<u>Update on Kenya Mortgage Refinance Company (KMRC) & Cytonn Weekly #06/2023</u>

Executive Summary

Fixed Income: During the week, T-bills remained oversubscribed, albeit at a lower rate, with the overall subscription rate coming in at 187.1%, down from 208.9%, recorded the previous week. Investor's preference for the shorter 91-day paper persisted as they sought to avoid duration risk, with the paper receiving bids worth Kshs 31.2 bn against the offered Kshs 4.0 bn, translating to a significant subscription rate of 780.0%, up from 718.6% recorded the previous week. The subscription rates for the 364-day and 182-day papers however declined to 43.8% and 93.3% from 105.3% and 108.5%, respectively, recorded the previous week. The yields on the government papers were on an upward trajectory, with the yields on the 364-day, 182-day and 91-day papers increasing by 5.3 bps, 4.5 bps and 2.0 bps to 10.6%, 10.0% and 9.6%;

In the Primary Bond Market, the Central Bank of Kenya released the auction results for the recently re-opened bond; FXD1/2017/010 and the newly issued bond; FXD1/2023/010, with effective tenors to maturity of 4.5 years and 10.0 years for FXD1/2017/010 and FXD1/2023/010, respectively. Notably, the bonds recorded an undersubscription of 39.1%, in line with our expectations, partly attributable to the investor's preference for the shorter dated papers as they sought to avoid duration risk, as well the tightened liquidity in the money markets, with the average interbank rate coming in at 6.2% during the period of the sale;

Additionally, the National Treasury presented the Supplementary Budget for FY'2022/23 to the National Assembly highlighting that the National Treasury is seeking to slightly increase the gross total budget by 0.4% to Kshs 3,373.3 bn from the previous estimates of Kshs 3,358.6 bn driven by an increase in the recurrent expenditure by 6.6% to Kshs 1,496.9 bn in the Supplementary estimates from Kshs 1,403.9 bn in the Original estimates. On the other hand, Development expenditure is set to reduce by 14.9% to Kshs 609.1 bn in the supplementary estimates from Kshs 715.4 bn in the original estimates;

Equities: During the week, the equities market recorded mixed performance, with NASI declining by 0.8%, while NSE 20 and NSE 25 gained by 0.5% and 0.1%, respectively, taking the YTD performance to gains of 0.7% and 1.4% for NASI and NSE 25, respectively, and a decline of 0.2% for NSE 20. The equities market performance was mainly driven by losses recorded by large cap stocks such as Bamburi and Safaricom of 2.9% and 2.4%, respectively. The losses were however mitigated by gains recorded by banking stocks such as NCBA Group and KCB Group of 5.8% and 1.4% respectively, while ABSA Bank and Co-operative Bank gained by 1.2% each;

Additionally during the week, the Central Bank of Kenya (CBK), released the Commercial Banks' Credit Survey Report for the quarter ended December 2022, highlighting that the banking sector's loan book recorded a 15.6% y/y growth, with gross loans increasing to Kshs 3.7 tn in Q4'2022, from Kshs 3.2 tn in Q4'2021. On a q/q basis, gross loans increased by 2.8% to Kshs 3.7 tn in Q4'2022, from Kshs 3.6 tn in Q3'2022;

Real Estate: : During the week, Absa Bank Kenya PLC announced that it had availed funding worth Kshs 6.7 bn to property developer Acorn Holdings Limited (AHL), for the construction of 10 Purpose-Built Student Accommodation (PBSA) projects worth Kshs 11.0 bn. In the retail sector, international fast-food chain ChicKing, in partnership with M/s Crispy Limited, a local franchise, opened a restaurant outlet located in Mombasa along Nyerere Avenue, the first outlet in Kenya and the East African market. In the Infrastructure sector, the Kenya National Highways Authority (KeNHA) announced plans to begin rehabilitation and improvement of sections of Mombasa road which were damaged during the construction of the Nairobi Expressway, within the next 2 months. In addition, two major roads; Murang'a-Kangema and Murang'a-Kiriaini-Othaya located in Murang'a County were upgraded to national status for the purpose of rehabilitation and other maintenance works. In the Real Estate Investment Trusts (REITs) segment, the Capital Markets Authority (CMA) in collaboration with the Sanduku Investment Initiative, the Association of Pension Trustees and Administrators of Kenya (APTAK) and the Nairobi Securities Exchange (NSE) announced ongoing plans to create a Kenya National REIT (KNR) as an accreditation body for REITs and their stakeholders within the Kenyan REITs market. Additionally, in the NSE, Fahari I-REIT closed the week trading at an average price of Kshs 6.2 per share, a 0.7% gain from Kshs 6.1 per share recorded the previous week. In the Unquoted Securities Platform, Acorn D-REIT and I-REIT closed the week ending 3rd February 2023 trading at Kshs 23.9 and Kshs 20.9 per unit, respectively, a 19.4% and 4.4% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price;

Focus of the week: The Real Estate sector in Kenya is characterized by a constantly growing demand for housing, but a low percentage of Kenyans are able to own homes due to the high costs. The government launched the Affordable Housing Programme (AHP) with the goal of delivering 200,000 affordable housing units annually, in order to curb the ever growing annual housing deficit. In April 2018, the Kenya Mortgage Refinance Company (KMRC) was established as a public-private partnership (PPP) firm to increase access to affordable mortgage financing in the country by providing long-term funds to Primary Mortgage Lenders (PMLs) at low and fixed interest rates. After commencing lending operations with funds worth Kshs 1.3 bn disbursed in 2021, KMRC has achieved several key milestones, but still faces several challenges which if addressed would be a step forward towards achieving the goal of a sustainable housing finance sector in the country. With the recent changes in lending thresholds from Kshs. 4 mn to 8 mn, we revisit our coverage of KMRC;

Company Updates

Investment Updates:

- Weekly Rates:
    - Cytonn Money Market Fund closed the week at a yield of 10.75%. To invest, dial *809# or download the Cytonn App from Google Playstore here or from the Appstore here;
    - Cytonn High Yield Fund closed the week at a yield of 13.69% p.a. To invest, email us at sales@cytonn.com and to withdraw the interest, dial *809# or download the Cytonn App from Google Playstore here or from the Appstore here;
- We continue to offer Wealth Management Training every Wednesday and every third Saturday of the month, from 9:00 am to 11:00 am, through our Cytonn Foundation. 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;
- Any CHYS and CPN investors still looking to convert are welcome to consider one of the five projects currently available for assignment, click here for the latest term sheet;
- 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;
- Cytonnaire Savings and Credit Co-operative Society Limited (SACCO) provides a savings and investments avenue to help you in your financial planning journey. To enjoy competitive investment returns, kindly get in touch with us through clientservices@cytonn.com;

Real Estate Updates:

- For an exclusive tour of Cytonn's real estate developments, visit: Sharp Investor's Tour, and for more information, email us at sales@cytonn.com;
- Phase 3 of The Alma is now ready for occupation and the show house is open daily. To rent please email properties@cytonn.com;
- We have 8 investment-ready projects, offering attractive development and buyer targeted returns; See further details here: Summary of Investment-ready Projects;
- For Third Party Real Estate Consultancy Services, email us at rdo@cytonn.com;
- For recent news about the group, see our news section here;

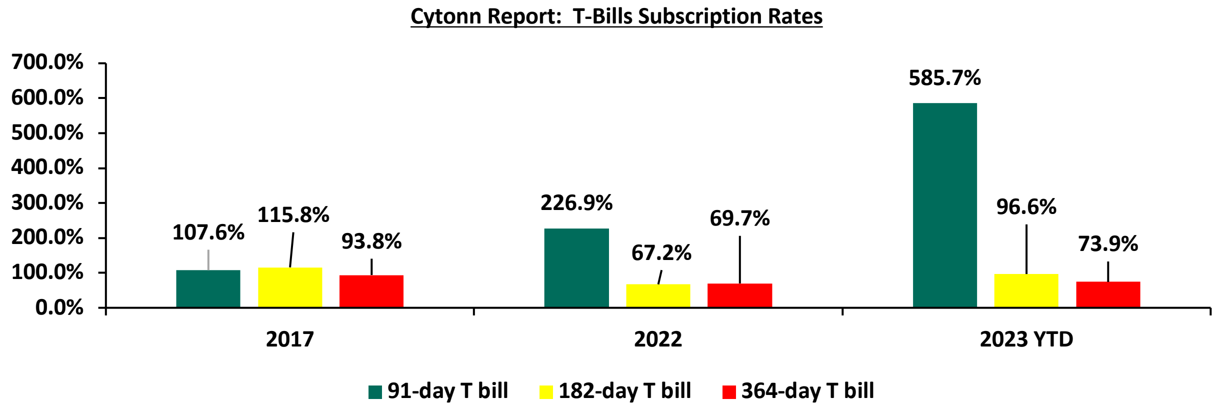
Hospitality Updates:

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

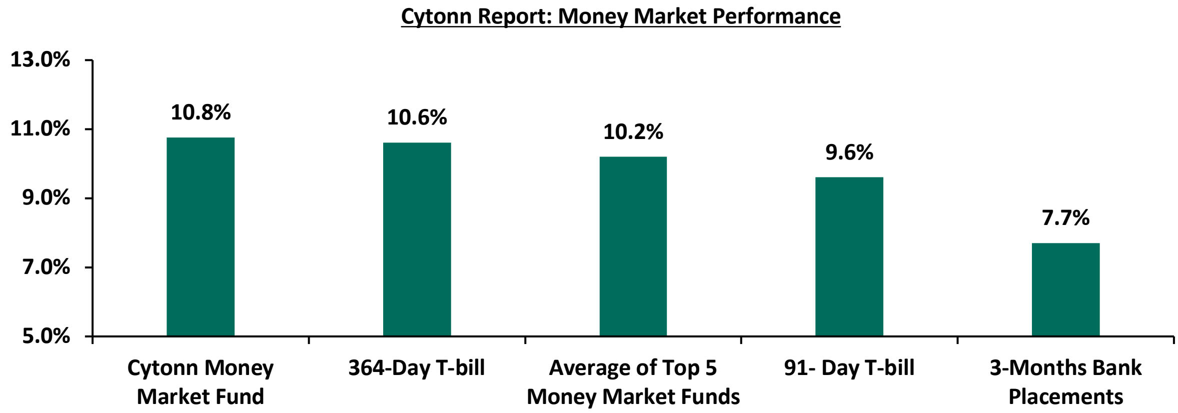
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills remained oversubscribed, albeit at a lower rate, with the overall subscription rate coming in at 187.1%, down from 208.9%, recorded the previous week. Investor's preference for the shorter 91-day paper persisted as they sought to avoid duration risk, with the paper receiving bids worth Kshs 31.2 bn against the offered Kshs 4.0 bn, translating to a significant subscription rate of 780.0%, up from 718.6% recorded the previous week. The subscription rates for the 364-day and 182-day papers however declined to 43.8% and 93.3% from 105.3% and 108.5%, respectively, recorded the previous week. The yields on the government papers were on an upward trajectory, with the yields on the 364-day, 182-day and 91-day papers increasing by 5.3 bps, 4.5 bps and 2.0 bps to 10.6%, 10.0% and 9.6%, respectively. The Government rejected expensive bids, accepting Kshs 40.6 bn worth of bids out of the Kshs 44.9 bn worth of bids received, translating to an acceptance rate of 90.5%. The graph below compares the overall T- bills subscription rates obtained in 2017, 2022 and 2023 Year to Date (YTD):



In the Primary Bond Market, the Central Bank of Kenya released the auction results for the recent re-opened bond; FXD1/2017/010 and the newly issued bond; FXD1/2023/010, with effective tenors to maturity of 4.5 years and 10.0 years for FXD1/2017/010 and FXD1/2023/010, respectively. Notably, the bonds recorded an undersubscription of 39.1%, in line with our expectations, partly attributable to the investor's preference for the shorter dated papers as they sought to avoid duration risk, as well the tightened liquidity in the money markets, with the average interbank rate coming in at 6.2% during the period of sale. The government issued the bonds seeking to raise Kshs 50.0 bn for budgetary support, received bids worth Kshs 19.5 bn and rejected expensive bids, accepting bids worth Kshs 16.7 bn, translating to an 85.7% acceptance rate. The weighted average yields for the bonds came in at 13.9% and 14.2% for FXD1/2017/010 and FXD1/2023/10, respectively, while the coupon rates came in 13.0% and 14.2% for FXD1/2017/010 and FXD1/2023/010, respectively.



In the money markets, 3-month bank placements ended the week at 7.7% (based on what we have been offered by various banks), while the yield on the 364-day T-bill and 91-day T-bill increased by 5.3 bps and 2.0 bps to 10.6% and 9.6%, respectively. The average yields on the Top 5 Money Market Funds and the Cytonn Money Market Fund remained relatively unchanged at 10.2% and 10.8%, respectively.

The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 10th February 2023:

Cytonn Report: Money Market Fund Yield for Fund Managers as published on 10th February 2023		
Rank	**Fund Manager**	**Effective Annual Rate**
1	Cytonn Money Market Fund (dial *809# or download Cytonn App)	10.8%
2	GenCap Hela Imara Money Market Fund	10.3%
3	Apollo Money Market Fund	10.2%
4	Zimele Money Market Fund	9.9%
5	NCBA Money Market Fund	9.9%
6	Nabo Africa Money Market Fund	9.9%
7	Old Mutual Money Market Fund	9.8%
8	Sanlam Money Market Fund	9.8%
9	Kuza Money Market fund	9.8%
10	Madison Money Market Fund	9.7%
11	Dry Associates Money Market Fund	9.7%
12	AA Kenya Shillings Fund	9.5%
13	Co-op Money Market Fund	9.3%
14	CIC Money Market Fund	9.2%
15	ICEA Lion Money Market Fund	8.7%
16	British-American Money Market Fund	8.6%
17	Orient Kasha Money Market Fund	8.6%
18	Absa Shilling Money Market Fund	7.9%
19	Equity Money Market Fund	7.6%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets remained tight, with the average interbank rate slightly increasing to 6.50% from 6.46% recorded the previous week, partly attributable to tax remittances that offset government payments. The average interbank volumes traded declined by 7.7% to Kshs 25.1 bn from Kshs 27.2 bn recorded the previous week.

Kenya Eurobonds:

During the week, the yields on Eurobonds were on an upward trajectory, partly attributable to increased perceived risks in the economy amid the country's dwindling forex reserves that raise concerns on the country's ability to service its public debt obligations. The yield on the 10-year Eurobond issued in 2018 recorded the largest gain having gained by 1.0% points to 10.9% from 9.9%, recorded the previous week. The table below shows the summary of the performance of the Kenyan Eurobonds as of 9th February 2023;

Cytonn Report: Kenya Eurobonds Performance						
	2014	2018		2019		2021
Date	10-year issue	10-year issue	30-year issue	7-year issue	12-year issue	12-year issue
Amount Issued (USD bn)	2.0	1.0	1.0	2.1*		1.0
Years to Maturity	1.3	5.0	25.0	4.2	9.2	11.3
Yields at Issue	6.6%	7.3%	8.3%	7.0%	7.9%	6.2%
02-Jan-23	12.9%	10.5%	10.9%	10.9%	10.8%	9.9%
01-Feb-23	11.2%	10.2%	10.6%	10.5%	10.3%	9.8%
02-Feb-23	10.6%	9.9%	10.4%	10.1%	10.0%	9.5%
03-Feb-23	10.9%	10.8%	10.5%	10.3%	10.3%	9.8%
06-Feb-23	11.2%	10.8%	10.6%	10.6%	10.5%	9.9%
07-Feb-23	11.2%	11.2%	10.6%	10.6%	10.5%	9.9%
08-Feb-23	10.8%	11.2%	10.5%	10.3%	10.3%	9.8%
09-Feb-23	10.8%	10.9%	10.5%	10.2%	10.2%	9.8%
Weekly Change	0.2%	1.0%	0.1%	0.1%	0.2%	0.3%
MTD Change	(0.4%)	0.7%	(0.1%)	(0.3%)	(0.1%)	-
YTD Change	(2.1%)	0.4%	(0.4%)	(0.7%)	(0.6%)	(0.1%)

**2019 aggregate amount issued for the two issues was USD 2.1 bn*
Source: Central Bank of Kenya (CBK)

Kenya Shilling:

During the week, the Kenyan shilling depreciated by 0.4% against the US dollar to close the week at Kshs 125.1, from Kshs 124.6 recorded the previous week, partly attributable to increased dollar demand from importers, especially oil and energy sectors against a slower supply of hard currency. On a year to date basis, the shilling has depreciated by 1.3% against the dollar, adding to the 9.0% depreciation recorded in 2022. We expect the shilling to remain under pressure in 2023 as a result of:

i. High global crude oil prices on the back of persistent supply chain bottlenecks coupled with high demand,
ii. An ever-present current account deficit estimated at 4.9% of GDP in 2022, despite improving by 0.3% points from 5.2% recorded in 2021, and,
iii. The need for Government debt servicing which continues to put pressure on forex reserves given that 69.3% of Kenya's External debt was US Dollar denominated as of October 2022.

The shilling is however expected to be supported by:

i. Improving diaspora remittances standing at USD 349.4 mn as at January 2023, representing a 3.2% y/y increase from USD 338.7 mn recorded in a similar period in 2022

Key to note, Kenya's forex reserves declined by 0.4% to USD 6.9 bn as at 9th February 2023 from USD 7.0 bn recorded the previous week. As such, the country's months of import cover remained relatively unchanged at 3.9 months, and are marginally below the statutory requirement of maintaining at least 4.0-months of import. The chart below summarizes the evolution of Kenya months of import cover over the last 10 years;

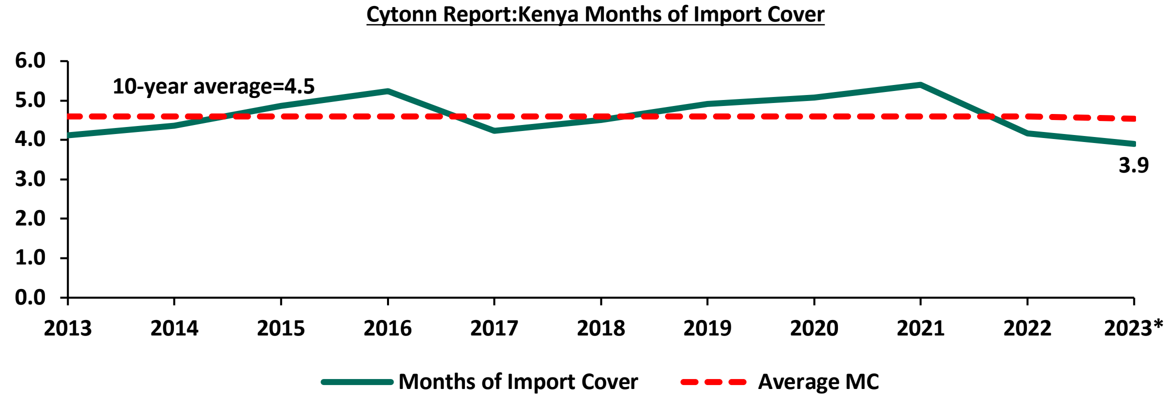


**Figure as of 9th February 2023*

Weekly Highlight: Supplementary Budget for the FY'2022/23

During the week, the National Treasury presented the Supplementary Budget for the Fiscal Year 2022/23 to the National Assembly. Notably, this will be the first supplementary budget under the new administration, and the Treasury is seeking to increase slightly the gross total budget by 0.4% to Kshs 3,373.3 bn from the previous estimates of Kshs 3,358.6 bn. The table below summarizes the overall change in the FY'2022/23 budget estimates;

Cytonn Report: FY'2022/23 Supplementary Budget Estimates (Kshs bn)			
Item	**Original Approved Estimates FY'2022/23**	**Supplementary Estimates FY'2022/23**	**% Change**
Recurrent Expenditure	1,403.9	1,496.9	6.6%
Development Expenditure	715.4	609.1	(14.9%)
Ministerial National Government Expenditure	**2,119.3**	**2,105.9**	**(0.6%)**
Consolidated Fund Services	869.3	867.8	(0.2%)
County Equitable Allocation	370.0	399.6	8.0%
Total Expenditure	**3,358.6**	**3,373.3**	**0.4%**

Source: The National Treasury

Key take outs from the table include;

i. The recurrent expenditure (Costs incurred to cover regular government expenses such as salaries, operational costs and maintenance costs) increased by 6.6% to Kshs 1,496.9 bn in the Supplementary estimates from Kshs 1,403.9 bn in the original estimates, against the current administration's commitment to cut on recurrent spending,
ii. Development expenditure (Costs incurred in order to create assets that will provide long term public infrastructure such as roads, hospitals, and schools) declined by 14.9% to Kshs 609.1 bn in the supplementary estimates from Kshs 715.4 bn in the original estimates, a detriment to the sectors such as infrastructure, energy, water and health that require heavy development financing,
iii. As such, the Ministerial National Government expenditure estimates for the FY'2022/23 Supplementary budget is set to slightly decline by 0.6% to Kshs 2,105.9 bn from Kshs 2,119.3 bn in the original estimates, saving the government only Kshs 13.3 bn, against a projected cut of Kshs 300.0 bn attributable to austerity measures such as cutting spending on foreign travel, training, purchases of furniture and motor vehicles as well as other non-essential spending under all Ministries, Departments and Agencies (MDAs) by the government to contain expenditures to remain within sustainable fiscal path signalling future fiscal consolidation,
iv. Consolidated Fund Services (CFS) (refers to the Consolidated Fund established in the Kenya's constitution into which development partners deposit funds before disbursing to the Exchequer accounts for projects such as servicing of public debt, and subscription to International

Organizations) has seen a slight decline of 0.2% to Kshs 867.8 bn from Kshs 869.3 bn in the original estimates. This is attributable to a 7.2% decline in external debt redemptions to Kshs 223.8 bn from Kshs 241.0 bn in the previously approved estimates with notable decline in the external debt redemptions owed to Italy by 54.5% to Kshs 9.1 bn from Kshs 14.0 bn, and Exim Bank of China by 10.2% to Kshs 72.5 bn from Kshs 80.7 bn. However, allocation for guaranteed debt servicing was revised up by a significant 548.1% to Kshs 14.7 bn from Kshs 2.2 bn in the original estimates, as expected, due to the elevated levels of public debt, which came in at Kshs 9,146.0 bn as at December 2022. This is also in line with the increased foreign financing, which was revised up to 2.7% of GDP from the original estimates of 2.0% of GDP for the FY'2022/23, and,

v. The County Equitable Share (allocation on national government revenue to county governments) increased by 8.0% to Kshs 399.6 bn from the original estimates of Kshs 370.0 bn, representing 11.8% of the total supplementary budget allocation to counties, amid calls from the county governments to increase allocation to Kshs 425.0 bn or at least 15.0% of the total revenue collected by the national government.

Additionally, the table below shows the allocation of the supplementary budget to key state departments and ministries;

Cytonn Report: Supplementary Gross Budget FY'2022/23 (Kshs bn)				
	Approved Original Estimates (Kshs bn)	Supplementary Budget Estimates (Kshs bn)	Change (Kshs bn)	% Change
Ministry of Energy	95.7	54.0	(41.7)	(43.6%)
State Department for Housing and Urban Development	20.4	12.4	(7.9)	(39.0%)
Ministry of Water & Sanitation and Irrigation	83.9	59.7	(24.2)	(28.9%)
State Department for Infrastructure	221.3	174.0	(47.3)	(21.4%)
Ministry of Health	122.5	113.5	(9.0)	(7.4%)
Other Ministries and State Departments	1,509.3	1,559.4	50.1	3.3%
State Department for Crop Development &Agricultural Research	41.5	66.6	25.1	60.5%
Ministry of Petroleum and Mining	24.7	66.4	41.7	169.3%
State Department for Cooperatives	2.3	22.0	19.7	871.3%
Total	**2,119.3**	**2,105.9**	**(13.3)**	**(0.6%)**

Source: The National Treasury

Key take outs from the table include:

i. The Ministry of Energy suffered the highest notable decline of allocation of 43.6%, to Kshs 54.0 bn from Kshs 95.7 bn in the approved original estimates. This is attributable to a 45.2% reduction in the allocation to power transmission and distribution to Kshs 39.6 bn from Kshs 72.2 bn in the approved original estimates, due to reduction on account of budget rationalization, amid proposed reforms to increase tariffs on electricity,

ii. The State Department for Cooperatives had the highest budget allocation increase by 871.3% to Kshs 22.0 bn from Kshs 2.3 bn in the original estimates, with an additional allocation to Kshs 12.2 bn for the provision of the Financial Inclusion Fund (The Hustler's Fund) in order to increase credit access to Kenyans,

iii. The State Department for Housing and Urban Development has seen its budget brought down by 39.0% to Kshs 12.4 bn from the original approved estimates of Kshs 20.4 bn, attributable to a 41.3% reduction to the allocation to the programme of Housing Development and Human Settlement to Kshs 8.4 bn from Kshs 14.4 bn due to budget rationalization. We expect this to undermine the ongoing efforts to facilitate the development of decent, safe and affordable housing under the Affordable Housing Programme,

iv. The State Department for Crop Development & Agricultural Research has seen its budget increased by 60.5% to Kshs 66.5 bn from Kshs 41.5 bn due to increase in allocation for crop development and management by 88.3% to Kshs 46.6 bn from Kshs 24.7 bn to cater for the ongoing fertilizer subsidy programme for the short and long rains. Additionally, the allocation for agricultural research and development was increased by 53.8% to Kshs 9.7 bn from Kshs 6.3 bn in the original estimates, to cater for provision of funding to settle the already terminated maize flour subsidy initiated by the previous administration, and,

v. The Ministry of Petroleum and Mining had its budget increased by 169.3% to Kshs 66.4 bn from Kshs 24.7 bn, due to the increase in the allocation for the programme of General Administration Planning & Support Services by 203.7% to Kshs 63.6 bn from Kshs 20.9 bn in the approved original estimates, in order to cater for the provision for fuel subsidy, despite the calls to the Administration completely do away with the programme since it has been a burden to the country's expenditure.

The approval of the FY'2022/23 Supplementary Budget projects to the overall fiscal deficit level including grants to 5.7% of GDP from the original projections of 6.2% of GDP, as well as reflect more austerity measures by the current administration to contain fiscal spending. Key to note, reducing the fiscal deficit as a percentage of GDP needs the government to meet the revenue collection targets as well as ensuring expenditure falls within the projected range. However, the government was not able to meet the revenue collection for the first half of FY'2022/23, with the period between July 2022 and December 2022, collecting Kshs 1,106.4 bn against a target of Kshs 1,158.2 bn, translating to a shortfall of Kshs 51.8 bn. As such, we expect the government to ramp up its revenue collection initiatives in the remaining 6 months for the current fiscal year to meet its original estimates target of Kshs 2.1 tn. Moreover, the budget allocation in the Supplementary Budget is aimed at addressing emerging priorities and emergencies such as the persistent drought that has necessitated relief food as well and fertilizer subsidies in a bid to reduce the cost of agricultural production. As such, we expect the proposed marginal budget cuts to only moderately support the government's plan to ease the elevated debt levels. However, the continuation of consumption subsidies such as for fuel calls into question the earlier announced efforts by the Administration to do away with subsidies and ease pressure on the country's expenditure.

Rates in the Fixed Income market have remained relatively stable due to the relatively ample liquidity in the money market. The government is 5.1% behind its prorated borrowing target of Kshs 362.8 bn having borrowed Kshs 344.3 bn of the Kshs 581.7 bn borrowing target for the FY'2022/2023. We expect sustained gradual economic recovery as evidenced by the revenue collections of Kshs 987.9 bn in the FY'2022/2023 as at the end of December, equivalent to a 46.1% of its target of Kshs 2.1 tn. Despite the performance, we believe that the projected budget deficit of 5.7% is relatively ambitious given the downside risks and deteriorating business environment occasioned by high inflationary pressures. We however expect the support from the IMF and World Bank to ease the need for elevated borrowing and thus help maintain a stable interest rate environment since the government is not desperate for cash. Owing to this, our view is that investors should be biased towards short-term fixed-income securities to reduce duration risk.

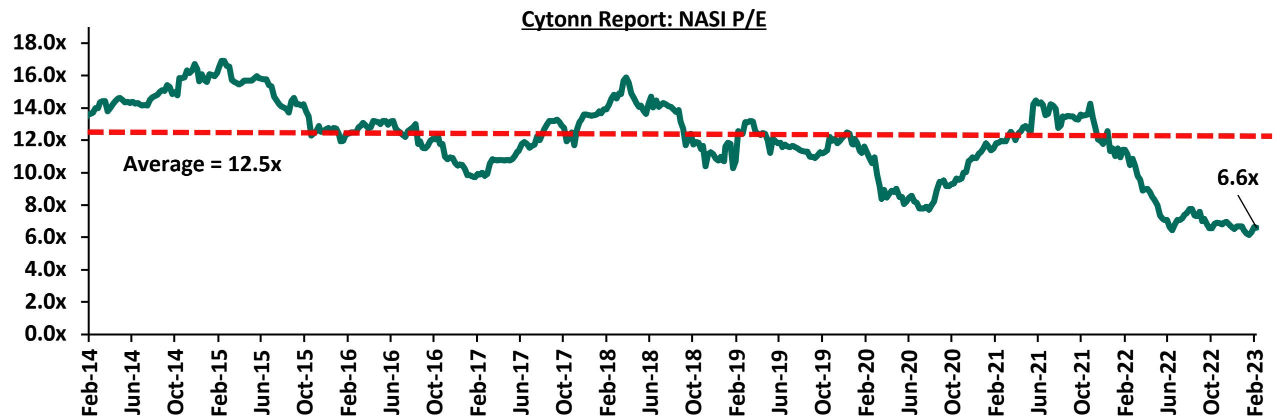
<u>**Equities**</u>

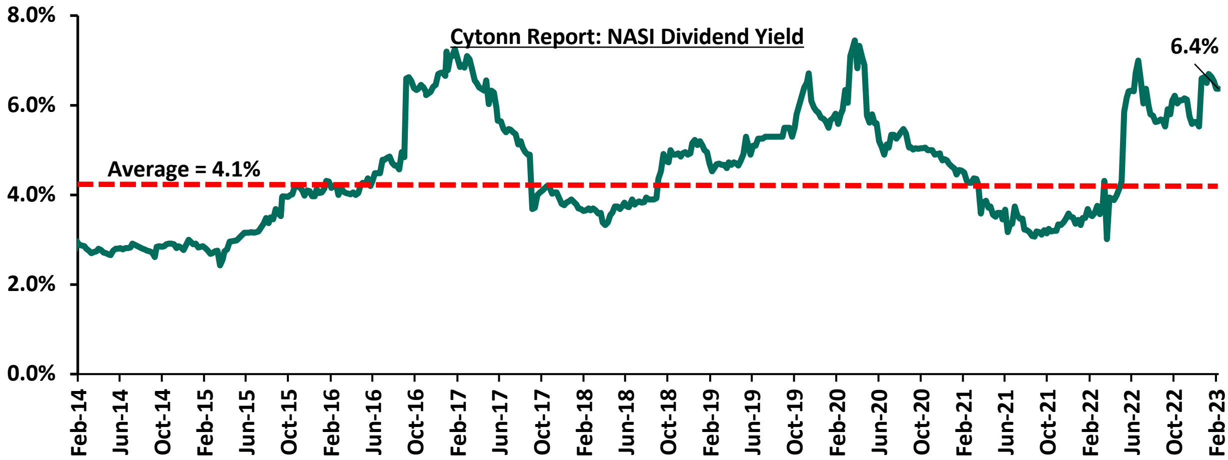
Market Performance:

During the week, the equities market recorded mixed performance, with NASI declining by 0.8%, while NSE 20 and NSE 25 gained by 0.5% and 0.1%, respectively, taking the YTD performance to gains of 0.7% and 1.4% for NASI and NSE 25, respectively, and a decline of 0.2% for NSE 20. The equities market performance was mainly driven by losses recorded by large cap stocks such as Bamburi and Safaricom of 2.9% and 2.4%, respectively. The losses were however mitigated by gains recorded by banking stocks such as NCBA Group and KCB Group of 5.8% and 1.4% respectively, while ABSA Bank and Co-operative Bank gained by 1.2% each.

During the week, equities turnover increased by 61.4% to USD 11.1 mn from USD 6.9 mn recorded the previous week, taking the YTD turnover to USD 78.9 mn. Additionally, foreign investors turned net buyers, with a net buying position of USD 2.4 mn, from a net selling position of USD 0.2 mn recorded the previous week, taking the YTD net selling position to USD 21.0 mn.

The market is currently trading at a price to earnings ratio (P/E) of 6.6x, 47.3% below the historical average of 12.5x, and a dividend yield of 6.4%, 2.3% points above the historical average of 4.1%. 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 may be 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;





Weekly Highlight: Central Bank of Kenya Credit Survey Report Q4'2022

The Central Bank of Kenya (CBK), recently released the Commercial Banks' Credit Survey Report for the quarter ended December 2022. The CBK undertakes the quarterly credit survey to identify potential drivers of risk particularly in the banking sector. For the quarter ended 31 December 2022, 38 operating commercial banks and 1 mortgage finance company participated in the Commercial Banks Credit Officer Survey. The report highlighted that the banking sector's loan book recorded a 15.6% y/y growth, with gross loans increasing to Kshs 3.7 tn in Q4'2022, from Kshs 3.2 tn in Q4'2021. On a q/q basis, gross loans increased by 2.8% to Kshs 3.7 tn in Q4'2022, from Kshs 3.6 tn in Q3'2022. The increase in gross loans was largely witnessed in the manufacturing, personal and household and real estate sectors.

Other key take-outs from the report include:

i. Profit before Tax (PBT) recorded a y/y increase of 16.0% to Kshs 57.2 bn in Q4'2022 from Kshs 49.3 bn in Q4'2021. However, on a q/q basis, PBT declined by Kshs 14.9% to Kshs 57.2 bn from Kshs

67.2 bn in Q3'2022, attributable to a higher increase in quarterly expenses by Kshs 19.4 bn as compared to Kshs 9.3 bn increase in quarterly income.

ii. The aggregate balance sheet recorded a y/y increase of 9.8% to Kshs 6.6 tn in Q4'2022 from Kshs 6.0 tn in Q4'2021. The expansion in the balance sheet is attributable to a 6.5% increase in deposits to Kshs 4.7 tn in Q4'2022 from Kshs 4.4 tn in Q4'2021. On a q/q basis, the aggregate balance sheet recorded a 2.8% increase to Kshs 6.6 tn in Q4'2022, from Kshs 6.4 tn in Q3'2022,

iii. The asset quality deteriorated, with Gross Non-Performing Loans (NPLs) ratio increasing 0.2% points to 13.3% in Q4'2022 from 13.1% in Q4'2021. However, on a q/q basis, the asset quality improved to 13.3% in Q4'2022, from 13.7% recorded in Q3'2022, attributable to 0.8% decline in gross NPLs coupled with a 2.3% increase in gross loans. The decline in gross NPLs is attributable to continued recovery in most sectors of the economy as well as sustained improvement in business environment evidenced by an average Purchasing Manger's Index (PMI) of 50.9 in Q4'2022, compared to 47.4 in Q3'2022,

iv. The Capital adequacy remained sufficient at 19.0%, 4.5% points above the minimum statutory of 14.5%. However, it was a decline from 19.6% recorded in Q4'2021. On a q/q basis, it remained unchanged from Q3'2022,

v. The Return on Equity (ROE) increased to 25.6% in Q4'2022 from 21.6% in Q4'2021. However, on a q/q basis, ROE decreased by 1.6% points to 25.6% in Q4'2022, from 27.2% recorded in Q3'2022, attributable to the decrease in profits, and,

vi. Liquidity in the banking sector remained well above the minimum statutory of 20.0% despite declining to 50.8% in Q4'2022 from 56.2% in Q4'2021. Also on a q/q basis it marginally declined by 0.7% points to 50.8%, from 51.5% recorded in Q3'2022.

We expect to see increased lending by the banking sector mainly as a result of the ongoing economic recovery in most sectors. Additionally, with sufficient liquidity, we expect credit extension to private sector to increase as banks looks to deploy the additional liquidity. Private sector credit growth increased by 3.9% points to 12.5% in December 2022, from 8.6% in December 2021 attributable to sustained improvement in business environment, evidenced by an average Purchasing Manger's Index (PMI) of 50.9 in Q4'2022, compared to 47.4 in Q3'2022. However, we expect credit uptake to be weighed down by high cost of borrowing as a result of high lending rates occasioned by the tightened monetary policy stance. Additionally, most sectors in the economy are likely to suffer from subdued consumer demand due to high commodity prices on the back of the high inflation at 9.0% in January 2023, which are likely to lower their earnings and thus elevating the risk of defaulting on loans. However, the banking sector remains well positioned, as the high lending rates are expected to increase their earnings.

Universe of coverage:

Company	Price as at 03/02/2023	Price as at 10/02/2023	w/w change	YTD Change	Year Open 2023	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Jubilee Holdings	185.8	182.0	(2.0%)	(8.4%)	198.8	305.9	0.5%	68.6%	**0.3x**	**Buy**
Kenya Reinsurance	1.8	1.8	(0.6%)	(5.9%)	1.9	2.5	5.7%	48.3%	**0.1x**	**Buy**
Liberty Holdings	4.6	5.0	8.5%	(1.0%)	5.0	6.8	0.0%	35.3%	**0.4x**	**Buy**
KCB Group* **	38.2	38.8	1.4%	1.0%	38.4	52.5	7.7%	43.2%	**0.6x**	**Buy**
Sanlam	8.3	8.3	(0.2%)	(13.2%)	9.6	11.9	0.0%	43.1%	**0.9x**	**Buy**
Britam	5.1	5.3	4.7%	2.7%	5.2	7.1	0.0%	33.3%	**0.9x**	**Buy**
ABSA Bank* **	12.4	12.6	1.2%	2.9%	12.2	15.5	12.0%	35.1%	**1.1x**	**Buy**
NCBA* **	35.5	37.6	5.8%	(3.6%)	39.0	43.4	11.3%	26.9%	**0.8x**	**Buy**
Equity Group* **	45.8	45.7	(0.3%)	1.3%	45.1	58.4	6.6%	34.4%	**1.1x**	**Buy**
Co-op Bank* **	12.5	12.6	1.2%	4.1%	12.1	15.5	7.9%	30.7%	**0.7x**	**Buy**
I&M Group* **	17.2	17.3	0.6%	1.2%	17.1	20.8	8.7%	29.4%	**0.4x**	**Buy**
Diamond Trust Bank* **	49.9	50.0	0.2%	0.3%	49.9	57.1	6.0%	20.3%	**0.2x**	**Buy**
CIC Group	2.0	2.0	1.0%	5.8%	1.9	2.3	0.0%	14.9%	**0.7x**	**Accumulate**
Stanbic Holdings	110.8	111.8	0.9%	9.6%	102.0	112.0	8.1%	8.3%	**1.0x**	**Hold**
Standard Chartered* **	158.0	158.0	0.0%	9.0%	145.0	166.3	3.8%	9.0%	**1.1x**	**Hold**
HF Group	3.2	3.6	9.6%	12.7%	3.2	3.4	0.0%	(3.4%)	**0.2x**	**Sell**

Target Price as per Cytonn Analyst estimates
****Upside/ (Downside) is adjusted for Dividend Yield**
*****For Disclosure, these are stocks in which Cytonn and/or its affiliates are invested in**

We are "Neutral" on the Equities markets in the short term due to the current adverse operating environment and huge foreign investor outflows, and, "Bullish" in the long term due to current cheap valuations and expected global and local economic recovery.
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.

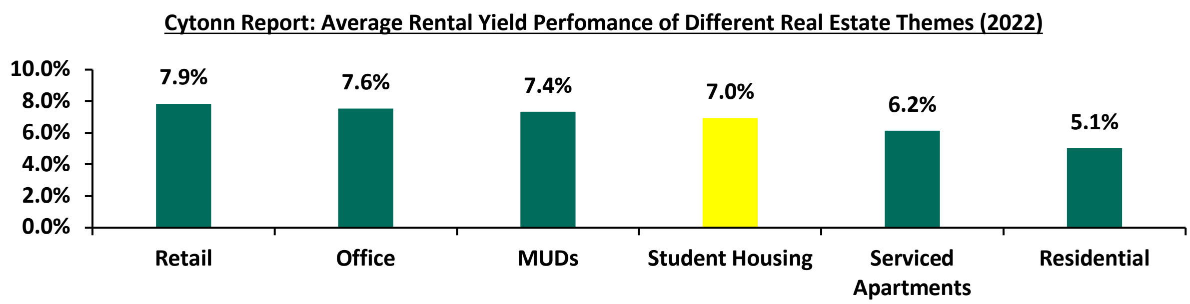
Real Estate

I. Residential Sector

During the week, Absa Bank Kenya PLC announced that it had availed funding worth Kshs 6.7 bn to property developer Acorn Holdings Limited (AHL), for the construction of 10 Purpose-Built Student Accommodation (PBSA) projects worth Kshs 11.0 bn. The balance in funding will be provided by Kshs 4.3 bn equity raised by investors in the Acorn Student Accommodation Development REIT (ASA D-REIT) for construction of the projects over a period of 3 years. These will consist of 12,000 bed-capacity hostels, targeting students within the University of Nairobi (UoN), Kenyatta University (KU), Jomo Kenyatta University of Agriculture and Technology (JKUAT), and other private universities, bringing AHL's investment in student accommodation to an average capacity of 21,000 beds from its current 11,013 bed-capacity either under development or operational. The projects will be run by ASA D-REIT, Qwetu, which is the premium offering, and, Qejani for the mass market, and will be sold to the Acorn Student Accommodation Income REIT (ASA I-REIT) when completed.

The developer, AHL, has continued to focus on PBSA investment owing to its positive track record in the sector with attractive returns offered to investors in its previously issued corporate and green bonds to fund its previous projects. This has contributed to financial institutions such as Absa Bank Kenya PLC gaining confidence in providing additional debt financing to supplement equity from its REIT investors for further development of PBSA projects. In addition to Qwetu and Qejani, AHL plans to launch Palma, a purpose-built accommodation investment project catered to young professionals and the middle working class. The Palma project is currently in its conceptualization and ideation phase. This stage includes project set up, data collection and review, target customer segment insights, concept benchmarks, market size estimation, and feasibility study of the project. Upon launch, it is expected that Palma will complement AHL's current portfolio by tapping into the housing demand of the young working class demographic, with Qwetu and Qejani catering for student accommodation.

In terms of performance, PBSA investments continue to provide relatively higher rental yields compared to other asset classes, such as the serviced and residential apartments in 2022 as highlighted below;



Source: Cytonn Research

We expect the appetite for investment in PBSA development in the Real Estate sector to continue growing supported by factors such as; i) rapidly increasing student population in higher learning institutions in the country, ii) proven resilience by student housing against economic headwinds, iii) increase in tertiary institutions of learning, iv) public policies boosting enrolment of international students to local institutions, and, v) attractive returns offered by PBSA owing to the high occupancy rates achieved in hostels. Consequently, the demand for student housing will continue on an upward trend thereby contributing to the growth of Kenya's Real Estate sector. On the other hand, setbacks such as increasing costs of construction on the back of elevated inflationary pressures from both local and global economic shocks is expected to subdue optimum investment efforts. This will translate to developers asking for higher rents and prices which will in turn limit optimum occupancy rates in certain regions of the country. Nevertheless, the concentration of developers such as AHL group in targeting international students and young professionals will continue holding up occupancy levels within the current and upcoming PBSA developments thereby underpinning higher rental yields to investors.

II. Retail Sector

During the week, international fast-food chain ChicKing, in partnership with M/s Crispy Limited, a local franchise, opened a restaurant outlet located in Mombasa along Nyerere Avenue, the first outlet in Kenya and the East African market. The Dubai-based Halal restaurant chain that specializes in fried chicken, burgers and French fries, announced plans to also open a new outlet in Nairobi as part of its expansion plans to have a total of 30 new outlets in Kenya, within a five-year time-frame, according to our Cytonn weekly #19/2022. The move by the international chain to open stores in the country is driven by;

i) Presence of young population in Kenya who prefer to eat fast-food products,
ii) Increasing Muslim population given Kenya's relatively attractive demographic profile which creates a high demand for Halal-prepared foods,
iii) Need to expand against the competition from other international fast food chains in Kenya such as Subway, Kentucky Fried Chicken (KFC), Burger King, and Eat'N'Go, among others,
iv) Continued growth of the global fast-food restaurant segment, currently valued at an estimated total market cap of USD 442.7 bn (Kshs 55.4 tn), which boosts investor appetite, and,
v) Kenya's recognition as a regional and global investment hub by multinational franchises.

We expect the expansion efforts with the growth of the fast-food segment to support the performance of the retail sector. In addition, the sector is expected to continue witnessing growth in terms of activities, facilitated by factors such as; i) aggressive expansion by local and international retailers such as Naivas, Carrefour, and QuickMart, among others, in a bid to achieve market dominance, ii) infrastructural developments leading to opening up of areas for economic activities, and, iii) increasing demand for retail products, due to Kenya's relatively high urbanization and population growth rates of 3.7% p.a and 1.9% p.a, respectively, against the global average of 1.6% p.a and 0.9% p.a, respectively as of 2021. However, the existing oversupply of physical space at approximately 3.0 mn SQFT in the Nairobi Metropolitan Area (NMA) retail market and 1.7 mn SQFT in the overall Kenyan retail market, increased adoption of e-commerce strategy in retail market, and reduced purchasing power amid the prevailing inflationary pressure are expected to continue hindering the performance of the sector.

III. Infrastructure

During the week, the Kenya National Highways Authority (KeNHA) announced plans to begin rehabilitation and improvement of sections of Mombasa road which were damaged during the construction of the Nairobi Expressway, within the next 2 months. The rehabilitation will cost Kshs 9.0 bn and will be undertaken by the operator of the Nairobi Expressway, Moja Expressway Company Ltd, through their engineering company, Procure and Construct (EPC) Contractor CALE Infrastructure Construction Limited. The scope of works on the road will include; i) re-carpeting the existing tarmac, ii) fixing the drainage system, iii) establishing infrastructure for a Bus Rapid Transit (BRT) system, iv) fixing damaged pedestrian walk-ways, v) setting up additional street lighting, and, vi) construction of additional pedestrian footbridges. This is after construction of the Nairobi Expressway chipped away some lanes of Mombasa road, leaving it narrower and increasing traffic congestion in the lower deck. The construction further limited pedestrian access due to motorists often using the walk-ways during rush hours. The rehabilitation efforts are expected to improve the condition of the old Mombasa road up to standards of the Nairobi Expressway thereby reducing the traffic gridlock and ensuring efficient transport along the road.

Additionally, during the week, two major roads; Murang'a-Kangema and Murang'a-Kiriaini-Othaya located in Murang'a County were upgraded to national status for the purpose of rehabilitation and other maintenance works. Previously, the roads were under the Kenya Rural Roads Authority (KeRRA), a State corporation mandated with development and maintenance of the rural road network in the country, to which Kshs 21.8 bn is allocated in FY'2022/2023, with plans to disburse Kshs 62.0 mn in every Constituency. The two roads will now be administered by the Kenya National Highways Authority (KeNHA), and will be rehabilitated using part of the Kshs 295.4 bn projected exchequer budgetary allocation. The rehabilitation of the aforementioned projects commenced in 2019, but had stalled owing to inadequate financing. Once the projects are complete, they are expected to spur Murang'a County's Real Estate sector performance through; i) higher returns from capital appreciation with increased property transactions owing to boosted economic activities, ii) lower costs to developers during transport of construction materials due to less trip times, and, iii) increased construction activity with the areas having better access to amenities.

We expect the continued improvement of infrastructure through the rehabilitation and improvement of the aforementioned roads to steadily boost the performance of the Real Estate industry through increased sector activity. However, the 2023 Draft Budget Policy Statement indicated that the government's allocation for Infrastructure, Energy, and Information and Technology (ICT) for the fiscal year 2023/2024 is expected to be Kshs 398.2 bn, a 4.4% decline from the previous fiscal year's allocation of Kshs 416.4 bn. In addition, the FY'2022/2023 Supplementary Budget to the State Department of Infrastructure was slashed by Kshs 47.3 bn, representing a 21.4% reduction in expected spending to Kshs 174.0 bn, from the previous Kshs 221.3 bn allocated towards infrastructure projects for the year ended June 2023. This comes as the government is prioritizing the completion of previously stalled projects and avoiding initiation of new expensive projects amid the current regime's promised spending cuts. Consequently, we expect the sourcing of funding for infrastructure projects in the country to further shift to alternative financing strategies such as; Public-Private Partnerships (PPPs), issuing of infrastructure bonds, joint ventures, and, grants and concessional loans from more foreign organizations, in order for the government to fast-track the infrastructural development that is critical in growing the Kenyan economy.

IV. Real Estate Investment Trusts (REITs)

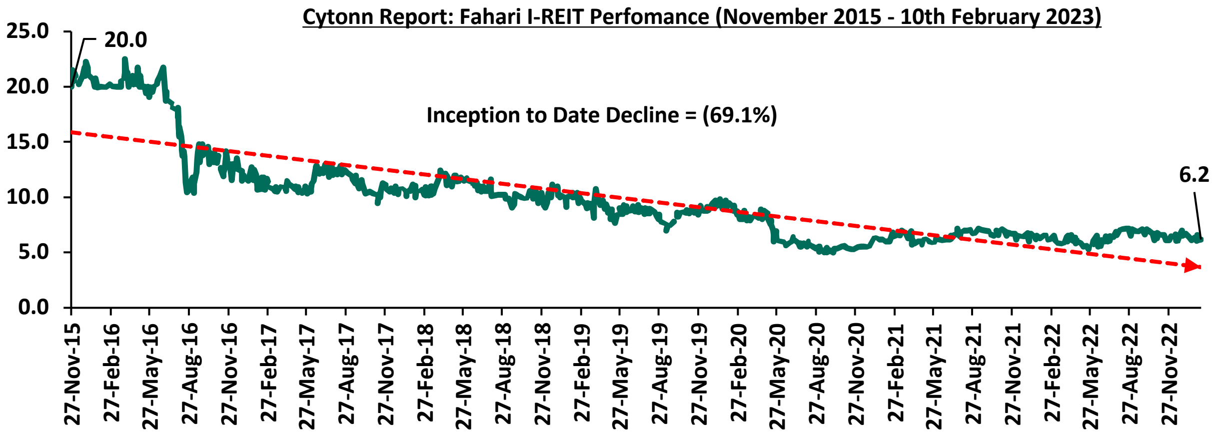
During the week, the Capital Markets Authority (CMA) in collaboration with the Sanduku Investment Initiative, the Association of Pension Trustees and Administrators of Kenya (APTAK) and the Nairobi Securities Exchange (NSE) announced ongoing plans to create a Kenya National REIT (KNR) as an accreditation body for REITs and their stakeholders within the Kenyan REITs market. REITs that will be registered under KNR will be structured for immediate investor uptake in the capital markets as scalable asset classes with the potential to contribute to national economic growth. The Retirements Benefits Authority (RBA) and the APTAK will also work with Trustees to review the REIT investment mandates, thereby allowing participation of pension funds in the KNR REITs as an alternative asset class. The objectives of KNR model include;

i) registering REITS for the development of affordable housing and infrastructure through Special Purpose Vehicles (SPVs),
ii) streamlining the incorporation process for REITs,
iii) increasing the investment appetite for REITs, and,
iv) acting as the focal point for the engagement of REIT stakeholders with policy makers.

The Sanduku Investment Initiative is a Public-Private Partnership (PPP) financing model launched by President Ruto to bring together the participation of financial sector players such as; pension funds, insurance companies, SACCOs, Islamic finance institutions, and global investors. The objective of the model is to raise Kshs 1.0 tn over the next five years, as part of Kenya's Economic Transformation Agenda. Sanduku aims to financially support the government's priority projects such as; the Railway City Development, Nairobi International Financial Centre, Kenani Leather Park, and Makongeni Modern Suburb, among others, in line with the government's plan for significant infrastructure initiatives and the Affordable Housing Programme (AHP). After the REITs market and industry stakeholders validate the proposed KNR model, additional engagements will be conducted to ensure there is investment appetite and support. This will be followed by structuring and launching a pilot REIT under KNR.

Going forward, we expect the envisioned KNR model to spur the Kenyan REITs market by reducing some of the existing obstacles in the sector by increasing investment from financial players such as pension funds. This will further complement the ongoing AHP by both the government and the private sector through fund raising from the capital markets. However, we note that much is yet to be done in terms of streamlining the Kenyan REITs regime that is marred by various challenges such as; i) inadequate investor knowledge of the investment vehicle, ii) lengthy approval process for REITs, iii) high minimum capital requirements for a Trustee at Kshs 100.0 mn, iv) only few entities capable of incorporating REITs, and, v) high minimum investment amounts set at Kshs 5.0 mn, which continue to hinder investors' appetite in REITs as a viable asset class in the country ever since formulation in 2013.

In the Nairobi Securities Exchange, ILAM Fahari I-REIT closed the week trading at an average price of Kshs 6.2 per share. The performance represented a 0.7% gain from Kshs 6.1 per share recorded the previous week, taking it to an 8.8% Year-to-Date (YTD) decline from Kshs 6.8 per share recorded on 3rd January 2023. In addition, the performance represented a 69.1% Inception-to-Date (ITD) loss from the Kshs 20.0 price. The dividend yield currently stands at 8.1%. The graph below shows Fahari I-REIT's performance from November 2015 to 10th February 2023;



In the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 23.9 and Kshs 20.9 per unit, respectively, as at 3rd February 2023. The performance represented a 19.4% and 4.4% 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 12.3 mn and 29.0 mn shares, respectively, with a turnover of Kshs 257.5 mn and Kshs 598.9 mn, respectively, since inception in February 2021.

We expect the performance of the Real Estate sector to continue on an upward trend, supported by factors such as; i) increased PBSA construction activities in the residential sector, and, ii) expansionary efforts by multinational franchises in the retail sector, and, iii) ongoing rehabilitation efforts in the infrastructure sector. However, the presence of financial constraints amid the prevailing tough economic

environment, the existing oversupply of physical space in selected sectors, and low investor appetite for REITs are expected to continue subduing the optimal performance of the sector.

Focus of the Week: Update on Kenya Mortgage Refinance Company (KMRC)

The Kenya Mortgage Refinance Company (KMRC) is as a non-deposit taking, public-private partnership (PPP) firm formed by the Government of Kenya and regulated by the Central Bank of Kenya (CBK). The primary mandate of KMRC is to ensure sustainable home financing in the country, by providing long-term funds to primary mortgage lenders (PMLs) such as; banks, microfinance institutions, and SACCOs at low and fixed interest rates. KMRC was incorporated in April 2018 under the Companies Act 2015, and authorized by the CBK to begin lending operations in September 2020. During 2021, the company received 12 applications and disbursed funds worth Kshs 1.3 bn to 7 PMLs. KMRC currently has 23 shareholders which include; the Kenyan government through the National Treasury (25.3%), 8 commercial banks and one microfinance bank (44.3%), 11 SACCOs (7.5%), with the remainder, 22.9%, being owned by 2 development finance institutions; Shelter Afrique and the International Finance Corporation.

As a wholesale financial institution, KMRC does not take deposits nor lend directly to individuals. This enables KMRC to focus on increasing liquidity to PMLs and developing standardized lending practices through working with the government and other stakeholders. This is geared to enable the mortgage lending institutions to continue lending to home buyers without worrying about a lack of long-term funding, by gaining ability to cover any unexpected short-term deposit outflows. In addition to providing long-term funding, KMRC also plays a key role in promoting the development of the economy in Kenya by expanding the capital markets through the issuance of corporate bonds for long-term financing. The Capital Markets Authority of Kenya (CMA) supervises KMRC's bond issuance activities. We have previously covered five topicals on KMRC namely;

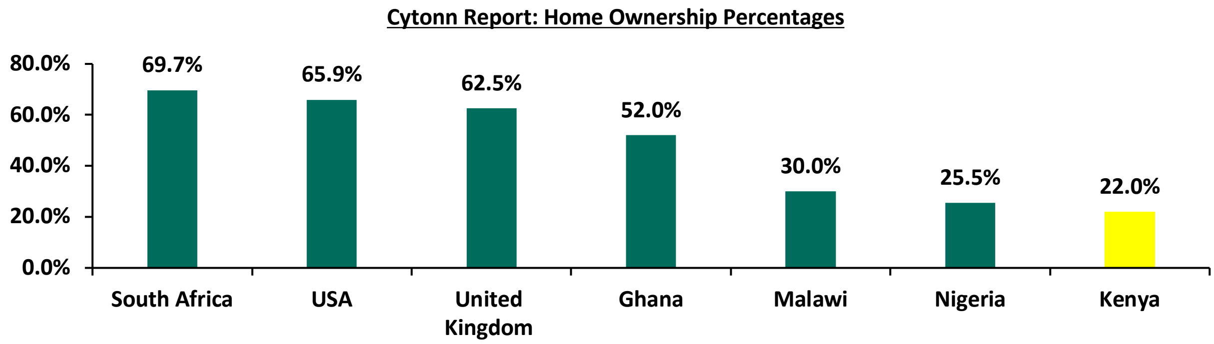
- Kenya Mortgage Refinance Company (KMRC) Progress, in May 2022 where we analyzed the performance of KMRC since the company commenced its lending operations,
- Kenya Mortgage Refinance Company Update in August 2021, where we benchmarked with the Jordan Mortgage Refinance Company,
- Kenya Mortgage Refinance Company Recap in November 2020, where we drew lessons from Saudi Real Estate Refinance Company,
- Kenya Mortgage Refinance Company Update in April 2019, where we reintroduced what mortgage refinance companies are, why they are needed, how they operate, what benefits they give, and,
- Kenya Mortgage Refinance Company in April 2018, where we introduced KMRC as a mortgage liquidity facility and demystified the conditions necessary for the KMRC to thrive.

This week, we update on the progress of KMRC by highlighting the key developments, challenges and milestones the company has achieved towards the goal of sustainable home financing in the country. In addition, we shall provide our expectations for KMRC and give recommendations regarding how to boost mortgage financing in Kenya by looking towards similar companies in other countries. This we shall cover through the following;

I. Overview of the Housing Sector in Kenya,
II. Home Financing in Kenya,
III. Kenya Mortgage Refinance Company (KMRC) Update,
IV. Case Studies and Lessons Learnt, and,
V. Conclusion.

Section I: Overview of the Housing Sector in Kenya

The housing situation in Kenya is characterized by a high demand for dwellings, driven by the relatively high urbanization and population growth rates averaging 3.7% and 1.9%, compared to the global averages of 1.6% and 0.9%, respectively, according to the World Bank as of 2021. The Centre for Affordable Housing Finance Africa (CAHF) estimates that Kenya has an 80.0% annual housing deficit, as only about 50,000 new houses are delivered each year against a demand for 250,000 units per year hence the demand outstripping supply at an average of 200,000 houses every year. The prevailing tough economic environment in the country has continually led to gradual increase in the costs of construction and building materials such as cement and steel on the back of elevated inflation, which in turn necessitates higher financing costs for developers, that they pass on to the market. This has led to a high cost of housing, with many people being unable to afford to buy or rent homes in the country. As a consequence, the percentage of Kenyans who own homes is relatively low, coming in at 22.0% in urban areas, with the majority of the population, 78.0%, being property renters. This is in contrast to other Sub-Saharan African countries such as South Africa and Ghana with home-ownership rates of 69.7% and 52.0%, respectively, as shown below;



Source: Centre for Affordable Housing Africa, US Census Bureau, UK Office for National Statistics

In response to this challenge, the Government of Kenya launched the Affordable Housing Programme (AHP), with two key components of delivery housing units, the supply side, and enabling purchasing of housing units, the demand side.

On the supply side, the government has set a goal of delivering 200,000 affordable housing units on an annual basis. To supply the required units, the government has been on a robust drive to launch affordable housing projects, with the AHP pipeline currently boasting about 30 projects being undertaken by both the government and private developers. This is through various incentives such as; i) exemption of VAT on importation and local purchase of goods for the construction of houses under the AHP, ii) lower corporate tax rate at 15.0% for AHP developers of over 100 units, iii) exemption from 4.0% (urban areas) and 2.0% (rural areas) stamp duty for first time buyers of houses under the AHP, iv) tax relief of 15.0% of savings to drive contributions towards home ownership, v) exemption from restrictions in interest expense deduction for foreign controlled companies undertaking AHP projects, and, vi) availing State land to County governments for the construction of affordable housing units.

On the supply side of the AHP is to increase access to mortgage financing for low and middle-income households in Kenya. To achieve this, the government aims to restructure the housing finance scheme in the country, by instituting a National Housing Fund and Cooperative Social Housing Scheme, which will guarantee uptake of houses that are developed under the AHP. This is envisioned to increase the number of mortgage accounts from the current 26,723 to a target of 1,000,000 by enabling affordable mortgages at monthly repayments of Kshs 10,000 and below. This is from the current average repayment amounts of Kshs 96,847 per month, given an average mortgage size of Kshs 9.2 mn repaid at an annual interest rate of 11.3% over 20 years. As such, the KMRC plays a vital role in supporting the ongoing AHP, through its objectives which include;

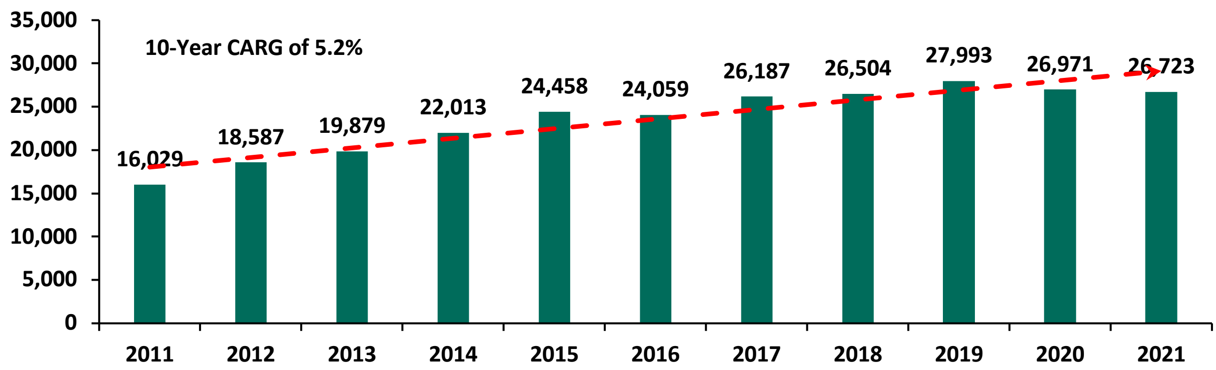
i) Providing sustainable, long-term funding at attractive rates to participating financing institutions which will enable them to scale up their mortgage lending operations,
ii) Boosting the growth of the capital markets in the country through the issuance of corporate bonds as a source of sustainable long-term funding,
iii) Standardization of mortgage practices in Kenya which is geared to enable efficiency of lending processes by working together with the government and stakeholders,
iv) Facilitating the entry of new mortgage lenders in the market in a bid to increase competition among PMLs in order to lead to a wider range of high-quality mortgage products,
v) Ensuring lower overall transaction costs to PMLs through pooling issuance, as compared to accessing the markets individually, that will in turn enable them to offer lower rates to homebuyers, and,
vi) Facilitating participating institutions to extend the mortgage maturity durations in line with the goal of achieving long-term housing finance.

Section II: Home Financing in Kenya

The housing finance industry plays a crucial role in Kenya's Real Estate sector. Despite its potential for growth, the mortgage sector, in particular, has not fully developed, as evidenced by recent declines in the number of mortgage accounts. In 2021, the number of mortgage accounts declined by 0.9% to 26,723 from 26,971 in 2020 which also represented a 3.7% decline from 27,993 accounts in 2019. The few number of mortgage accounts, even with the entrance of KMRC in the sector in 2021, still represents a relatively smaller portion of the overall financial landscape, contributing only 1.9% to the country's GDP as at 2021.

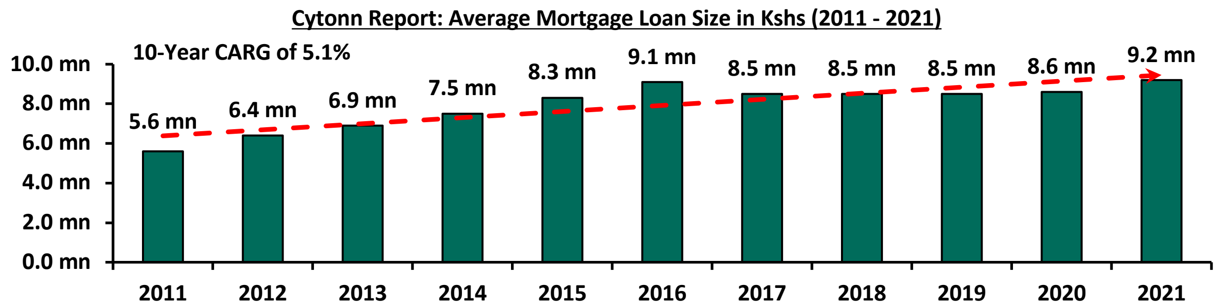
However, the average number of loan accounts has recorded a 10-year Compounded Annual Growth Rate (CARG) of 5.2%, showcased by a growing demand for homeownership among Kenyans, driven by steady economic growth and a subsequent increase in disposable income to invest in property especially during the pre-COVID-19 period. The recent decline in the number of mortgage accounts suggests that there are still challenges to overcome to sustain this growth in the future. Despite these challenges, there is significant room for growth in the Kenyan housing finance industry, as more Kenyans look for ways to invest in the real estate sector such as personal savings, sale of other assets, SACCO loans, inheritance/gift, investment groups, and a blend of several financing. The graph below shows the average mortgage loan accounts from 2011 to 2021;

Cytonn Report: Number of Mortgage Loan Accounts (2011-2021)



Source: Central Bank of Kenya

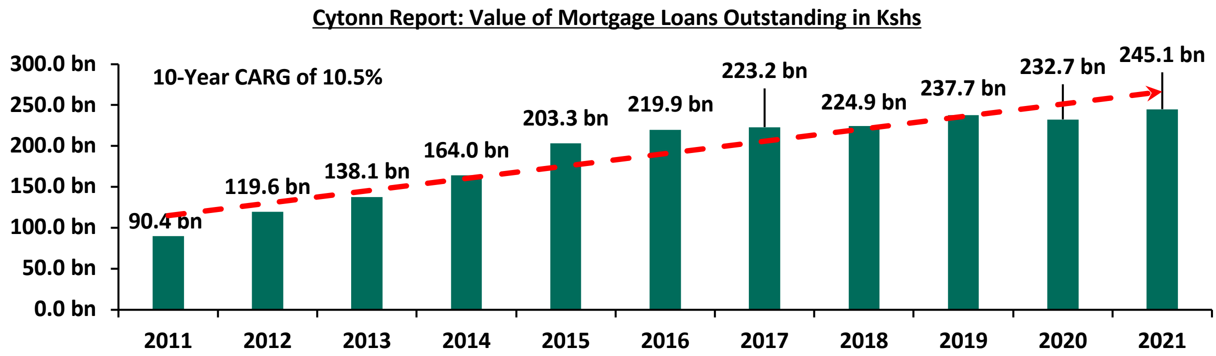
In line with the growth of mortgage loan accounts, the trend of average mortgage loan size has also been upward in the recent past, realizing a 10-year CAGR of 5.1% to Kshs 9.2 mn from Kshs 5.6 mn as shown in the graph below;



Source: Central Bank of Kenya

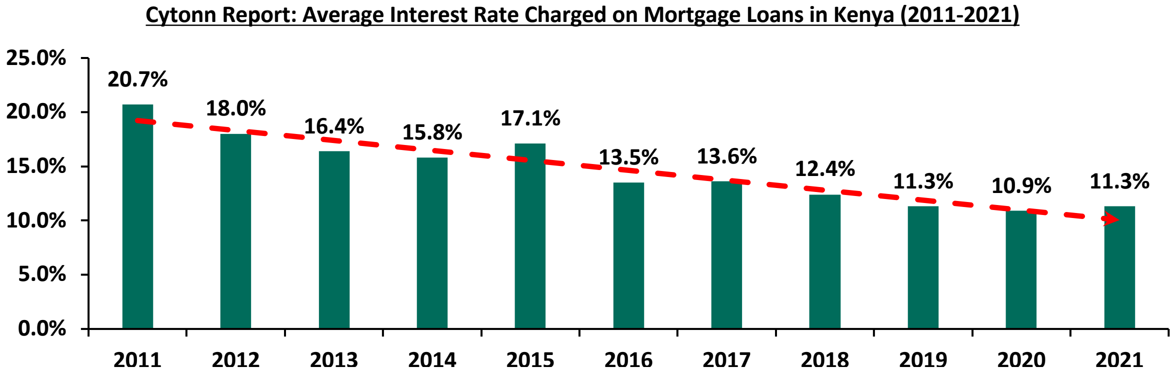
This growth can be attributed to the joint efforts of the government and private financial institutions in enhancing financial accessibility and providing more reasonable and flexible mortgage options which accommodate the general public.

According to Bank Supervision Annual Report 2021, the value of mortgage loans outstanding increased by Kshs 12.4 bn, representing 5.3% increase to Kshs 245.1 bn in 2021 from Kshs 232.7 bn in 2020. The upward trajectory of the loans which also represented a positive 10-year CARG of 10.5% was attributed to increase in the value of mortgages granted by banks, with the average loan size significantly adjusted to Kshs 9.2 mn from Kshs 8.6 mn in 2020 and Kshs 8.5 mn in 2019. This was at the back of recovery of the economy from a depressed 2020, where the mortgage sector was negatively affected by the COVID-19 pandemic. The graph below illustrates the trend of value of mortgage loans outstanding from 2011 to 2021;



Source: Central Bank of Kenya (CBK)

Additionally, the industry recorded an average interest rate charged on mortgages of 11.3% which was 0.4% points increase from 10.9% recorded in 2020. The interest rates majorly ranged from 7.1% to 15.0% in 2021 compared to a range from 7.0% to 15.0% charged in 2020. The increase in the interest rates was attributed to the consistency of increasing interest rates in the economy during 2021. However, for the past decade, the interest rate charged on mortgage loans has been on a downward trajectory mainly attributed by the introduction of the interest rate cap imposed by the Central Bank of Kenya (CBK) in September 2016 and later removed in November 2019. This resulted to significant drop in interest rates offered by banks during the period as shown in the graph below;



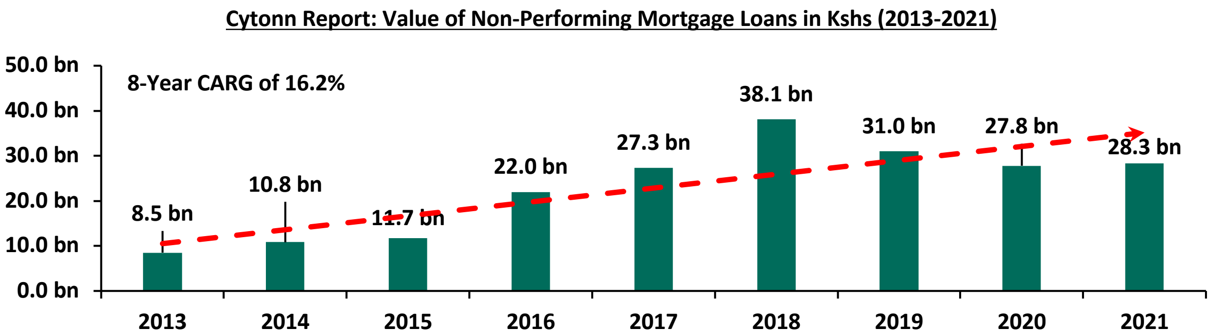
Source: Central Bank of Kenya (CBK)

Nevertheless, this rate is still considered unaffordable for most low-income and low-middle income earners. Assuming a low-middle income earner applies for a mortgage size of Kshs 9.2 mn, at an interest rate of 11.3%, and a maximum repayment term of 20 years, the client would need to pay approximately Kshs 96,847 per month, given that the average median household income in Kenya is Kshs 50,000 per month. Additionally, we expect that the continued adoption of risk based pricing models by commercial banks will drive interest rates further upwards, given that banks will be able to adequately price their risks.

The maximum loan that an average median household income of Kshs. 50,000 can afford, assuming 30% of the income, Kshs. 15,000, goes into mortgage payment is 2.5 mn (assuming interest rate of 11.3%, 20 years payment, and 15,000 per month payment.)

On the other hand, the maximum loan as a percentage of property value, also known as Loan to Value Ratio stabilized at 90.0% since 2014, whereas the average maturity of the loans was 12 years. Loan maturity ranged from 5 years as the minimum and 25 years as the maximum number of years. This was a one-year increase of 11 years recorded in 2020 ranging from a minimum of 4 years to a maximum of 20 years.

The outstanding value of Non-Performing Mortgage Loans increased by 1.8% to Kshs 28.3 bn in 2021 from Kshs 27.8 bn in 2020. This was attributed to ripple effect of COVID-19 pandemic which caused widespread economic disruption in 2020, leading to widespread job loss and reduction in income for many individuals. As a result, a significant number of housing investors found it difficult to service their mortgage loans. The pandemic also disrupted housing market activity, leading to a slowdown in Real Estate sales and making it more difficult for investors to sell their homes and refinance their mortgages during the period. However, the Non-Performing Mortgage Loans to Gross Mortgage Loans ratio was at 11.6%, 2.5% points lower compared to industry gross non-performing loans to gross loans ratio of 14.1%. The graph below shows the performance of non-performing mortgage loans from 2013 to 2021;

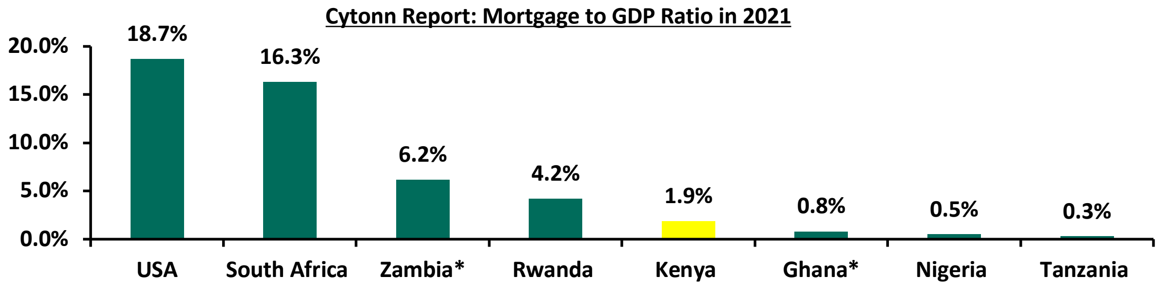


Source: Central Bank of Kenya (CBK)

On the other hand, the value of Non-Performing Mortgage Loans recorded an 8-year CARG of 16.2% between 2013 and 2021, which was majorly attributed by a significant increase of 88.0% in the value of

Non-Performing Mortgage Loans to Kshs 22.0 bn in 2016 from Kshs 11.7 bn in 2015. Additionally, the political instability caused by the August 2017 general elections and the repeat elections in October 2017 likely had a negative impact on the housing market in Kenya, contributing to the 39.7% increase in the value Non-Performing Mortgage Loans between 2017 and 2018. This instability majorly caused a slowdown in Real Estate sales and made it more difficult for individuals finance their mortgages, leading to an increase in non-performing loans.

Subsequently, Kenya's mortgage to GDP continues to underperform at approximately 1.9%, compared to countries such as South Africa and Rwanda which are at approximately 16.3% and 4.2% as at 2021, respectively, as shown below;



**(2020)*

Source: Centre for Affordable Housing Africa

Currently, Kenya has 26,723 mortgage loan accounts with an average size of Kshs 9.2 mn bringing the total value of mortgages to Kshs 245.1 bn, which translates to a 1.9% mortgage-to-GDP ratio. To match South Africa's 16.3% mortgage to GDP ratio, the Kenyan mortgage market needs a Kshs 2,121.9 bn expansion. This means we require an additional 230,646 mortgages given the same average mortgage size to achieve that target.

However, several challenges have contributed to the underperformance of the Kenyan mortgage market such as;

i) Ripple negative impact of COVID-19 in 2021 which continued to cause economic downturns and uncertainty regarding investing in Real Estate hence most borrowers struggled to repay the loans or take more mortgages,
ii) Low level of income among most consumers which reduces their ability to qualify for and make mortgage repayments, increasing the risk of default, and consequently putting pressure on banks to manage their risks and comply with the sustained new financial regulations,
iii) High cost of property purchase making it difficult for the consumers to afford high monthly repayments hence slowing down the mortgage process. On the other hand, the value of collateral used to secure the mortgage loans has also been on the rise, making it more difficult for banks to recover their losses in an event of default,
iv) Limited access to affordable long-term finance as most consumers struggle to access credit from banks and financial institutions due to strict lending criteria imposed especially during the COVID-19 period,
v) Weak property rights regarding disputes over the ownership of a property undermine most consumers to secure mortgages and making it difficult for a bank to recover its funds in case of defaults,
vi) KMRC, which officially began its lending in 2021, is yet to stamp its dominance in the market and increase its attractiveness to more stakeholders in the sector, and
vii) Political and economic instabilities such as general elections and elevated inflationary pressures has made banks become more cautious about granting mortgages, as they are concerned about

the risk of default and the potential loss of their funds, hence discouraging investments and limiting the growth of the mortgage market.

Section IV: Kenya Mortgage Refinance Company (KMRC) Progress Update

a. Overview of the Kenya Mortgage Refinance Company

The Kenya Mortgage Refinance Company (KMRC) is a treasury backed non-deposit taking financial institution established in 2018 under the Companies Act 2015, and was licensed by the Central Bank of Kenya (CBK) to commence core business operations in September 2020. KMRC is the sole institution licensed to carry out Mortgage Liquidity Facility (MLF) activities in Kenya, which include provision of long-term funds to Primary Mortgage Lenders (PMLs) such as banks, microfinance institutions and SACCOS for purposes of increasing availability of affordable home loans to Kenyans. Typical of all MLFs, the KMRC acts as an intermediary between PMLs and the capital markets through issuance of bonds subject to regulation and supervision of the CBK and Capital Markets Authority (CMA), with the objective of providing long term funds at better rates. As such, KMRC does not lend directly to individual borrowers. The issuer was established as a crucial component in the implementation of the Affordable Housing Plan aimed at increasing the low rates of home ownership, particularly in urban areas coming in at 22.0%, resulting from limited and inaccessible housing financing as well as high housing costs. In support of this, KMRC was purposely established through a public private partnership arrangement between the Government of Kenya, and World Bank with majority ownership being by the private sector at 75.0%. Currently, KMRC has 23 shareholders which include;

<table>
<tr><th colspan="4">Cytonn Report: KMRC Shareholders</th></tr>
<tr><th>#</th><th>Umbrella Body</th><th>Individual Shareholders</th><th>Estimated Stake (%)</th></tr>
<tr><td>1</td><td>The Government of Kenya</td><td>The National Treasury and Economic Planning</td><td>25.3%</td></tr>
<tr><td>2</td><td>Development Finance Institutions</td><td>International Finance Corporation (IFC), Shelter Afrique</td><td>22.9%</td></tr>
<tr><td>3</td><td>Commercial Banks</td><td>KCB Bank, Co-operative Bank, Stanbic Bank, NCBA, Credit Bank, DTB, Absa Bank Kenya, HFC Limited</td><td rowspan="2">44.3%</td></tr>
<tr><td>4</td><td>Microfinance Bank</td><td>Kenya Women Microfinance Bank (KWFT)</td></tr>
<tr><td>5</td><td>Savings and Credit Cooperatives (SACCOs)</td><td>Stima, Imarisha, Ukulima, Tower, Mwalimu, Unaitas, Harambee, Bingwa, Kenya Police, Safaricom & Imarika SACCOs</td><td>7.5%</td></tr>
</table>

Source: Kenya Mortgage Refinance Company (KMRC)

KMRC, through the provision of low-interest, fixed, long-term financing to participating primary lenders at 5.0% with a repayment period of up to 25 years, has boosted the funds available for subsequent lending to borrowers at single-digit rates. Correspondingly, KMRC has increased the supply of housing finance in Kenya's housing market by refinancing mortgage loans of its member PMLs. To this end, KMRC has been fundamental in the push to increase homeownership in Kenya. In terms of products, KMRC's offers two key refinance loan products categorized as either:

- **Affordable Housing Loans**: These are loans extended to Primary Mortgage Lenders to refinance mortgage portfolios defined as "Affordable" by the Government capped at Kshs 8.0 mn in Nairobi Metropolitan Area (Nairobi, Kiambu, Machakos & Kajiado) and Kshs 6.0 mn in other parts of the country to individual borrowers whose monthly household income is not more than Kshs 150,000. These mortgages are predominantly refinanced through the concessional funding provided by the World Bank (up to 80.0% of portfolios presented to KMRC by PMLs) and AfDB funding (up to 40.0% of portfolios presented to KMRC by PMLs), and,
- **Market-Rate Housing Loan**: These are PML loans for mortgages with a value of more than Kshs 8.0 mn. These mortgages are partially refinanced through the concessional funding provided by

the World Bank (up to 20.0% of the portfolio presented to KMRC by PMLs), the AfDB financing (up to 60.0% of the portfolio presented to KMRC by PMLs) and future bond issuances.

b. KMRC Progress and Key Milestones Achieved

KMRC was incorporated in April 2018 in accordance with the requirements of the Companies Act 2015. In 2019, KMRC completed a successful capital mobilization drive resulting in the Government of Kenya, eight commercial banks, one microfinance bank and eleven SACCOs becoming shareholders of the Company. In June 2020, KMRC held its first Annual General Meeting and was later issued with its license in September 2020. Following its licensing by the CBK to begin core business operations, KMRC in December 2020 approved loans for disbursement of cumulative value Kshs 2.8 bn to participating PMLs. They included; KCB Bank Kenya Limited, Housing Finance Company Limited, Stima Sacco Society Limited, and Tower Sacco Society Limited. These approvals for disbursement were to be funded from the World Bank line of credit. It is worth noting however, that despite most of KMRC's business operations beginning in 2020, actual lending operations to PML began in 2021. In 2021, KMRC disbursed Kshs 1.3 bn to seven PMLs out of the twelve received applications closing the year on a high note, and reported a Profit After Tax (PAT) of Ksh 0.2 bn for the year, a 154.6% increase from Kshs 0.1 bn in 2020. This improvement in performance was attributed to growth in investment income and disbursements to the primary mortgage lenders. The table below shows a summary of KMRC's income statement for FY'2020 and FY'2021;

Cytonn Report: Summary of KMRC Statement of Comprehensive Income			
	FY'2020	FY'2021	y/y Change
Interest Income:			
Interest on Loans and Advances	-	24,419,799	100.0%
Other Interest Income	221,094,696	686,526,589	210.5%
Total Interest Income	**221,094,696**	**710,946,388**	**221.6%**
Interest Expenses	(25,389,655)	(246,873,372)	872.3%
Net Interest Income	**195,705,041**	**464,073,016**	**137.1%**
Impairment Provision	-	(440,814)	100.0%
Other expenses	(78,474,909)	(178,353,474)	127.3%
Total expenses	**(78,474,909)**	**(178,794,288)**	**127.8%**
Profit Before Tax (PBT)	**101,615,001**	**285,278,728**	**180.7%**
Income Tax Expense	(24,397,662)	(88,667,655)	263.4%
Profit After Tax (PAT)	**77,217,339**	**196,611,073**	**154.6%**

Source: Kenya Mortgage Refinance Company (KMRC)

The table below shows a summary of KMRC's balance sheet for FY'2020 and FY'2021;

Cytonn Report: Summary of KMRC Statement of Financial Position			
	FY'2020	FY'2021	y/y Change
Assets			
Loans and Advances	-	1,286,717,998	**0.0%**
Cash and Cash equivalents	6,062,907,771	6,684,792,247	**10.3%**
Total Assets	**6,309,802,091**	**9,823,579,908**	**55.7%**
Liabilities			
Borrowings	3,725,173,478	6,771,588,698	**81.8%**
Total Liabilities	**3,793,113,568**	**7,456,134,267**	**96.6%**
Equity			
Share Capital	1,291,000,100	1,808,375,125	**40.1%**
Total Equity	**2,516,688,523**	**2,367,445,641**	**(5.9%)**

Source: Kenya Mortgage Refinance Company (KMRC)

Other key milestones achieved by KMRC during 2021 and 2022 include;

i. **Blue Company Certification** – KMRC become a certified blue company, an initiative that is geared towards helping to create a corruption-free business environment in East Africa,
ii. **Standardization of mortgage origination practices** – KMRC successfully managed to standardize mortgage origination practices for participating SACCOs. This was in turn expected to revolutionize mortgage lending to SACCOs and increase loan processing efficiency, and,
iii. **Convened the first Affordable Housing Conference** – In December 2021, KMRC convened its first Affordable Housing Conference geared towards enhancing demand and supply sides linkages, and discussing issues affecting the delivery of affordable housing and how to resolve them.

In January 2022, KMRC received approval from the CMA to issue a Medium-Term Note (MTN) under its inaugural bond program. The table below shows the particulars of the MTN;

Cytonn Report: Summary of KMRC Medium-Term Note	
Issuer	Kenya Mortgage Refinance Company (KMRC)
Trustee	Ropat Trust Company Ltd
Aggregate Nominal Amount	Kshs 10.5 bn
Issue Date	4th March 2022
Listing Date	14th March 2022
Nairobi Securities Exchange (NSE) Market Segment	Fixed Income Securities Market Segment (FISMS)
Tranche 1	Kshs 1.4 bn
Oversubscription Rate	478.6%
Expected Date Tranche 2	June 2023
Interest Rates	12.5% p.a., payable semi-annually in arrears
Placing Agent	NCBA Investment Bank Ltd.
Receiving Bank	KCB Bank Kenya Ltd.
Specified Denomination	Kshs 100,000 with integral multiples of Kshs 100,000 thereof
Tenor	7 years amortizing, with a Weighted Average Life of 4.5 years
Interest on Late Payments	Initial Interest Rate plus a margin of 2.0% p.a. to trade creditors
Credit Rating	GCR-AA+AA- (Highest certainty of timely payment of obligations)
Default	In case of default, issuer commences negotiations with any one or more of its creditors with a view to the general readjustment or rescheduling of its indebtedness. N/B; Trade creditors not mentioned

Source: Kenya Mortgage Refinance Company (KMRC), Cytonn Research

The high oversubscription rates were attributable to the attractive returns to investors of 12.5%, and was partly on the back of the increased optimism on the firm having raised funds from the World Bank and African Development Bank. Following the MTN's listing, KMRC's subsequent bond issuing will most likely face competition from government instruments offering higher rates. To put this into context, 10-year government bonds currently offer coupon rates of up to 14.2% and would seem more attractive to investors. Notably, KMRC bond was assigned a national credit rating of AA- and AA+ in the long term and short term respectively, with an average risk score of 9.75 by the Global Credit Rating (CGR). The table below summarizes the rating particulars;

Cytonn Report: KMRC Global Credit Rating Scorecard					
Rated Entity	**Rating Class**	**Rating Scale**	**Rating**	**Rating Description**	**Outlook**
Kenya Mortgage Refinance	Long Term Issuer	National	AA-(KE)	Very high credit quality relative to other issuers or obligations in the same country	Stable Outlook

Company Plc	Short Term Issuer	National	AA+(KE)	Highest certainty of timely payment of Short term obligations relative to other issuers or obligations in the same country	

Source: Global Credit Rating (CGR)

Furthermore, during the year, KMRC disbursed an additional Kshs 5.7 bn, bringing the total number of funds disbursed to Kshs 7.0 bn as at September 2022, out of the Kshs 8.1 bn approved for refinancing to eight PMLs out of the 20 PMLs members. The disbursed amount represented 2,475 mortgages out of the total 2,781 mortgages approved for refinancing. KMRC refinancing activities are estimated to have created 9,900 jobs directly and indirectly and benefitted approximately 11,124 assuming an average household size of 4, with an estimated 30.0% of supported jobs benefitting females. Evidently, KMRC has made immense progress since it began operations two years ago and continues to deploy refinancing loans to support PMLs access long term liquidity and originate new affordable housing mortgages for the target income groups. African Development Bank (AfDB) latest September Implementation Progress and Results Report on KMRC reiterates the mortgage refinancing company's positive progress in achieving its targets and objectives as being on track and has deemed it satisfactory.

c. Recent Developments

Some of the recent developments by the KMRC aimed at improving the Kenyan mortgage market in 2023 include;

1. In January, KMRC announced an increase in the limit or size of maximum mortgage in Kenya to be issued to its clients. The table below highlights the adjustments made;

Cytonn Report: Kenya Mortgage Refinancing Company (KMRC) limit of maximum mortgage in Kshs		
Region	**Previous limit of maximum mortgage in Kshs**	**New limit of maximum mortgage in Kshs**
Nairobi Metropolitan Area- Nairobi County - Kiambu County - Kajiado County - Machakos County	4.0 mn	8.0 mn
The rest of the 43 counties	3.0 mn	6.0 mn

Source: Kenya Mortgage Refinance Company (KMRC)

Multiple factors served as impetus for the decision to revise the limit upwards including; i) renewed demand from buyers who previously postponed acquisitions during the height of the COVID-19 economic downturn, ii) hike in the prices of key construction materials such as steel, paint, and cement occasioned by supply chain bottlenecks resulting from the Russia-Ukraine war, ii) global and domestic inflationary pressures affecting the overall cost of goods and services, and iv) the continuing depreciation of the Kenyan Shilling against the US dollar. However, the Kshs 8.0 mn KMRC-backed mortgage is still relatively lower than the average maximum home loan amount, offered by other financial institutions averaging at Kshs 9.2 mn as at 2021, and,

2. Moreover, KMRC raised the Loan to Value Ratio (LTV) to 105.0% from 90.0%, eliminating the need for a home-buyer to pay a 10.0% deposit prior to obtaining the mortgage plus another 5% needed for transaction costs. KMRC highlighted that the extra 5.0% above the value of the house under purchase was facilitated to cover incidental costs such as legal and appraisal fees. This move will greatly reduce the obstacles facing buyers in acquiring homes, thereby making the state-backed mortgage more attractive and affordable, particularly for first-time buyers in the low to middle-income bracket. As an illustration, to buy a house of Kshs. 8 mn, a buyer needed to come up with a 10% deposit of Kshs. 800k plus another Kshs. 400k for transaction costs, hence an upfront cost totaling Kshs. 1.2 mn. As of today, the buyer will no longer need to come up with the 1.2 mn, as they will only need to demonstrate an ability to service a loan of Kshs. 8.4 mn.

It is anticipated that KMRC's policy changes will enhance its competitiveness in providing affordable mortgages, thereby drawing more financial sector partners to expand loan opportunities. As a result, the move is expected to: i) increase homeownership for Kenyans, particularly in urban areas which currently stands at 22.0%, ii) drive growth in mortgage uptake, and iii) help address some of the major obstacles hindering mortgage uptake in the country. For more information regarding these recent developments, please see our Cytonn Monthly-January 2023.

d. KMRC Achievements

The following are key achievements by KMRC;

i. **Increased liquidity to Primary Mortgage Lenders**: KMRC's long-term funding has helped increase the liquidity of the mortgage market, making it easier for lenders to access the funding they need to provide mortgages to borrowers. In 2021, KMRC closed the year having disbursed Kshs 1.3 bn to seven PMLs. In 2022, as at September, KMRC had disbursed an additional Kshs 5.7 bn, bringing the total amounts disbursed to Kshs 7.0 bn, from the Kshs 8.1 bn available for refinancing. Notably, KMRC has continued to grow its affordable mortgage refinancing portfolio and as such has increased funding available to PMLs for onward lending to borrowers,

ii. **Increased Mortgage Uptake in the country**: The wholesale lender to PMLs cumulatively refinanced 2,475 mortgages out of the available 2,781 mortgages available for refinancing at a low interest rate of 5.0%. Consequently, this has enabled banks and SACCOs in partnership with KMRC to lend at a single digit rate of 9.5%, which is comparatively lower than market rates of between of 11.5% and 18.8%. This has made mortgages affordable and within the reach of many clients thereby increasing mortgage uptake,

iii. **Promoted Financial Sector Inclusion**: KMRC successfully managed to standardize mortgage origination practices for participating SACCOs in 2021. SACCOs play a vital role in Kenya's finance and housing finance sector by bridging the gap in the housing finance market experienced in the lower income brackets, through the provision of unsecured, medium-term loans to their members. In support of this, the integration of the SACCO sector, which has demonstrated resilience and durability, could be a potential solution for providing mortgage loans to low- and informal-income earners in the near future, thereby boosting home ownership rates in the lower market segment,

iv. **Improved Standards of Living**: KMRC has improved the lives and living standards of many through job creation and employment. It is estimated that KMRC has benefitted approximately 11,124 persons, created and sustained 9,900 jobs in the mortgage industry and related sector. This number is expected to increase as the number of refinanced mortgages by the company increases,

v. **Promoting homeownership in Kenya**: KMRC has helped improve the overall availability of housing funding in Kenya's housing sector by providing long term funds and liquidity to PMLs. In this regard, KMRC has been instrumental in the push to increase homeownership in Kenya and in supporting the government's Affordable Housing Plan,

vi. **Successful issuance of its inaugural bond**: KMRC got a nod from the CMA to roll out its Kshs 10.5 bn Medium Term Note programme in January 2022. In the first tranche of the issuance, the firm aimed to raise Kshs 1.4 bn and recorded an over subscription of 478.6%. Additionally, through its issuance of bonds, KMRC is contributing towards the development and advancement of the capital market in Kenya which remains severely under developed,

vii. **Strengthened mortgage market infrastructure**: KMRC has helped build and strengthen the infrastructure needed to support a thriving mortgage market in Kenya by establishing standard procedures and practices, and supporting capacity building initiatives for mortgage lenders. These efforts have helped increase the overall stability, efficiency, and quality of the mortgage market, making it easier for borrowers to access financing and become homeowners.

e. KMRC Challenges

Despite the above achievements, KMRC has faced numerous challenges which include**;**

i. **High Property Prices:** Rapidly rising residential property prices are increasingly making it difficult for low-income earners to access mortgages. This is attributable to land high costs especially in urban areas, rising construction costs, and costly land registration processes for multi-unit developments resulting in mortgaged purchases being priced higher by as much as 10% or more to cover developer's carrying costs. During FY'2022, prices for detached units averaged at Kshs 12.4 mn while that of apartments averaged at Kshs 9.1 mn which are both higher than the KMRC affordable housing loan limits of Kshs 8.0 mn in the NMA region and Kshs 6.0 mn elsewhere. The table below shows the performance of both apartments and detached units in the Nairobi Metropolitan Area (NMA) in FY'2022 assuming an average size of 90-SQM unit;

Average Property Prices						
Segment	**Average Unit Size (SQM)**	**Average Price per SQM FY'2022**	**Price FY'2022**	**Average Rental Yield FY'2022**	**Average Price Appreciation FY'2022**	**Total Returns**
Detached Units						
High End	90	193,036	17.4 mn	4.4%	**1.4%**	**5.8%**
Upper Mid-End	90	147,178	13.2 mn	4.5%	**1.1%**	**5.6%**
Satellite Towns	90	73,696	6.6 mn	5.0%	**1.0%**	**6.0%**
Detached Units Average	**90**	**137,970**	**12.4 mn**	**4.7%**	**1.1%**	**5.8%**
Apartments						
Upper Mid-End	90	126,751	11.4 mn	5.4%	**0.5%**	**5.9%**
Lower Mid-End	90	94,406	8.5 mn	5.5%	**1.1%**	**6.6%**
Satellite Towns	90	82,586	7.4 mn	5.5%	**1.4%**	**6.9%**
Apartments Average	**90**	**101,248**	**9.1 mn**	**5.5%**	**1.0%**	**6.5%**

Source: Cytonn Research

ii. **Inability to Meet Criteria Threshold for Mortgage Products:** The primary lending institutions have a set of eligibility criteria to meet before they can receive funding from KMRC, mostly set under the World Bank and African Development Bank (AfDB) standards. Most of these requirements have not been met thus limiting the number of primary mortgage lenders for the loans. For instance, in 2021, KMRC disbursed funds to only 7 PMLs out of the 12 applications received,

iii. **Competition from other sources of financing:** KMRC recently doubled its maximum loan limit to 8.0 mn however, it remains lower than the average maximum home loan amount, offered by other financial institutions averaging at Kshs 9.2 mn. Due to the low qualifying amounts, KMRC faces competition from other sources of financing, such as commercial banks, microfinance banks, and other financial institutions which offer higher maximum loan sizes or limits. This essentially means that absorption rates for KMRC backed mortgages will continue to be low,

iv. **Elevated Credit Risk owing to a High Number of Non-Performing Loans (NPLs):** According to Quarterly Economic Review July-September 2022 by the Central Bank of Kenya (CBK), Gross Non Performing Loans (NPLs) in the Real Estate sector increased to Kshs 75.6 bn in Q3'2022 from Kshs 69.2 bn recorded in Q3'2021, representing a 9.2% Year-on-Year (y/y) increase attributable to increased Real Estate loan default rates. An increase in NPLs in the Real Estate sector, indicates a higher risk for lenders and can indicate a downturn in the market. This can make it more difficult for KMRC to attract funding from its capital markets, as investors may become more cautious about lending money to the company. Additionally, if the Real Estate market continues to decline and more loans become NPLs, KMRC may face increased pressure to write off bad loans. This can impact the company's bottom line and reduce its ability to provide new loans to other borrowers, and,

v. **Cost of capital:** KMRC's current funding model is unclear and unsustainable, owing to the large negative spread between its cost of capital and lending rate. Based on KMRC's latest issuance, its 7 year tenor bond raised in the market cost 12.5%. It is therefore not clear how the firm will maintain lending at a 5.0% rate while its borrowing costs are high hence deeming clarity on how KMRC will sustainably fund mortgages using its current financing model, once it exhausts the funding that was contributed by the original shareholders.

Section V: Case Studies and Lessons Learnt

In our previous topicals, Kenya Mortgage Refinance Company Progress 2022, Kenya Mortgage Refinance Company Update 2021, Kenya Mortgage Refinance Company Recap 2020, we provided case studies of Tanzania Mortgage Refinance Company, Jordan Mortgage Refinance Company and the Saudi Real Estate Refinancing company, respectively. In this topical, we now look at the lessons and key takeout's that we can derive from the aforementioned mortgage refinancing companies alongside France's Caisse de Refinancement de l'Habitat (CRH), and Nigeria Mortgage Refinancing Company (NMRC);

Cytonn Report: Summary of Mortgage Refinance Companies in Various Countries	
Institution	**Key Takeouts/Achievements**
Jordan Mortgage Refinancing Company	• Jordan Mortgage Refinance Company (JMRC) is a public shareholding company established in 1996 and headquartered in Amman Jordan, whose main purpose is providing medium and long-term financing for the Jordanian housing sector by extending loans to banks and financial institutions in the country • The firm successfully issued 12 bonds for mortgage funding in H1'2021 with a nominal value of USD 0.125 bn (Kshs 13.7bn). The interest rate on latest JMRC 7-year bond issue in August 2021 at 4.4% reflects the low risk associated with the company, given that the government's risk free rate for a 7-year bond is 4.1% • The firm has been able to increase access to capital for Primary Mortgage lenders through signing 12 refinance loan agreements with 8 financial institutions for an amount of USD 0.132 bn (Kshs 14.5 bn) in H1'2021, and, • JMRC has been able to maintain low interest rates to clients, in 2001, mortgage rates for major banks in Jordan ranged from 9.0%-11.0% but 20 years down the line, the rates have declined to between 5.6%-7.6% in the market and this can be partly attributable to the Kshs 345.2 bn (2.140 bn JD) in loans that JMRC has issued since inception. Primary mortgage lenders in Jordan are able to do onward lending at interest rates as low as 5.6%
Saudi Real Estate Refinance Company	• Saudi Real Estate Refinance Company (SRC) was formed in 2017 with the primary goal of developing the housing finance market in Saudi Arabia. It was established to enable the originators offer long term and short term financing solutions to home buyers using intermediaries mainly the financial institutions and lends to them at a rate of 6.0%, • The firm has been able to boost the growth in the number of financial institutions offering loans which has generally contributed to the growth of mortgage accounts in Saudi Arabia. According to Saudi Arabian Monetary Authority (SAMA), the total number of individual mortgage contracts until August 2019 stood at 96,787 compared to approximately 27,000 contracts during the same period in 2018, • SRC has contributed to increased home ownership in Saudi Arabia which was at 47.0% in 2017 to 62% in 2020. This is primarily attributed to the fact that it is able to provide financing to potential home owners to construct or buy houses, • The Saudi Real Estate Refinance Company issued a Kshs 61.0 10 year Sukuk (Islamic Version of Conventional Bonds) in December 2021 recording a 2.5 times oversubscription to support the push for access to housing including making an effort to achieve a 70.0% home ownership target of 2030, and, • The SRC has helped to increase access to financing evident by the 168.0% growth in mortgage financing between 2018 and 2019 to reach approximately Kshs 72.0 tn (USD 7.2 bn), as mortgage financing companies and commercial banks benefitted from subsidized financing designed to increase home ownership
Tanzania Mortgage Refinance Company	• TMRC is licensed as a non-deposit taking financial institution licensed by the Bank of Tanzania whose core activity is to refinance mortgages, • As at June 2017, the mortgage market registered a 7.0% growth from march 2017 with the outstanding loan value at USD 199 mn (Kshs 20.1bn), • The number of mortgage lenders in TMRC has increased to 34 as at June 2019, from 2 in 2011, • Mortgage loans average duration also increased since the creation of the TMRC, from 5 to 10 years to 30 years, implying that potential home owners are able to get extended duration before making loan repayments thereby making an effort to make favorable repayment terms, • In January 2020, IFC, a member of the World Bank Group, announced an investment of up to USD 5.6 mn (6.4 bn) in the Tanzania Mortgage Refinance Company (TMRC) to help grow Tanzania's underdeveloped mortgage sector

	and increase access to affordable housing. As of 2018, TMRC had issued two medium-term notes totaling 21.7 bn Tanzanian shillings (1.1) bn aimed at providing access to funds for refinancing, and, • TMRC in May 2021 issued a 345.5 mn (7.0 bn Tanzanian Shillings) which recorded an over subscription of 28.6%. The funds raised through the bond are aimed at raising capital to be used by the firm to refinance loans.
France's Caisse de Refinancement de l'Habitat (CRH)	• Frances Housing Refinance Fund (CRH) is a non-profit making institution founded in 1985, with the sole purpose of refinancing housing loans granted by shareholder's credit institutions through issuing bonds, and by acquiring notes issued by these institutions under the same conditions of rate and duration of the bonds • CRH operates in a unique way. It charges the same interest rates to primary mortgage financial institutions as it would when it borrows funds from investors or issues bonds. This means that there are no extra margins added/charged to shareholder primary mortgage banks of CRH during refinancing • CRH in 2022 established USD 26.8 bn Euro Medium Term Note Programme that has issued high quality secured bonds with high quality ratings. As at January 2023, CRH has 14 bond issues in the market worth USD 18.3 bn, with borrowing costs averaging 1.8% • The total amount of loans granted by the CRH since its creation exceeds USD 106.4 bn, refinancing approximately 82.0% of the French Home Market which has enabled banks to maintain low interest rates standing at 2.1% as at December 2022 • CRH is hailed for its business model which involves minimizing financial risks by aligning assets and liabilities based on current market values, reducing prepayment risk, securing repossession through laws that allow for a security interest in the housing loan, limiting over-collateralization to 25.0%, and strong shareholders support ensuring its members are committed to providing necessary liquidity if needed. CRH also benefits from a strong, legal-specific framework developed over the years that ensures investors protection • Additionally, CRH accommodates both owner-occupation and rental development investments in its mandate towards provision of home loans in accordance to French Housing Dynamics, with rental investments accounting for 14.0% of all home loans • The company's unique set-up and special privileges have ensured a superb risk rating on its bond issuances and a smooth trajectory with no losses or write-downs since its inception
Nigeria Mortgage Refinance Company	• Nigeria Mortgage Refinance Company (NMRC) was incorporated in June 2013 as a public limited liability company registered with the Securities & Exchange Commission (SEC). It is regulated by the Central Bank of Nigeria (CBN) as a non-deposit taking financial institution with the core activity of refinancing mortgages • NMRC specializes in the issuance of Mortgage Backed Securities (MBS) in Nigeria by aggregating mortgage portfolios of partner banks for investors in the capital market to buy. First, in July 2015, NMRC successfully issued a USD 17.3 mn Series I Bond with coupon rate of 14.9% under its 15 year USD 866.2 mn Medium Term Note Programme which was structured as a Residential Pass-Through Bond Program with the benefit of a Federal Government Guarantee, becoming the first Mortgage Refinance Company in Africa to issue bonds to finance its operations. (Pass-through securities are essentially pools of fixed-income securities backed by a package of assets, in this case mortgages) • To further boost liquidity in the country's mortgage market, NMRC again in June 2018, successfully completed a USD 23.8 mn Series II Bond Issuance at a cost of 13.8% which was oversubscribed by 200.0%, and later in 2020 issued its USD 21.7 mn Series III bond, with a coupon rate of 7.2% that was also oversubscribed by 328.0%. NMRC onward lends proceeds realized to primary mortgage banks at 65 bps above the bond coupon rate. With introduction of NMRC, average interest rates were reported to reduce to 18.0% in 2018, from 26.0% in 2015 • So far, NMRC has raised USD 62.3 mn through Bond Issuances from the Capital Market to refinance mortgage portfolios of its member banks. The resulting improved liquidity in the market is empowering mortgage lenders to for the first time give commercial mortgage loans that are payable over 15-20-year periods at significantly lower interest rates per annum • Securitization of mortgages in Nigeria is possible owing to NMRC successful efforts in standardizing mortgage origination and administration processes which has enabled NMRC issue Residential Mortgage Backed Securities (RMBS) bonds • In 2021, NMRC refinanced mortgage loans worth USD 50.8 mn for four banks compared to USD 41.9 mn in 2020. In 2022, the company is reported to have refinanced loans worth USD 72.2 mn • NMRC from 2015 to date issued approximately USD 62.8 mn from the local debt capital market and deployed the same to finance mortgage portfolios of lenders, and has attracted circa USD 168.0 mn worth of financing through multilateral International Development Association (IDA) loans

Based on the aforementioned case studies, the following measures can be put in place to speed up funding for KMRC, and enhance its operations;

i. **Diversify funding sources**: CRH has a diversified funding base, which includes both long-term and short-term bonds, which helps ensure sustainability of funding. KMRC can diversify its funding sources by issuing bonds with both longer and shorter tenors. Longer term bonds can provide a stable and predictable source of funding for KMRC over the long term whereas, short-term bonds can be used to meet immediate financing needs, as they can be issued and redeemed quickly. By issuing both, KMRC can attract a wider range of investors and increase its access to capital, helping to diversify its funding sources. Currently, KMRC only one 7-year tenor MTN issued under its inaugural bond program,

ii. **Innovative Products and Services**: NMRC has established a secondary market for mortgage-backed securities, which allows mortgage lenders to sell their existing mortgages to other investors in the secondary capital market. This has provided mortgage lenders with much-needed liquidity and helped to deepen the Nigerian mortgage market. Securitization presents a plausible channel to raise capital for KMRC. However, the lack of standardization of lending terms in Kenya has been a hindrance to the development of mortgage backed securities market. KMRC had back in 2021 initiated harmonization of the same, however that is yet to materialize. KMRC would benefit from an additional avenue to raise funding and should therefore see to having it implemented,

iii. **Foster partnerships and collaboration with member PMLs**: Support provided by members of the CRH is a key component of the MLFs business model that have contributed to its success. KMRC should prioritize the establishment of a solid solidarity mechanism and foster partnerships and collaborations among its shareholders. This will ensure that all stakeholders have a vested interest in the success of the company and are obligated to regularly contribute to meet its liquidity,

iv. **Increased Transparency**: Many market participants have questions about KMRC's funding model and the sustainability of its lending rate considering its high cost of capital. As such, it would be constructive for KMRC's board and management to come out and address this market concern,

v. **Low Qualifying Amounts**: The low qualifying amounts of up to Kshs 8.0 mn fall below the average mortgage size of Kshs 9.2 mn offered by other financial institutions as at 2021, implying that the uptake of mortgages backed by KMRC will remain low due to this mismatch. KMRC should consider revising the limits regularly to be in tandem with other financial institutions so as to remain competitive,

vi. **Further develop its Legal and Regulatory Framework**: KMRC has failed to accommodate financing of rental development in its mandate despite its significant role in achieving affordable housing. Rental housing is an important component of the affordable housing ecosystem, as it provides a more flexible and accessible option for those who cannot afford to buy a home. Incorporating financing of rental development into KMRC's mandate could play a crucial role in achieving the affordable housing agenda in Kenya by increasing the supply of affordable rental housing, thereby improving living standards,

vii. **Public Education and Increased Awareness**: KMRC should work towards increasing awareness of its existence and its mortgage products to potential home owners through awareness campaigns. Public education is critical in creating awareness of available mortgage products and their demystification. This is likely help in increasing mortgage uptake in Kenya which has remained relatively low partially due to limited knowledge of affordable home financing options,

viii. **Tax exemptions**: Interest earned and profits realized from bonds issued by the JRC are exempted from tax. KMRC should incentivize investors by doing away with tax on the interests and profits realized by their investors. Currently, investors are charged a 15.0% withholding tax, and,

ix. **Green Shoe Option in Bonds**: Lastly, KMRC should consider incorporating the green shoe option, which is an overallotment provision in its subsequent bond issuances. This would allow for the issuer to capitalize on oversubscription rates over and above issued bond amounts if demand by investors is higher than expected, thus allowing the lender to raise more capital.

Section VI: Conclusion

The Kenya Mortgage Refinance Company (KMRC) has made considerable strides towards its goal of enhancing the flow of long-term funds in the Kenyan mortgage industry, and offering affordable financing options to mortgage lenders. The company's efforts to offer mortgages to clients at low interest rates will continue to spur mortgage uptake, leading to an increase in home ownership rates. However, the sustainability of KMRC's funding model remains our primary concern, which we fathom requires attention due to the negative spread between the cost of capital and its lending rate. However, we expect the integration of the SACCO sector will be a vital contributor and key lever in originating and distributing mortgage loans to low-income and informal-income earners in the near future. Moreover, we expect to see KMRC issue more bonds, with a particular emphasis on environmentally friendly green bonds that are gaining widespread popularity globally. This is on the back of the issuer's expressed interest to tap into the Green Market in July 2022, in line with the Kenya Green Bonds Program aimed at encouraging development of affordable green housing in Kenya. Overall, we are of the view that KMRC's role as a refinancing service provider, its ability to provide mortgages at lower borrowing costs, and its support in the growth of the mortgage industry make it a pivotal player in achieving Kenya's affordable housing plan.