REITS ASSOCIATION OF KENYA (RAK)

NEWSLETTER

7TH EDITION JANUARY 2022

RAISING CAPITAL THROUGH A REIT

TABLE OF CONTENTS

Welcome Note from **RAK Chairman**

The 7th Edition of the RAK Newsletter is here.

RAK is committed towards improving transparency and providing quality research and information to local, regional and international investors. In line with this, the theme of this newsletter is "Raising Capital through a REIT", where we share professionally researched and authored articles that could be beneficial to organizations that are considering establishing REITs. Firstly, we investigate the technical side of raising capital through a REIT, where readers will be able to gain understanding of the origin and purpose of REITs, types of REITs and approaches to raising capital through a REIT.

Additionally, we dissect the Unquoted Securities Platform (USP), and explain why potential REIT issuers should be considering listing through the USP, over listing directly on the main board. Lastly, we feature a case study of the newest kids on the block – the Acorn REITs. What can potential REIT issuers and investors learn from Acorn's journey to the culmination of the REITs launch? Read more about this from page 20.

On the events front, we partnered with ILAM Fahari I-REIT, Acorn and the Nairobi Securities Exchange to Host a Media Breakfast and Training on Tuesday 13th July 2021, from 7am to 9am at the Nairobi Serena Hotel. The event was aimed at engaging with editors of leading Business Publications with the aim of continuing targeted market education on the growing REITs Sector in Kenya. Moreover, we partnered with Octagon Africa on the 9th Annual Property Investment Conference which took place from 27th – 29th October 2021 in Diani, where we made a presentation on REITs and explained alternative investment opportunities available to pension funds.

I would like to highlight RAK's dedication to partnering with like-minded organizations to catalyse knowledge transfer and learning experiences. We have entered into a Collaborative Agreement with the University of Nairobi (UoN), which is mainly aimed at building RAK's research capabilities with the goal of building the Association's capacity to become an authoritative source of research and data on REITs and Real Estate investments.

In conclusion to my welcome remarks, I urge interested corporates, government agencies, associations, academic institutions and professional individuals to join the RAK membership: https://rak.co.ke/join-rak

Thank you for continuing co-operation.

Welcome and enjoy the read!

Kenneth Masika

RAK CHAIRMAN

THE TECHNICAL SIDE OF RAISING CAPITAL **THROUGH A REAL ESTATE INVESTMENT TRUST (REIT)**

TRIPLEOKLAW ADVOCATES

On September 14, 1960, President Dwight D. Eisenhower signed legislation that created a new approach to income-producing real estate investment – a manner in which the best attributes of real estate and stock-based investment are combined. REITs brought the benefits of commercial real estate investment to regular citizens of the state – benefits that had previously been available only through large financial intermediaries and to wealthy individuals. The original legislative intent was that REITs would be an inclusive approach that would allow all Americans to enjoy the benefits of investing in high-quality commercial real estate. The REIT approach to real estate investment has been refined and enhanced over the ensuing years, but this goal of inclusivity remains at the core of the REIT model. Research by the National Association of Real Estate Investment Trusts (Nareit) shows that REITs have fulfilled this promise. Today, approximately 145 million Americans live in the roughly 43% of American households that own REIT stocks,

> **"REITs brought the benefits of commercial real estate investment to regular citizens of the state – benefits that had previously been available only through large financial intermediaries and to wealthy individuals"**

directly or indirectly through mutual funds, ETFs or target date funds. The popularity of REITs in financial markets is not without reason. Historically, REITs have delivered competitive total returns based on high, steady dividend income and long-term capital appreciation. Their comparatively low correlation with other assets makes them an excellent portfolio diversifier that can help reduce overall portfolio risk and increase returns.

For the Republic of Kenya, REITs present a unique funding opportunity. The rapid growth of the population in Kenya has caused an unprecedented boost in housing demand. The estimated demand for housing

[1] Nareit is an American trade association that deals with real estate investment trusts (REITs) and serves as the industry's voice to policymakers, investors and the general public.

What are Real Estate Investment Trusts **(REITS)?**

in 2010 was 206,000 units (124,000 in rural areas and 82,000 in urban centres). Despite this increase in demand, there exist limited funding options to meet this need in the Kenyan economy as the primary mortgage market remains the principal source of funds for housing in the country. REITs thus offer a valuable alternative for developers to raise capital for various real estate projects. The latter is further accelerated by the Kenyan government's current affordable housing agenda, which has set a target for the construction of 500,000 new residential homes for its citizens.

Through the enactment of the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations, 2013, REITs have been introduced into the Kenyan economy. Regulation 2 defines "real estate investment trust" means a trust established in Kenya for investment in real estate but does not include an exempted real estate investment trust. Further, "real estate investment trust scheme" or "REIT scheme" means an arrangement made or established for the purpose of collective investment by persons in real estate for the purpose of earning profits or income from real estate as beneficiaries of a trust which is divided into units in which:

a. persons contribute money or money's worth as consideration to acquire rights or interests to gain the benefits from pooling of funds and the investment in real estate;

b. the persons investing do not have the day-to-day control over the management of the assets of the real estate investment trust; and

c. the assets are managed by an entity; and includes such other arrangements as may be prescribed by the Capital Markets Authority to be a real estate investment trust scheme but does not include an exempted real estate investment trust. Regulation 7 requires that all REIT assets be held in the name and under the control of a trustee for the benefit of unit holders .The REIT Regulations restricts the trustee of a REIT to, inter alia, invest in eligible real estate assets through investment in an Investee LLP incorporated in Kenya which directly owns the eligible real estate and which is wholly beneficially owned and controlled by the trustee in its capacity as the Trustee of the REIT. The Trustee only acts in a fiduciary capacity as trustee of the REIT to protect the interests of the unit holders and does not take part in the day to day management of the REIT. Regulation 54(1) requires a REIT to be managed and administered by a licensed REIT manager whose mandate is prescribed in accordance to the regulations.

Types of REITS

1. Income Real Estate Investment Trusts (I-REITs):

This is a real estate trust that primarily derives its revenues from rental properties. The investors gain through rental income and capital appreciation from the investments undertaken.

The objectives of an I-REIT are generally limited to acquiring long-term investment of income generating real estate, marketing and sale of real estate, retention and management of real estate assets with the objective of earning income, undertaking incidental and connected activities related to the assets of the trust and undertaking development and construction activities.

2. Development Real Estate Investment Trust (D-REITs):

This is a type of real estate trust where resources are pooled together with the goal to develop real estate projects. Once a development has been completed, a D-REIT may be converted to an I-REIT and here the investors may choose to either re-invest their funds, sell, lease their shares or they can choose to sell the developments that have been undertaken.

The objectives of a D-REIT are limited to acquisition of eligible real estate, investment in eligible investment, undertaking of real estate development and construction projects which include but are not limited to, housing and commercial projects. They also market and sell real estate, retain and manage the real estate assets and undertake incidental or connected activities.

3. Islamic REITs:

Regulation 122 states that where it is proposed that REIT securities be issued in respect of a real estate investment trust scheme which is to be offered or in any way represented as an Islamic REIT or Islamic securities, then in addition to complying with the provisions of the Act and these Regulations, the trustee shall:

a. prior to any offer or issue being made, appoint a Shariah adviser to assess the compliance status of the REIT scheme and in the event of the resignation, retirement or termination of such adviser, the trustee shall ensure that a substitute Shariah adviser is appointed as soon as is practicable;

b. in appointing a Shariah adviser, comply with the requirements on any law in Kenya and the views of any Kenyan regulatory authority and may take accounts of the views of any party whose views are influential or accepted as determining or ruling on Shariah principles applicable in Kenya, and

c. together with the REIT Manager, ensure that the Shariah adviser establishes and updates from time to time Shariah guidelines for the assistance of the trustee and the REIT manager and conducts Shariah compliant assessments:

   I. of the terms of the scheme documents and of the REIT securities;

   II. on any real estate asset prior to acquisition or disposition;

   III. of the tenants and changes in tenancy arrangements to ensure that only permissible activities and businesses are conducted by the tenants or if some non-permissible activities are conducted, then the level of such activities falls below the acceptable maximum and by how much;

   IV. on the method and terms of any borrowing or financing to be entered into in respect of the trust;

   V. of any insurance contracts and the parties with whom such contracts or arrangements are entered into; and

   VI. of the proposed method and terms of investment in any eligible assets.

1. The Shariah adviser shall, in addition to any other periodical report required to be prepared by the Authority and matters to be included in semi-annual and annual reports, prepare and submit to the trustee a report confirming compliance with Shariah principles.

2. In the case of an Islamic REIT, the trustee shall request a report from the Shariah adviser confirming that any acquisition or disposal shall not affect the compliance of the Islamic REIT with Shariah principles.

3. The Trustee and REIT Manager shall consult the Shariah adviser whenever required and put in place a reporting mechanism and procedures to ensure that the continuing disclosure obligations under regulation 42 are complied with as regards with the compliance of an Islamic REIT and Islamic REIT securities with Shariah principles.

It is important to note that the Regulations state that a Shariah adviser shall be deemed to be an expert who by virtue of his occupation, religious standing, expertise or reputation combined with his understanding of the Kenya financial sector, capital markets and Shariah requirements as regards finance is accepted by the Authority from time to time as being competent to provide an authoritative statement on the compliance of a real estate investment trust scheme with Shariah law.

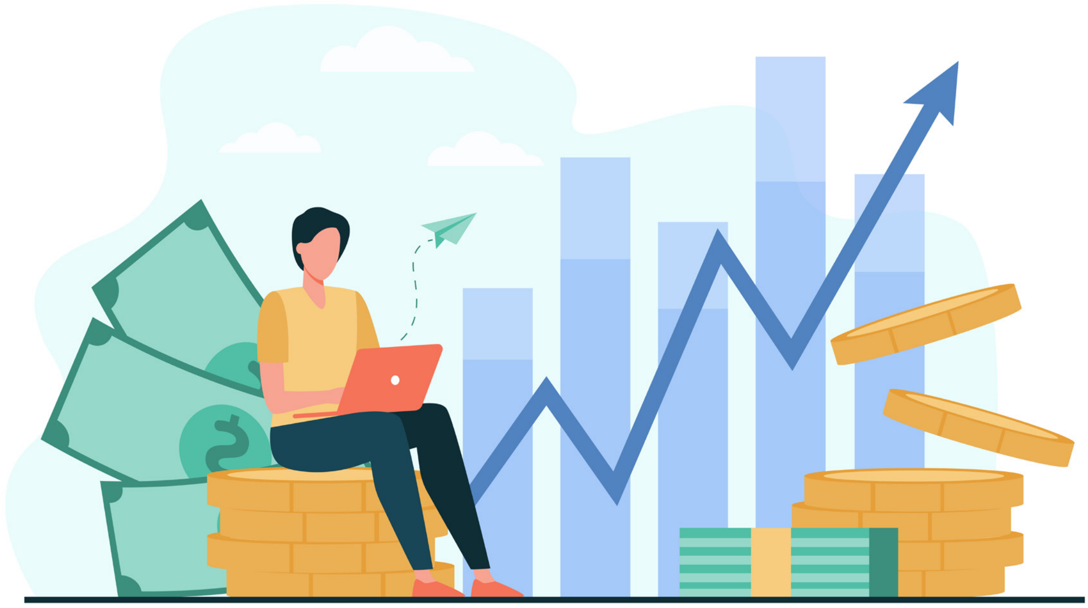
WAYS OF RAISING **CAPITAL THROUGH REITS**

Equity Financing

One of the core proponents of implementing REITs in an economy, especially for property developers is the capacity for REIT structures to raise capital through the issuance of units. In a REIT structure, a unit is a stock-based investment security which acts as an undivided share, right, interest or entitlement in the assets held by the REIT as a whole. Purchasers of units in a REIT scheme are named unitholders, and through the beneficial interest tied to each unit, are entitled to any financial distributions made in the REIT as the scheme's beneficiaries. In this manner, units are similar to dividend-paying stocks which offer regular payments to their holders.

Notably, units do not confer an interest in any particular asset held by a REIT. This improves the sustainability of the REIT scheme, as it substantially insulates the scheme against legal risk. Through the sale of units in a REIT scheme, developers can access financing from public markets in order to construct new properties, improve and develop current REIT assets and optimize the management and operation of REIT assets held by the REIT scheme.

Despite the fact that Islamic REITs present an opportunity for developers to access Islamic finance through Shariah-compliant means, an Islamic REIT is yet to be brought to market.



Debt Financing

Debt financing in REITs is yet another advantage which ought to be considered by developers. According to a paper published by the Federal Reserve Bank of Chicago , bank loans to REITs are typically moderately sized two to three year credit lines that are distributed through the syndication market. The normal financing pattern for REITs is to finance real estate acquisitions with unsecured credit and then refinance the debt with common or preferred stock offerings or senior notes and subordinated debentures because they lack the ability to retain much cash (80% of realized income must be distributed to shareholders).

As stated, due to the inability of REITs to retain cash, lenders expect to be repaid from the proceeds of equity or subordinated debt issues. Therefore, a fundamental aspect of REIT lending by banks is focused on a REIT's ability to access the capital markets. In determining a REIT's access to capital markets, certain factors are considered by lenders. These factors include:

- **Experience:**

Lenders prefer REITs with strong operating histories and experience, and penalize companies with poorer expertise and experience.

• Legislation:

Tax considerations play a key role in accessing both local and international finance. Notably, via the Tax Laws (Amendment) Act. 2020, promulgated on 25th April 2020, Kenyan REITs enjoy tax exemptions when transferring properties to a REIT. Further, REIT investee corporations enjoy corporate tax exemption, currently at 25% per annum.

• Complex structure:

If the market has difficulty determining who is ultimately responsible for a project and the true financial picture, lenders can be reluctant to provide financing. Complicated management structures can obscure the true leverage of the organisation.

• Ratings issued from rating agencies:

In order to access financing, especially in a primary financial market such as Kenya, REITs ought to be rated by a reputable rating agency. Despite the fact that ratings are not a substitute for meticulous and professional analysis, a strong rating can stimulate access to longer term debt issued by international financial institutions.

• Asset values:

Rating agencies consider the value of the underlying real estate assets when assigning ratings. A negative outlook for the assets for a particular real estate sector may impact the listing price of REITs investing in these assets and increase the cost of leverage as well.

According to the Regulations in Kenya, through the trustee, REITs can enter into borrowing arrangements subject to the provisions of the scheme documents. The arrangement can be by the initiative of the trustee so as to preserve the value of the assets of the trust and this must be done in the best interests of the REIT security holders. The trustee may also do so on the request of the REIT manager so as to give effect to the objectives of the scheme, to acquire real estate assets, to undertake capital expenditure or to refinance existing borrowing. It is important to note that the trustee is authorized to provide security over the assets of the trust to secure the funds borrowed.

In an I-REIT, the total borrowing entered into by the trustee or by any REIT investee company or investee trust cannot exceed, in aggregate, at the time the liability is incurred, thirty five percent of the total asset value of the trust. However, the limit of the total borrowing does not prevent the rolling over or refinancing of any debt and the amount rolled over or refinanced should not be more than the amount originally borrowed. The above notwithstanding, the trustee may, on its own initiative or on the recommendation of the REIT manager and with the approval of REIT security holders by way of an ordinary resolution, borrow up to a maximum of forty percent of the total asset value of the trust for a temporary purpose for a term not exceeding six months. The latter limit varies in D-REIT schemes whereby the trustee, with the approval of REIT security holders by way of an ordinary resolution borrow or enter into a financing arrangement of up to a maximum of seventy-five percent of the total asset value, for a temporary purpose for a term not exceeding six months.

Conclusion

As Kenya continues to unravel the potential which REITs represent, one can only be excited at the myriad possibilities which may source from the adoption of the REIT model by developers in Kenya's real estate market. Further, the promulgation of the Finance Bill 2021, which introduced various tax incentives has created the unique opportunity for local and international real estate developers and financiers to utilise REITs as an efficient vehicle to turbocharge the growth of both the real estate and financial markets in Kenya.

Post-coronavirus, we believe that the REIT model and its various benefits, particularly its capacity to unlock both local and international capital for the development of various types of real estate will be a staple of Kenya's financial markets. It is essential to consider that one of the core challenges facing the adoption of REITs is the lack of understanding of the REIT model and its benefits by both retail and sophisticated investors in Kenya. The efforts of the REITS Association of Kenya in sensitizing the general public regarding the existence and benefits of REITs will enable Kenya's financial and real estate markets a great deal by educating Kenya's investing public.

STERLING REAL ESTATE ADVISORY

HOW REIT ISSUERS CAN BENEFIT FROM **THE UNQUOTED SECURITIES PLATFORM (USP)**

Authored by: Elizabeth Njenga, CFA - Acting CEO Sterling REIT Asset Management Limited and **Davis Gathinji** – Research Analyst, Sterling Capital Limited

INTRODUCTION

- The Unquoted Securities platform (USP) is an automated solution for the trading of securities of unquoted companies. The platform offers trading and information services as well as enables company's access to capital markets for long term funding through private placements.
- Companies that can list shares on the USP include: REITs, commercial banks, insurance companies, Co-operative societies and private companies.

- With respect to REITs, presently, the Nairobi Securities Exchange (NSE) has the ILAM Fahari IREIT on the main board and the Acorn I-REIT and D-REIT listed on the USP.

BENEFITS OF THE USP PLATFORM TO ISSUERS

- Access to a wider pool of domestic and international investors who did not have access to company's securities in the manual OTC market.

- Flexible listing and regulatory compliance.
  Automated trading infrastructure for issuer's securities reducing time and costs involved in facilitating trades.

- Issuers can benefit from price discovery and exit mechanism in an automated market.

- Enhanced liquidity of company shares through access to an integrated system that can match orders.

- Access to a wider number of trading participating agents as opposed to a single broker per counter, leading to increased liquidity of trades.

BENEFITS OF THE USP PLATFORM TO INVESTORS

- Convenient and cost effective transfer of securities.
- Increased liquidity and execution speed for trading of securities of quoted companies.
- Efficient access to market information.
- Increased transparency for investors as daily reports with bid-offer prices will be generated.
- Settlement delays and settlement failures are avoided since funds are held by a custodian who confirms availability of funds before settlements is done.
- Automated transactions processing eliminates possibilities of human errors associated with manual processing.
- The system allows surveillance by the exchange and the regulator. This makes reporting by market participants simpler and faster.

REITS IN KENYA

- The regulatory framework for REITs was launched in Kenya in 2013 and has thus far yielded two listings, namely; ILAM Fahari (I-REIT) which is listed on the main board and Acorn (I-REIT and D-REIT) which is listed on the USP.

- ILAM (Formerly Stanlib Fahari I-REIT) listed in 2015 having raised KES.3.6Bn through its IPO offering against a targeted amount of KES.12.5Bn (minimum success threshold of KES.2.6Bn). The REIT listed at a share price of KES.20, boasting of revenues in excess of KES.300Mn per annum and an asset base of KES.3.7Bn.

- The I-REITs revenue has seemingly stagnated, having only grown to KES.350Mn in 2019 before declining to KES.324Mn in 2020. It is however worth noting that the REIT has grown its net profits by a CAGR of 9% (from KES.106Mn to KES.148Mn) within the same period while its asset base has expanded to KES.3.9Bn.

- Regardless of this, given the REITs high listing price and relatively low dividend payout ratio, the REIT currently trades at KES.6.16 (As at 8th December 2021) which is a 69.2% decline from its listing price of KES.20

- On the other hand, Acorn holdings listed both a D-REIT and an I-REIT on the USP platform in 2021. The listing raised KES.2.1Bn against a targeted amount of KES.7.5Bn representing a 28.4% subscription rate (minimum success threshold of KES.754.4Mn).

- Acorn's D-REIT boasts of a total asset value of KES.6.1Bn, mainly comprising of assets in investment properties whereas the I-REIT has KES.3.5Bn in total assets driven by KES.3.4Bn in student housing properties.

- The D-REIT posted a net profit of KES.26.9Mn in HY2021, whereas the I-REIT reported a profit of KES.141.3Mn. Both the D-REIT and I-REIT begun trading at a share price of KES.20 and have since appreciated to KES.20.18 and KES.20.62 respectively (As at 8th December 2021).

- With regard to Acorn holdings, the company sought to have its listings on the USP rather than the main board for a number of reasons;

1. To reduce the level of scrutiny accorded to the company.

2. To ensure that accredited investors (who would see and understand the long term value of the company) would participate in the listing thereby increasing the value of the listed units.

3. The platform offers flexibility in listing requirements and obligations.

Benefits of the USP Platform over the Main Board

The USP provides numerous benefits to both issuers and investors.

Benefits to the Issuers

Some of the benefits accruing to those listing on the platform include;

1. As an exit market, it stands to open up the private equity market since it provides an easy exit solution to investors in private companies.

2. Enables the company to remain private while enjoying the benefits of a listed company such as share price discovery.

3. Increases the company's liquidity and potential pool of investors which serves to increase the value of the company while it remains private.
4. Offers flexibility with regard to listing requirements and obligations unlike the main board which is subject to stringent listing requirements.

5. Reduces the level of scrutiny accrued to company's which is a benefit to companies that want to keep their affairs private.

Benefits to Investors

Benefits that accrue to investors who choose the USP over the main board include;

1. Helps to increase the potential pool of investments an investor can allocate their capital to since it opens investors up to private companies.

2. Exposes investors to new companies that they otherwise would have been unable to invest in since investments in private companies require large capital outlays that are out of reach to the average investor.

3. Helps investors in private companies to reduce or increase their investments within said companies with ease.

Unquoted Securities Platform (USP) Fees

	USP
Transactional Costs	✓ Application fee: KES. 5,000 ✓ Initial Admission fee of 0.03% of the outstanding amount subject to a maximum cap of KES. 500,000 and a minimum of KES. 150,000 will be payable to the NSE. ✓ Annual Service Fee 0.015% of the outstanding amount subject to a maximum of KES. 250,000 and a minimum of KES. 100,000. ✓ USP Secondary Transfer/ Per Transaction 1.5% of the transaction value on both buy and sell side to the trading participating agents. ✓ 1% of the transaction value to the Platform administrators ✓ Fundraising Fees 0.50% of amount raised. ✓ Financier Initial access fee of KES. 100,000.00 0.5% of amounts funded ✓ Settlement custodian 0.5% of the amounts transacted on both buy and sell side. Other bank charges (APIs, RTGS) will be dependent on the amounts and as per the bank rules ✓ Stamp duty that is paid by the purchaser or transferee of the units; capital gains tax is applicable on transfer of shares between unit holders.
Tax benefits	Exempted from corporation and income tax subject to approval except for the payment of withholding tax on interest income and dividends.
Time to listing	1 – 2 months
Regulations	Minimal

USP Admission Procedure

Submit a completed Application Form as per the terms and conditions, providing the following: –

a) full legal name of the applicant, and any trading names as may be applicable;

b) the address of the registered office;

c) the details and qualifications of the applicant's Board and Management;

d) description, history and outlook of the Applicant's business;

e) the Transaction Advisor's Application Letter on behalf of the Applicant.

f) the amount of the authorized share capital of each class of and number of USP securities in each class

g) the abbreviated name of the Issuer; and

h) the full name and physical address of the Transaction Advisor, and all other parties involved in

i) the Issuer's admission onto the NSE LLP.

j) Any other document that may be required by the management committee to assist in the admission process.

k) Submit audited annual financial statements for minimum one year or as maybe determined by the Management Committee Provide the following: -

- Board resolution authorizing the Applicant to list;
- Certified copies of incorporation documents;
- Certified copies of any applicable licenses;
- Non-refundable application fee; and
- An undertaking to pay annual admission fees and any other fees as may be prescribed

Any other documents that maybe required by the Management Committee.

The NSE LLP shall process the application and provide feedback within twenty-one (21) calendar days of receipt of the application.

Upon successful admission of the USP securities, the NSE LLP shall issue a certificate of admission.

USP Continued Issuer Obligations

An Issuer shall: -

a) disclose all material information;

b) publish audited annual financial statements within 4 months of the Issuer's financial year-end

c) through electronic or any other means as be convenient to the issuer.

d) submit a copy of the notice of its AGM or EGM at least three (3) business days before its

e) publication.

The Issuer shall ensure that any statement, document or other information published is not misleading, false or does not omit any material facts.

Where an event of default occurs, the Issuer shall notify the NSE LLP in writing within 24 hours of such an occurrence, providing full details of the event including remedial actions and shall communicate the same to investors.

For the purposes of this sub-section, events of default include:

a) failure to distribute declared dividends in accordance to the published timetable;

b) non-payment of interest or failure to make interest payments on USP securities in accordance with the published timetable; or

c) removal or the resignation of an underwriter.

Where the NSE LLP becomes aware of any event of default, the NSE LLP may carry out investigations into such event of default and shall direct the defaulting party to implement any corrective action it deems appropriate.

As soon as is reasonably practicable, the Issuer shall notify the NSE LLP of: -

a) any change in the Issuer's professional advisors;

b) any change in the board composition or management of the Issuer;

c) any change in the Issuer's name and address;

d) any changes in the terms and conditions applying to a corporate action carried of the Issuer;

e) any Board resolution authorizing the Issuer to issue additional USP securities in the class already

f) issued and causing the authorized capital to exceed the initially disclosed quantum;
g) any changes to the terms and conditions of USP securities in issue; or

h) any intention to alter the authorized or quoted USP securities, as may be permitted by the Issuer's

i) constitutive documents or by resolution of shareholders providing comprehensive details of such

j) intention including the date of effect, the amount to be so reduced and the balance upon alteration.

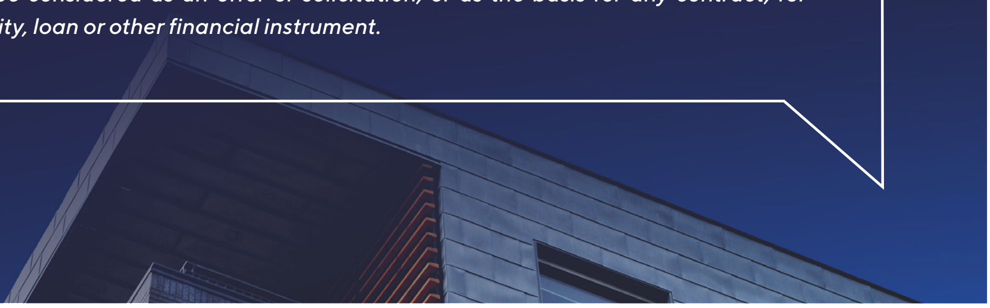
k) Any other information that may be deemed material.

Where an Issuer is contemplating actions that may influence the price of its USP securities or where the Issuer acquires knowledge of the leakage of any material price sensitive information, it must publish a cautionary announcement advising investors to exercise caution when dealing in the USP securities until full details regarding the matter are announced.

Issuers contemplating a significant transaction shall publish a detailed notice of the proposed transaction or corporate action and fix in advance the record date for determining investors' entitlements.

Source: Nairobi Securities Exchange (NSE) USP Brochure and USP Operational Guidelines.

Disclaimer:
This report has been prepared by Sterling real estate advisory for restricted distribution. Neither STREAD nor any of its affiliates and/or officers, employees shall in any way be responsible or liable for any losses or damages whatsoever which any person may suffer or incur as a result of acting or otherwise relying upon anything stated or inferred in or omitted from this presentation. This presentation is for information purposes only and is based on information provided from sources that STREAD belives to be reliable, but no representation is made that it is accurate or complete and no information herein should be relied upon as such. Opinions and projections found in this presentation reflect our opinion as of the presentation date and are subject to change without notice. This presentation is neither intended nor should be considered as an offer or solicitation, or as the basis for any contract, for purchase of any security, loan or other financial instrument.



ROUTE TO MARKET FOR A SUCCESSFUL REITS ISSUANCE: CASE STUDY – ACORN STUDENT ACCOMODATION REITS

acorn

Authored by: Wangui Maranga-Okello, Executive Director, Acorn Holdings Limited

Since the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations were gazetted in 2013, there had only been one Income REIT issued in Kenya (the ILAM Fahari I-REIT), until February 2021.

In what was certainly a challenging environment; in the midst of the COVID-19 pandemic, Acorn Holdings Ltd successfully launched two REITs in February 2021; the world's first Development REIT, the Acorn Student Accommodation D-REIT (ASA D-REIT), and the region's second Income REIT, the Acorn Student Accommodation Income REIT (ASA I-REIT), at a total Net Asset Value of KES 7.6 billion. The REITs attracted both local and international capital from pension funds, insurance and reinsurance companies, high net worth individuals and anchor investor, Infraco Africa.

Despite the corporate failures in the recent years that slumped investor confidence in the capital markets, it is evident that demand exists for well-structured asset-backed securities, as was demonstrated first by Acorn's issuance of Africa's first green housing bond in October 2019, that raised KES 4.3 billion, and subsequently with the REITS issuance.

The ASA D-REIT is the investment vehicle that develops Purpose Built Student Accommodation (PBSA) properties from land acquisition to construction and completion. Once the assets have achieved stable occupancy, they are sold to the ASA I-REIT on a commercial arms-length basis, providing D-REIT investors with attractive capital gain returns.

The ASA I-REIT on the other hand, holds the income generating PBSA rental units on a long-term basis to give investors steady dividends and capital appreciation over time.

Acorn made a strategic decision to pool its assets into REITS vehicles for a number of reasons:

1. **Tax efficiency:** This model of housing development projects in the D-REIT which are then sold to the I-REIT once completed and stabilised, provides a highly efficient structure for Acorn and 3rd party investors, with no tax friction between the D-REIT and the I-REIT, as provided in the regulations. The REITs assets do not suffer any capital gains tax or stamp duty on sale, nor do they incur any income tax or VAT.

2. **Funding from capital markets:** Capital Markets provide an efficient mechanism for connecting entrepreneurs or businesses with capital from institutional investors and domestic savings. This is done through transparent investment vehicles that are regulated and professionally managed thereby giving investors protection, good returns and liquidity.

3. **Diversification:** For the same amount of investment made in one building, investing in a REIT spreads one's investment over multiple properties, tenants, locations and markets, providing long-term return stability and sustainability.

WHAT CAN POTENTIAL REITS ISSUERS AND INVESTORS LEARN FROM ACORN'S JOURNEY TO THE CULMINATION OF THE REITS LAUNCH?

These were Acorn's learnings:

1. **Strong sponsor:** The REIT promotor requires vast in-house experience and expertise in real estate investments, complemented by a track record in operations and management.

2. **Sponsor stake:** A significant investment in the REIT shows that the promotor has sufficient skin in the game to give investors comfort that their interests are aligned.

3. **Robust real estate platform:** Acorn has deployed significant resources in its integrated real estate platform, which is necessary for its business model, providing end to end delivery capabilities for the group's development management, property management and investment management operations.

4. **REIT management fees:** To align investor interests with the REIT manager, the fee structure needs to be skewed towards performance. Investors prefer a low management fee to cover overhead costs, with a performance fee (also known as carried interest) that is earned above a stated preferred return.

WHAT CAN POTENTIAL REITS ISSUERS AND INVESTORS LEARN FROM ACORN'S JOURNEY TO THE CULMINATION OF THE REITS LAUNCH?

(Continued)

5. **Deal pipeline:** Access or control of high-quality deal pipeline of development projects or income generating properties gives investors visibility of future scale and return potential.

6. **Risk-return trade-off:** REITs with investments in several good quality assets offer diversification and compelling risk-adjusted returns to investors.

7. **Listing on day 1:** REITs need to build a track record of dividend/distribution pay-outs and achieve scale before listing. Without this, the market is likely to significantly discount its market value to NAV. It is for this reason that the two REITS will initially trade on the Unquoted Securities Platform at the Nairobi Securities Exchange until the two objectives of scale and dividend track record are achieved.

8. **Investment Policy:** A REIT's investment strategy and policy needs to be clear and specific with regards to the assets that are eligible to be invested in by the REIT. This could be in terms of sector, location, expected returns, size, occupancy levels, etc. This makes forecasting and valuation easier for an investor, thus making the REIT a more attractive investment option.

Acorn Holding Ltd.'s CEO, Edward Kirathe, aptly put it during the launch of the Acorn REITS in February 2021 when he said, *"The Real Estate investment space is by and large an unregulated space and many Kenyans have fallen prey and sunk their hard-earned savings into Real Estate projects and investments promoted by sponsors who have no expertise or experience. They lure their targets using highly opaque investment vehicles with the promise of out-sized returns. As a result, the Real Estate landscape is littered with the wrecks of these entities that have taken down billions in savings that could have generated substantial wealth for Kenyans. The Capital Markets can be part of the solution, because, when they work well, they offer transparent investments that are regulated and professionally managed thereby giving investors protection, good returns and liquidity"*

Joint Media Breakfast Forum

Kenneth Masika, Chairman of the REITs Association of Kenya

Geoffrey Odundo, Chief Executive Officer of Nairobi Securities Exchange

Einstein Kihanda, Chief Executive Officer of ICEA LION Asset Management

Raghav Gandhi, Managing Director of Acorn Investment Management Limited (AIML)

FA. David Kanyi, Former Manager Product Development and Uptake at Capital Markets Authority- Kenya

***From left to right:** Hilda Njoroge, RAK Secretary/Chair of Membership and Events Committee, Raghav Gandhi, Managing Director of Acorn Investment Management Limited (AIML) and Ruth Okal, Asset and Portfolio Manager at ILAM Fahari I-REIT.*

Highlight of RAK at Octagon Africa 9th Annual Property Investment Conference

RAK Chairman, Kenneth Masika, makes presentation at Octagon Property Investment Conference

RAK Chairman receives token of appreciation from Conference organizers

RAK Partners with the University of Nairobi (UoN)

The REITs Association of Kenya (RAK) has entered into a Collaborative Agreement with the University of Nairobi (UoN) to develop the knowledge repository in Real Estate. The agreement provides a framework for co-operation between the two parties with the aim of developing the real estate industry knowledge repository in RAK, increasing awareness on the real estate industry in Kenya, information and knowledge exchange, providing an opportunity for mutually applied research, among other areas of mutual interest. The agreement is yet another positive step in enhancing synergy between research institutions working closely with industry bodies.

STERLING CAPITAL

A) Nawiri

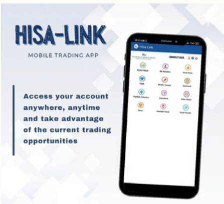
Our Nawiri investment product offers investors a competitive guaranteed return on their investment. The underlying investment assets in Nawiri include Government of Kenya issued Treasury bonds, Treasury bills or Eurobonds. We have two products under Nawiri;

I) Nawiri Kes

This product is backed by the issued Government of Kenya Treasury bonds and Treasury bills. Our current offer for Nawiri Kes is 10.5% per annum with a minimum investment amount of Kes 100,000.

II) Nawiri USD ($)

Nawiri USD brings home closer to you by giving you access to diverse investment solutions with a smaller degree of risk through Eurobonds. The underlying asset is Government of Kenya Eurobonds. Our current offer for Nawiri USD is 4% per annum for 1 Year-1.5 Years with a minimum investment amount of $ 1000.



B) Hisa Link

This is a secure and convenient mobile application that allows clients to buy and sell shares listed on the Nairobi Securities Exchange (NSE). Hisa link can be downloaded from either play store or apple store.

c) Mkopo Dhamana

Mkopo Dhamana is a Swahili phrase which means 'Guaranteed Loan'. Our lending options gives you convenience to borrow against your shares. We have two products under Mkopo Dhamana;

I) Margin trading

Our clients can borrow cash to buy pre-qualified listed shares on the NSE. An interest of 0.1% per day is charged.

II) Loan against shares

Allows clients to borrow money for personal use against pre-qualified listed shares. An interest rate of 0.12% is charged per day with approval in 24 hours.

STREAD

Sterling REIT Asset Management/ Advisory

The primary objective of Sterling REIT Asset Management Limited as a REIT manager is to formulate long-term strategies that will ensure optimum returns for underlying shareholders of real estate assets under management (or REIT assets under management).

Wendy Owade, RAK Senior Administrator

The Exchange, 55 Westlands Road

P. O. BOX 43633 – 00100 (GPO) Nairobi, Kenya | Tel: +254 (020) 283 1000

Email: raksecretariat@nse.co.ke | wowade@nse.co.ke | Website: www.rak.co.ke

@REITSKenya   REITS Association of Kenya

kapudigital.co.ke | biz@kapudigital.co.ke