financial Literacy:** In Kenya, a relatively low level of financial literacy among retail investors exacerbates the transparency challenge. Many investors may not fully understand the risks associated with SPVs or the legal and financial nuances of participating in such vehicles. This lack of knowledge creates a fertile ground for misinformation or even fraudulent schemes disguised as SPVs. For instance, cases of pyramid schemes masquerading as legitimate investment vehicles have eroded public trust in financial innovations, including SPVs.
g. **Market Fragmentation:** Kenya's capital markets remain relatively small and fragmented, which limits the pool of potential investors for SPVs. Additionally, the lack of a secondary market for trading SPV interests reduces liquidity, making it harder for investors to exit their positions. This lack of liquidity is a significant deterrent, especially for institutional investors who prioritize flexibility in portfolio management.

Section VIII: Recommendations and Conclusion

To maximize the potential of SPVs in Kenya, various strategic actions can be undertaken by stakeholders, including the government, private sector, and investors. These include:

a. Enhance Public and Stakeholder Education: The High Court in Insolvency Petition 063 of 2021, issued liquidation orders on its own motion primarily on the grounds that a fund not having the traditional banking charge on real estate projects and lending to related entities is akin to a fraud. Yet SPVs under one group typically lend to and borrow from each other in the ordinary cause of business and the securities among them are not the traditional securities that banks provide.
b. **Enhance Regulatory Framework-** Simplifying the formation and registration process, establishing clear guidelines, and enforcing strong investor protection measures are key steps to create a more favorable environment for SPVs. Additionally, businesses must strictly adhere to global accounting standards like IFRS and GAAP for accurate and transparent financial reporting. This ensures that SPVs operate within legal frameworks and helps maintain investor confidence.
c. **Facilitate Access to Capital-** The costs associated with establishing and maintaining SPVs can be prohibitive, particularly for smaller projects. Many SPVs struggle to secure funding due to stringent lending requirements or lack of investor confidence and since SPVs operate as separate entities, they often lack the creditworthiness of their sponsor companies, making it challenging to secure funding at favorable terms.
d. **Strengthen Governance and Transparency-** SPVs must have well-defined governance frameworks that specify roles, responsibilities, and decision-making processes. Independent directors and transparent reporting can significantly reduce the risk of mismanagement and misuse. Additionally, develop comprehensive internal control systems to ensure that all financial transactions are accurately reported, preventing the concealment of liabilities or financial misstatements and conduct regular Auditing.

e. **Risk Management and Operational Efficiency-** Conduct comprehensive risk assessments when designing and structuring SPVs. This includes identifying potential financial, operational, and legal risks to better manage and mitigate them. Clearly define the SPV's purpose and scope to avoid mission creep, which can lead to inefficiencies or unintended liabilities. The SPV should focus on specific objectives such as asset holding, project financing, or risk isolation.

f. **Simplify and Streamline Financial Reporting-** SPVs introduce additional complexity into accounting and financial reporting due to their distinct legal and financial structures. If a parent company control over an SPV or assumes its risks, accounting standards requires the consolidation of the SPV's financial statements with those of the parent company. However, the process can be intricate, requiring detailed assessments of control, risks, and benefits associated with the SPV. Any improper handling, misrepresentation, or omission of SPV financials can lead to serious consequences, including regulatory penalties, damaged investor trust, and reputational harm. Businesses must prioritize accuracy, compliance, and transparency in reporting SPV financials to mitigate these risks and uphold stakeholder confidence**.**

g. **Facilitate Capacity Building-** Provide training and resources for regulators, financial institutions, and corporate entities to understand SPV complexities, ensuring informed decision-making and effective oversight.

SPVs are independent entities established to isolate financial risks, facilitate capital raising, and manage assets efficiently. They offer advantages such as tax benefits, improved access to funding, and protection for parent companies. By isolating risks, facilitating structured investments, and fostering public-private collaborations, SPVs contribute to the country's economic growth and development. They are essential to raising capital that is needed to addressing big projects such as housing and infrastructure and should be natured to bring capital and impact to these sectors. However, their success hinges on strong governance, stakeholder awareness, regulatory compliance, and transparency to build investor confidence and sustain long-term benefits.

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