Kenyan investors must now build strong pillars away from property

Karanja relocated from Kenya to the US to pursue his career in financial management in a different type of market. Upon arrival, he assumed that he could only rent a flat for him and his young family. However, after only a year of building a loan credit history through credit cards, American banks were willing to give him a mortgage.

Excited, Karanja searched for a home around Houston, Texas, America's fourth largest city with a population of 6.1 million. He realised he could obtain a three-bedroom home for as low as Sh8.7 million in a safe neighbourhood. The interest rate totalled only 4.27 per cent fixed for 30 years. A shorter mortgage for 15 years was available at a fixed rate of 3.21 per cent per annum.

Further, he only had to pay Sh69,600 up front to close the deal since the bank financed Karanja at 100 per cent and closing costs such as title registration, and legal fees total less than one per cent of purchase prices in the US compared to four per cent in Kenya. Most American states have no stamp duty; so, he saved again.

Such a home in Nairobi would cost him more than Sh500,000 per month with a mortgage, while Karanja only paid Sh42,891 in the US.

What would warrant such a difference in property prices? The World Bank reports gross national income per capita in the US totals the equivalent of Sh840,360 per month. In Kenya, the figure is Sh516,312.

Following in the footsteps in recent days of Business Daily commentators Wallace Kantai and Carol Musyoka's brilliant pieces, I too wade into the controversial real estate debate. Should Kenyans fear a real estate bubble?

Many indicators in the Kenyan real estate market point to worrying trends: historical doubling of real estate prices in short periods less than 24 months, real estate prices growing faster than gross national income per capita or real wage rates, and the middle class and new home buyers largely blocked from purchasing a dwelling in Nairobi.

Expounding on Ms Musyoka's example, one may only receive Sh75,000 rental income on a flat in Kilimani that cost them Sh15.9 million. A foreign investor would walk at the paltry returns. A rule of thumb in the US, for example, entails rental property owners receiving one per cent of the value of the property back every month in rent. So, a Sh15.9 million flat in Kilimani should yield the owner Sh159,000 per month in rental income. Economists call trends in the “price-to-rent ratio” gaps as one of the key precursors to real estate bubble.

The Kenyan equilibrium does not seem likely to hold. Something must give....but what? Are we inclined in the midst of a real estate bubble?

Japan during the 1980s held the hottest property market in the world. In fact, in one square block of central Tokyo, the combined value of those properties totalled a higher value than the entire worth of the combined real estate prices in the entire US. By 1991, Japan's real estate bubble burst and the effects decimated Japan's economy for the next 10 years in what Japanese call their “lost decade” of flat economic growth.

Then, we all know the more recent examples of property bubbles that popped in the United States and Dubai in the 2008 global financial crisis. Surely the vast majority of Kenyans wish to avoid the terrible economic and societal effects that follow real estate bubble crashes. Which countries do analysts predict are ripe for housing bubbles to burst? China, Australia, Canada, and ...you guessed it ... Kenya.

In response, should we all sell our properties and buy stocks on the Nairobi Securities Exchange, gold, or international bonds instead? I would argue not to act quite yet. Kenya's free market economy of supply and demand has already realised the anomalies. According to the Hass Property Index, property price increases have cooled to low single digits in most urban areas and even slightly negative trends in a few ritzy suburbs. Meanwhile, rental rates have grown in many areas by upwards of eight per cent. The market is correcting for the lopsided statistics.

Further, the World Bank surveyed real estate developers in Kenya, Uganda, Tanzania, and Zambia. Developers in the latter three countries each reported that they built homes and flats to rent them out. Kenyan developers, on the other hand, reported that they built to sell the units. The study confirms what Kenyans already know: real estate stands as Kenyans’ preferred wealth method to store value of their wealth. Europeans desire amenities and stock equities. Russians favour precious minerals such as gold, while Kenyans buy property....and more property. Kenyans land-bank unlike elsewhere in the world. Inasmuch, Kenyans’ demand for real estate remains strong and the cultural property fixation is unlikely to diminish in the short to medium term.

Kenya maintains one of the most sophisticated property markets in Africa. Though frustration boils over at Ministry of Land, most citizens of other African nations would gladly trade their systems for Kenya’s that by and large protects buyers, tracks actual owners, there are court systems to settle disputes, and even obtain financing.

Finally, the Japanese and American real estate bubbles mentioned above were largely fuelled by access to cheap mortgage financing. Kenyans know, however, that obtaining and servicing a Kenyan mortgage is harder than having the dentist pull all of one’s teeth without novocaine to numb the pain. Therefore, with fewer than 20,000 mortgages in Kenya, the African Development Bank estimates that mortgages comprise only 2.5 per cent of Kenya’s GDP, compared to Namibia at 19.6 per cent, South Africa with 26.4 per cent, 50 per cent for Europe, and 70 per cent for the US.

Inasmuch, Kenyan property purchases are fuelled by cash as citizens prefer property of all types and sizes as their preferred store of value. Given Kenyans’ love of property, one should watch out for a mammoth title wave causing a massive bubble if Kenyan banks drop mortgage interest rates down to four per cent and ease application restrictions.

So, I would think twice before buying more property due to paltry returns. However, I would not advise Kenyans to sell their property for fear of impending doom. A rational strategy would likely entail holding the property you already have, but place additional investments into theNSEand diversify some funds into global markets. Debate at #KenyaTop10 on Twitter.

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