FACTORS AFFECTING VOLATILITY OF RETURNS IN REAL ESTATE INVESTMENT IN FREE AREA ESTATE, NAKURU MUNICIPALITY, KENYA

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A RESEARCH PROPOSAL SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION OF KENYATTA UNIVERSITY

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Factors affecting volatility of returns
DECLARATION BY THE CANDIDATE
This research project is my original work and has not been submitted for a degree to any other university.

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D53/CE/14470/2009

DECLARATION BY SUPERVISOR
This research project has been submitted for consideration with my approval as the University supervisor.

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DEDICATION

I dedicate my research work to my parents, dad Dickson and mum Eunice. You give meaning to my life.
I acknowledge the contributions made by different parties towards the success of my research. First, my lecturer, especially Mr. Ongiri and M/s Njoka of Kenyatta University for their content delivery during my coursework. My special appreciation to my supervisor Dr. Ambrose Jagongo for guiding me through my research. Your commitment and positive criticism made it possible for me to finish my research.

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ABSTRACT

Real Estate investment is not the path to easy riches, but it provides a path to wealth creation that is surprisingly available to middle and upper income investors. It is a path that is both available and largely unused. This study therefore sought to investigate the factors influencing volatility of financial returns in the real estate investment in Free Area estate of Nakuru Municipality. The objectives of the study were; to establish the relationship between the duration of holding real property and returns of real estate investment, to determine the effect of cost of funds on the returns of real estate investment, to find out the effect of type of property on the returns of real estate investment, and to establish the effect of the volume of units on the returns of real estate investment. The study was carried out in Free Area estate. The study was carried out using descriptive survey research design. The study population comprised of real estate investors and real estate agents. The researcher used simple random sampling method for real estate investors, and census sampling method for the real estate agents. The researcher first secured an introductory letter from Kenyatta University to carry out the study. The letter was used to apply for permission to carry out the study in the county through Nakuru County Commissioner. The Researcher used questionnaires to collect data from the investors and interview schedules on the real estate agents. Before the actual data collection a pilot study was conducted on the questionnaires and the interview schedule, which involved Test Retest method in an interval of 2 weeks. Their results were then compared and their correlation coefficient calculated to be significant at a Crowbatch alpha coefficient of 0.8. Quantitative data was analyzed using SPSS whereby the responses were tallied and summarized in frequency distribution tables using percentages. Qualitative data was analyzed using inferential statistics and the results were presented using graphs. The researcher found out that volatility of returns in real estate investment in Free Area estate is affected by duration of holding real property, cost of funds, type of property, and the volume of units. The researcher suggests that mortgage firms should increase their financial base to be able to handle more real estate investors’ financial requirements, lower their interest rates, while financial institutions should relax their requirements for real estate investors to qualify for financing. Municipalities’ planners on their part should provide detailed information to investors who wish to invest in their areas.
Definition of Terms

**Portfolio:** The combined holdings of more than one stock, bond, real estate asset, or other assets owned by an investor.

**Prepayment:** Payment of mortgage loan, or part of it, before due date.

**Principal:** The basic element of the loan, as distinguished from interest and mortgage insurance premium.

**Property:** The term used to describe the rights and interests a person has in lands, chattels, and other determinate things.

**Real estate investment trust:** An entity that allows a very large number of investors to participate in the purchase of real estate, but as passive investors. The investors do not buy directly, but instead purchase shares in the REIT that owns the real estate investment.

**Real property:** Land and buildings and anything that may be permanently attached to them.

**Statement of cash flows:** A statement reporting the impact of a firm’s operating, investing, and financing activities on cash flows over an accounting period.

**Tax:** Enforced charge imposed on persons, property, or income to be used to support the state.

**Valid:** Having force or binding forces; legally sufficient and authorized by law.

**Valuation:** The act or process of estimating value; the amount of estimated value.
## LIST OF ABBREVIATIONS

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<td>CD</td>
<td>Certificate of Deposit</td>
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<td>REIT</td>
<td>Real Estate Investment Trust</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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<td>UNCHS</td>
<td>United Nations Commission on Housing and Settlement</td>
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CHAPTER ONE

INTRODUCTION

1.1 Background to the Problem

According to Haight and Singer (2004), investing in real estate is not the path to easy riches, but it provides a path to wealth creation that is surprisingly available to middle and upper income investors. This path is both available and largely unused. Successful real estate investing is hard work, but it rewards those who are willing to do the work. Many elderly have had a comfortable retirement because of successful real estate investments, many students have gone to college funded by successful real estate investments, and many boats and vacation homes have been financed by real estate investments. Such accomplishments cannot be taken for granted. Successful real estate investors must have the skill, knowledge, and energy to find appropriate properties, evaluate them as investments, arrange for financing, and either manage these properties or find a buyer for them.

Even though individuals are primarily motivated to own a home because they need a place to live or like the amenities it offers, home ownership has been a financial boon to many middle-class investors (Wanyeki, 1998). Homes constitute the largest and most profitable asset majority of the people own. To a considerable extent, the economic benefits of home ownership have been incidental to the home’s function as a residence. Commercial real estate investment implies investing in real estate for a specific economic end, to make a profit. It does not matter if the property under consideration is a single-family home, a duplex, a condo or an office building. Purchasing such a property to make a profit makes it a commercial activity. The fact of the matter is that, when many people think about investing today, they think about putting their money into a savings account, buying a certificate of deposit (CD), buying some stock, or buying mutual fund shares. That is unfortunate because they overlook the world of opportunity in commercial real estate. Most people who could or should be investing in commercial real estate fail to do so because they lack the knowledge of how to do it, feel they do not have the money to do so, or they feel it is strictly an area for professionals. While an individual may lack the knowledge of how to be a successful real estate investor, that can be rectified.
Peca (2009) says that investors also diversify by getting into real estate investment along other investments. When one sorely relies on a strategy of investing in equities such as vehicles for wealth creation is a defective strategy because owning different stocks does not mean an individual is diversified. Most stocks are tightly linked to the performance of the overall market. Such investors would have been much better off if they had diversified some of their wealth into real estate. Real estate investment has an excellent public relations team. The opinion in the business sections of newspapers, business magazines, and business radio and television shows focuses on real estate performance and the performance of other individual stocks. This is because attention to the stock market feeds investors, real estate managers, investment banks, mutual funds, researchers, analysts, writers, and personal financial consultants. Portfolios of investing home owners benefit from the inclusion of Real Estate Investment Trust (REIT’s) in their portfolios both in terms of higher return and lower volatility (risk.). While there would not necessarily be a correlation between their performance and a specific commercial real estate investment, such findings are suggestive of the fact that many stock market investors could benefit from diversifying into commercial real estate. In addition, because they are freely traded on the major exchanges, they provide the investor with liquidity, a commodity not readily available in other types of real estate ownership. The first decade of the 21st century will prove itself a great time to invest in commercial real estate. Interest rates have been lowering and inflation has been low. The real estate market appears poised for substantial growth. All these factors point to the fact that this is the right time to buy because this is a situation is likely to continue.

In the late 1980s, a real estate boom was moving toward its peak. Interest rates and inflation were climbing (Berges, 2004). Real estate was widely seen as a way to hedge against inflation. The stock market was declining and when lenders became overextended and the monetary authorities contracted credit, the market collapsed. This was not a good time to buy. Sophisticated investors were selling, while neophyte investors were buying.
By the early 1990s, the real estate market in almost all areas had collapsed. Many commercial real estate developers became bankrupt; a lot of office buildings, hotels, motels, houses, and apartment buildings were sold cheaply. Real estate investors were completely discouraged.

It was a great time to buy, but it required courage and a sound understanding of the real estate markets. Today’s real estate market appears to have moved out of that low environment of the mid-1990s and to be on its way to prosperous times. From 2008 to 2010, interest rates were low, and inflation was high. Capital gains taxes, dividend taxes, and a variety of simulative tax measures created greater opportunities for real estate investors.

Conditions have been created that favor real estate investing, but certainly, there are no guarantees in real estate investment (Worzala et al, 1997). Real estate markets have exhibited great volatility in the past and will undoubtedly do so in the future. However, buying real estate now appears to give the wise investor, the opportunity to gain a foothold for compounding future earnings that constitute the surest form of wealth creation. Buying right requires understanding the basic conditions for success in a particular real estate sector and having the capability of evaluating the financial dynamics of a particular investment opportunity.

Statistics from Nakuru Municipal Council shows that Nakuru is one of the fastest growing towns in East and Central Africa, at an alarming rate of 7% population growth per year, with corresponding spatial expansion along the main transport line, along which it is linking up to the surrounding towns of Gilgil and Njoro, and extending fast towards Nyahururu and Molo (UNHCS, 2009). This expansion is attributed to the move from rural to urban areas in search for job opportunities and the influx of people fleeing from violence in other parts of the country. Residential housing is the largest consumer of space in the municipality. The houses are both private and public owned. Public housing comprises of government houses, corporations and local government to house their staff, while the private houses comprises of housing stock developed by individuals for rental purposes or for their own habitation.
There are at least 6,956 public housing units within the municipality, 5434 of which are owned by the Municipal council of Nakuru and 1522 by the central government corporations (UNHCS 2009). The private sector is the largest provider of housing in the municipality. There are numerous typologies of housing including flats, maisonettes, bungalows, semi-detached, terrace housing, row housing and informal housing.

The spatial structures of housing in the town are based on socio-economic development. It is estimated that majority (87%) of Nakuru residents are tenants, while 13% of them own and occupy their units (DURP, 2008).

1.2 Statement of the Problem

The foregoing background literature portends that as investors migrate from the stock market to the real estate markets, the need for financial analysis is greater than ever. Additionally, Haight and Singer (2004) say that just as buying high flying stocks with no regards to intrinsic values resulted in hundreds of thousands of investors losing their live savings so will buying real estate with reckless disregard to property values result in a similar outcome. Failure to understand the key concepts in the real estate development will almost result in the failure of individual investor. At minimum, it will place them at a competitive disadvantage among those who understand them. While studies by Wanyeki (1998), Berges (2009), Peca (2004) and Worzala et al, (1997) have advised on how to buy and sell real estate, the market is devoid of any works that systematically address the principles of valuation and return measurements as they apply to real estate management. There exist scanty systematically documented studies that outline the determinants returns in real estate investment in Kenya. This study therefore investigated the factors influencing volatility of returns in real estate investment in Free Area estate in Nakuru municipality.
1.3 Objectives of the Study

1.3.1 General Objective of the Study

The general objective of the study was to investigate the factors influencing volatility of financial returns in the real estate industry in Free Area estate of Nakuru Municipality.

1.3.2 Specific Objectives of the Study

The specific objectives of the study were;

a) To establish the effect of duration of holding real property on returns to real estate investment.

b) To determine the effect of cost of funds on the returns of real estate investment.

c) To find out the effect of type of property on the returns of real estate investment.

d) To establish the effect of the volume of units on the returns of real estate investment.

1.4 Research Questions for the Study

The following were the research questions for the study;

a) What is the effect of duration of holding real property on returns of real estate investment?

b) In which ways does the cost of funds affect the returns of real estate investment?

c) Does the type of property affect the returns of real estate investment?

d) How does the volume of units affect the returns of real estate investment?

1.5 Significance of the Study

The study findings will be significant to those investing in income generating properties, aspiring potential investors and current investors intending to divest off their investments at some time. It will also significant to government planners and policy makers to streamline regulatory frameworks and create awareness on sound investment in real estate. Researchers and scholars will also use the gaps left by the study for further research in the area.
1.6 Scope and Limitations of the Study

1.6.1 Scope of the Study

The study was confined to volatility of returns of real estate investment. It was carried out in Nakuru Free Area estate. The study findings are based on real estate investments in 2012 when the study was carried out.

1.6.2 Limitations of the Study

The study had different limitations, for instance some respondents were not available for an interview. Since the researcher had booked for appointment in advance, only those who were available were interviewed for the study. Others hid or distorted important information. In such cases, the researcher respected the answers given by respondents freely. It was also difficult to locate all the sampled respondents. In such cases, the researcher only collected data from those who were available, and used it to generalize the study findings.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this chapter, theoretical and empirical literature is reviewed on; duration of holding real property, cost of funds, type of property, and volume of units, conceptual framework, summary and gaps.

2.2 Duration of Holding Property

To achieve a high level magnitude of investment activity, an investor must have clearly defined goals. The goals you establish will directly impact your financing strategies: Three primary financing elements around which all real estate investment activity centers is time, volume, and the type of property (Wanyeki, 1998). Once the time horizon, has been determined, the rate at which one intend to buy and sell, along with the type of real estate one will invest in, the proper financial instruments may then be put in place. Most real estate professionals incorporate the element of time into their investment strategy. The element of time refers to the duration of the holding period. In other words, it is the length of time a particular piece of investment property is intended to be held. While some investors prefer to adopt a short-term approach by flipping houses, other investors prefer to adopt an intermediate-term approach, which includes buying, managing, and holding rental property for three to five years. Others prefer to purchase office or industrial buildings and hold them for periods as long as 10, 20, or even 30 years.

According to Worzala et al (1997), establishing an investment horizon before obtaining financing is crucial to developing a sound strategy. One must know beforehand if he is going to hold the property for just a short time, for many years, or for somewhere in between, since the variable of time is used to calculate interest rates. Time will also have an impact on whether you obtain a floating rate or a fixed-rate loan, as well as any prepayment penalties that may be associated with the loan.
Wiley (2004), elaborated on the element of time as follows; time can have a significant impact on the growth rate of a real estate portfolio, time affects the tax rate applied to one’s gain or loss. The long term capital gains tax rate has historically been more favorable than the short term tax rate. Time is also the variable in the rate of inventory turnover. Large retailers are willing to accept lower profit margins on items they merchandise in exchange for a higher inventory turnover rate. An investor can accept a lower rate of return on each property bought and sold and earn a higher overall rate of return, provided that the frequency, or turnover rate, is increased. This does not take into consideration transaction costs. These costs may or may not be significant depending on the specific situation, but they must be factored in when analyzing a potential purchase.

Straka (2000) say that investment time horizons typically fall into one of three categories; short term, intermediate term, and long term. Short-term investors are defined as those individuals who buy and sell real estate with a shorter duration. They typically hold their investments less than one to two years. This class of investor most often seeks gains by adding value through making improvements to the property, or by taking advantage of market price inefficiencies, which may be caused by different factors, including distress sales from the loss of a job, a family crisis such as divorce, or perhaps a death in the family. The shorter holding period does not allow enough time for gains through natural price appreciation caused by supply and demand issues or inflationary pressures. The short-term investor may further more seek to profit by using the higher-inventory-turnover strategy and, as a result, may be willing to accept smaller returns, but with greater frequency, thus realizing an overall rate of return considerably higher than the long-term approach. Since current tax codes penalize short-term investors by imposing higher tax rates on short-term capital gains, they must factor this into their analysis before ever purchasing a property. The proper financing mechanism is also a key part of an investor’s analysis. In a short-term strategy, an investor can often take advantage of a loan with a more favorable floating or adjustable rate as opposed to a longer-term fixed-rate loan. In addition, depending on the type of financial instrument procured, principal payments may not be required. This provision allows an investor to minimize his or her outgoing cash flow by making interest-only payments.
Finally, one should be aware of any prepayment penalties that may be imposed on short-term financing. Banks are especially notorious for assessing this additional type of fee income on a loan. Their decision to do so is based on the premise that since the loan is short term in nature, they must charge additional fees to offset their other costs associated with making the loan, such as administrative costs. That argument is to justify charging a loan-origination fee. If one has a good track record and is an established investment professional, prepayment penalties can usually be negotiated down to a minimum and often times will be waived all together.

Intermediate-term investors most often hold their properties for at least two years but no more than five years (Kusienya, 2004). This class of investor typically seeks gains through a combination of increases in property values, resulting from price appreciation due to supply and demand constraints in the local market, and by making modest improvements to the property. Reducing debt to increase cash flow is not as high a priority for intermediate-term investors as it is for their long-term counterparts. This class of investor also tends to be more highly leveraged than do long-term investors. Finally, since intermediate term investors hold their investment properties for a minimum of two years, they are able to take advantage of the lower and more favorable long-term capital gains tax rate. Once again, the proper financing mechanism is a key part of an investor’s analysis. In an intermediate-term strategy, an individual can, like the short-term investor, take advantage of a more favorable floating-rate loan. If the time horizon is firmly established as one that will not exceed five years, using floating-rate instruments is recommended, since they almost always carry lower interest rates than do fixed-rate loans. The exception to this recommendation is, however, that if rates are forecast to rise in the near future, it may be better to lock in a fixed rate now than to run the risk of rapidly increasing rates. Similarly to short-term financial instruments, one may be able to obtain a loan in which principal payments are not required. Depending on the needs of the seller, one may be able to negotiate a deal in which no periodic payments whatsoever are required. This includes both principal and interest.

Long-term investors may purchase real estate properties and keep them for generations (Peca, 2009).
Long-term investors seek gains through capital appreciation by simply holding and maintaining their investments while making improvements on an as-needed basis. They sometimes seek to minimize the associated debt and maximize the cash flow generated by the property through an acceleration of both interest and principal payments. Although in the short term, investors adopting this strategy will decrease the property’s cash flow by making larger monthly payments, they will eventually increase its cash flow by eliminating the debt altogether. As a result, long-term investors are usually not fully leveraged. They generally prefer the positive cash flow to being excessively leveraged. Long-term investors are able to take advantage of the more favorable long-term capital gains tax rates when they do eventually decide to sell. In addition, long-term investors may elect to take advantage of deferring the tax liability indefinitely through a provision outlined. Investors adopting a long-term strategy will most likely desire to insulate themselves from variations that occur in a sometimes volatile interest rate environment by locking in fixed-rate loans at the time of purchase. However, like short-term investors, they can take advantage of more favorable floating-rate loans. Depending on the type of financing instrument used, long-term investors may or may not be subject to prepayment penalties. Some debt instruments, such as conduit loans, carry heavy prepayment penalties in the early years. Conduit loans are reserved for larger income-producing properties and usually have a minimum loan, although smaller loans are available. A complex prepayment penalty is almost always imposed on these types of loans, since the loans are securitized and then sold to investors. The prepayment penalties are used to ensure that investors who buy the loans are guaranteed a minimum yield on their related investment.

2.3 Cost of Funds

The cost of funds is also an element that affects real estate financing and, consequently, real estate value. The cost to borrow funds is expressed in terms of an interest rate and represents the portion of the loan payment that the lender charges for loaning money.
Changes in the interest rate charged to purchase income-producing property have a direct effect on the property’s value. There are three primary appraisal methods, one of which is the income capitalization method. This appraisal method rests on the premise that a stream of income can be converted into a single capital value. If there is a reduction in the stream of income, the capital value must likewise be reduced. An increase to any degree in the cost of funds borrowed would have a negative effect on an investment property’s income stream and would subsequently reduce its capital value. The cost of funds, or interest rate, varies widely among lenders.

Berges (2004) say that both banks and mortgage companies tend to be fairly competitive, as do conduit lenders. Banks typically offer loans for shorter durations and price their loans using the prime lending rate as the benchmark. Mortgage companies, on the other hand, often offer loans for longer durations and price them using an index such as Treasury bills. Likewise, conduit loans are also benchmarked off Treasury bills. The loan is priced according to a spread, which is added to the term of a Treasury note and which corresponds to the term of the loan. In other words, a loan with a 10-year term is priced by adding a spread to a 10-year Treasury note. It takes a small change in the interest rate to have a dramatic impact on the rate of return.

2.4 Type of Property

According to Cole et al. (2003) the type of property an investor purchases affects an investor’s strategy and the returns obtained. Property types that produce income are most commonly classified as single-family, multifamily, or commercial. The type of loan obtained for any real estate property will largely be determined by the type of property being purchased. Financial institutions provide an array of products that are suited for particular investment types. The term single-family property encompasses all real estate with at least one living unit and not more than four living units. In other words, a house, as well as a duplex, triplex, and fourplex, are all classified as single-family properties as far as lenders are concerned.
Because single-family properties are the most common of the three types, mortgages are readily available for them from most financial institutions. Loan provisions for single-family properties will of course vary from lender to lender. By either shopping around yourself or using the services of a mortgage broker, one can easily compare the alternatives available among conventional lenders and select the one that best meets your needs. Conventional bank financing is often available through small local banks. These types of banks may operate with just one or two branches and have a small deposit base.

One primary advantage to using a local bank is that they can often provide borrowers with more flexibility than more conventional sources such as a mortgage company (Gilbert, 1993). Local banks may loan money to purchase a rental property as well as to make improvements to it. Small local banks are also much more likely to be familiar with the local area and would therefore have a greater degree of confidence in the specific market than a larger regional or national lender would. A personal relationship with a local banker is much easier to establish also than with other types of lenders such as conventional mortgage companies. In a local bank where decisions are made in part based upon these relationships, an investor can go into a bank, introduce himself and speak directly with the lender. This affords investors with an opportunity to sell themselves as well as their project. Once a relationship has been established and the banker gets to know a client and is comfortable with him, future loan requests will be much easier and will likely require less documentation, possibly as little as updating one’s personal financial statement. Local banks are one of many sources available to finance single family properties. Additional alternatives one may wish to consider include obtaining a mortgage, using an existing line of credit, or having the seller carry all or part of the note.

According to Ziobrowski et al. (1997), one may also want to consider using an option agreement. Financing for multifamily properties typically involves using a network of institutional lenders or investors different from those mortgage companies that provide financing for single-family properties. The primary criterion that separates the two property types is the number of units. Single-family housing is considered to be anything from one to four units, whereas multifamily properties are those with five or more units.
Wiley (2004), described several of the lending programs available to multifamily investors. Specialty apartment lending programs are designed specifically with the small multifamily investor in mind. They are the product of listening to feedback from investors and have been streamlined and tailored especially for borrowers in the apartment business. In addition, since many lenders focus on the larger-sized loans, these programs were devised to serve a once overlooked segment of the apartment lending business. Interest rates for this type of loan are usually very competitive and typically below prime. Loan amounts vary according to the underwriting guidelines established by each lender.

A variety of terms are offered, including one, three, five, seven, and ten years (Ball et al, 2004). Other advantages of this type of loan include lender fees, which are kept to a minimum, and third-party report requirements, which are often not as stringent. A primary disadvantage of the specialty apartment lending programs is that there is a maximum loan amount usually set. Since this type of loan was designed with the smaller investor in mind, the maximum loan amounts are capped at lower levels. For larger real estate investments such as office buildings, retail strip centers, or large-scale apartment complexes, the financial instruments used become more sophisticated and complex. One common financing mechanism is a conduit loan. Conduit loans are typically originated by large institutional firms, such as insurance companies, which usually have hundreds of millions, or even billions, of shillings in investment capital. Conduit loans apply to multifamily unit financing and differ from conventional bank loans in several ways. First, they are pooled together when a certain amount is reached. They are then securitized and sold to investors who seek to maintain a specific yield or return on their capital. Since the loans are pooled together, it is very difficult to pay off a single loan out of the pool prior to the end of the term, and in many cases, the borrower is prohibited from prepaying the loan.

According to Peca (2009), conventional bank loans, on the other hand, are not securitized but are instead treated as individual loans and maintained and serviced directly by the issuing bank. Another key difference is that unlike conventional bank loans, which are priced off of the prime lending rate, conduit loans are generally priced off of an index such as Treasury notes, which correspond to the term of the loan. A loan with a 10-year term may use the 10-year Treasury as its benchmark.
A spread is then factored into the rate by adding the spread to the 10-year Treasury. Conduit loans also differ from conventional bank loans in the degree of personal liability associated with each type. With conduit loans, there is usually no personal liability while there is almost always full personal liability for conventional bank financing. After completing two or three smaller-scale commercial or multifamily purchases using a more traditional financing mechanism such as a conventional bank loan, one should be ready to accept the challenge of the more sophisticated conduit loans. Conduit loans are designed for investments with a longer holding period and therefore would not be suitable for a fix and flip type of application.

2.5 Volume of Investment Activity

The element of volume is another significant factor that affects an investor’s strategy and the type of financing to be used (Nigel and David, 2002). For example, increasing the volume of units bought and sold, or flipped, increases the investor’s opportunity to generate profits. By the same token, increasing the volume of units bought, managed, and held in a portfolio increases the investor’s opportunity to generate income. Increasing the volume, however, can significantly increase one’s transaction costs, especially if a short-term investor. If the lender charges every time one obtains a loan for a house one is going to flip, the costs for financing can add up quickly and will significantly increase the annualized rate of interest. The best way to eliminate fees of this type is by negotiating with one’s lender for a line of credit. A line of credit will provide one with a predetermined amount of money to draw against to finance not only the purchase of the houses, but also the repair work that will be needed as well. A line of credit is just like a credit card, but with a much higher limit. An investor can borrow as much as needed up to the predetermined credit limit. Since funds are borrowed only as they are needed, this helps to reduce the overall carrying costs the investor might otherwise incur.

As a general rule, Haight and Singer (1997) say that lenders will not extend a line of credit to anyone who does not have a solid financial statement, which includes strong cash reserves. Lines of credit are most often unsecured, which means the lender has no collateral. One can arguably draw the conclusion that lenders must be insecure,
since they always want some type of security. But in reality, lenders just want to protect their interests. When they loan money, they like to get something of value in return to hold as collateral just in case the borrower defaults. With an unsecured line of credit, the lender has no such protection, and that is exactly why it is difficult to get unsecured loans. Although you may not be able to get an unsecured line of credit, one may be able to start with a secured line of credit by offering the lender some type of collateral.

Forms of collateral you may be able to offer include equity in any type of asset you own, such as personal residence, investment property one may own and have equity in, business property such as an office building or equipment, notes payable to someone that are secured by an asset, financial instruments such as stocks, bonds, certificates of deposit, and annuities, retirement accounts, precious metals such as gold, silver, and platinum, personal assets such as boats, automobiles, jewelry, and furnishings (Cummings, 2006). Once investors have proven to a lender that they are capable of repaying loans on a timely basis, the lender may gradually become more comfortable with extending larger lines of credit. This will depend in large part on an investor's own personal financial strength. If lenders determine that particular investors are tapped out and have depleted their cash reserves, those lenders may not be willing to lend them anything. This depends on relationships and trust over an extended period of time.

2.6 Theoretical Literature Review

The present study is guided by the theory of 'demand and supply of commercial property' by MacGregor (1998). The theory considers supply and demand in property markets. First, in the short run the model of supply and demand is presented in the four interlinked markets namely; the user, financial asset, developer and land markets. The model examines the interaction of the factors determining the supply of a good or service, and those influencing the demand for it. The general outcomes are equilibrium prices and quantities, although it is the causal processes by which that equilibrium is reached that are of greatest interest.
When setting up commercial property markets using the model, it is initially necessary to define the meaning of prices and quantities. In the user market, the payments a firm makes in order to use a given amount of commercial property for a particular time period is called building rent. In the present study, the building rent is the full cost to users of hiring commercial space referred to as the cost of funds. The theory agrees on the owner occupied commercial property, which is the cost of use that implicitly constitutes rent often known as ‘imputed rent’. Building rent plays the role that price usually does. It acts as the key signal to agents active in the market, and, through its rises and falls, clears these markets by equating the quantity supplied with that demanded. In the financial asset market, the price of a commercial building is the current estimate of its value. All commercial properties are bought and sold on the basis of a professional valuer’s estimate of their current worth, rather than simply on the basis of a direct trade between buyer and seller. Land costs are determined by the quality or location of the land and the price of land per hectare in that location. The most important limiting factor on the applicability of the model is that it assumes competitive markets.

For there to be full equilibrium in the overall property market, all four submarkets must simultaneously be in equilibrium. Equilibrium is an ideal construct, illustrating the adjustment pressures in a market rather than describing their normal states. This is because, in reality, markets are continuously having to adjust to new conditions of demand and supply, including unforeseen shocks and, thus, are unlikely to be in full equilibrium at any point in time. Processes of disequilibrium adjustment are likely to feature highly in property markets arrangements and conventions such as long leases induce further lags. Adjustment processes in property markets are, therefore, inevitably slower than in many other markets. Rents also tend to be sticky for a variety of reasons. They consequently do not tend to fall rapidly to short-run market clearing levels, whenever there is a temporary glut. This mixture of quantity and price stickiness in commercial property markets makes adjustment in them far longer than in many other markets.
In the present study, returns on real estate investment is determined by factors influencing demand on real property for instance type of property and costs of funds in relation to the supply in real estate investment for instance duration of holding property and the volume of investment. The higher the demand for real estate property like rental houses or plots, the more the plots and houses owners will inflate their prices and thereby discouraging interested clients in the long run. This will force the prices of plots and rent rates to reduce in the long run leading to an increased supply. These changes of demand and supply will go on until an equilibrium level is attained in the property market.

2.7 Conceptual Framework

There are different factors that affect the volatility of returns to real estate investments. This relationship is illustrated in Figure 2.1

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**Fig. 2.1: Conceptual Framework**
Figure 2.1 shows that volatility of returns to real estate will depend on the duration of holding property which is investors do in short-term, intermediate or long term. The cost of funds depends on the financial institutions, for instance while banks offer short-term loans to investors which is more cheaper in the long-term, mortgage companies give them long-term loans which is more expensive in the long-term. The type of property is owned as a single family; multifamily, or commercial properties, and lastly the volume of investment which depends on whether the investor has collateral or depends on an unsecured loan from financial institutions.

2.8Summary and Gaps to be filled by the study

Duration of holding property depends on the investor’s defined goals. Wanyeki (1998) say that time refers to length of time a particular piece of investment property is intended to be held. While some investors prefer to adopt a short-term approach by flipping houses, other investors prefer to adopt an intermediate-term approach, which includes buying, managing and holding rental property for three to five years. Others prefer to purchase office or industrial buildings and hold them for periods as long as 10, 20, or even 30 years. The present study wished to find out how long and why investors in free area are willing to hold their property. According to Worzala et al (1997), time determines whether one obtain a floating rate or a fixed-rate loan, as well as any prepayment penalties that may be associated with the loan. It was therefore important to know whether holding of property affect the type of loans given to real estate investors in Free Area estate. Straka (2000) divided time horizons into short-term investors who buy and sell real estate in less than one to two years. Intermediate-term investors hold their properties for at least two years but no more than five years (Kusienya, 2004). Lastly, long-term investors purchase real estate properties and keep them for generations (Pece, 2009). Investors adopting a long-term strategy will most likely desire to insulate themselves from variations that occur in a sometimes volatile interest rate environment by locking in fixed-rate loans at the time of purchase. The study therefore evaluated the reasons why real estate investors choose the different time horizon in Free Area estate.
The cost of funds is expressed in terms of an interest rate and represents the portion of the loan payment that the lender charges for loaning money. Berges (2004) say that both banks and mortgage companies tend to be fairly competitive like conduit lenders. Banks typically offer loans for shorter durations and price their loans using the prime lending rate as the benchmark. Mortgage companies, on the other hand, often offer loans for longer durations and price them using an index such as Treasury bills. The present study set out to find out the factors that determine the cost of funds for real estate investors in Free Area of Nakuru. According to Cole et al (2003), the type of property an investor purchases affects an investor's strategy and the returns obtained. The study wished to establish the proportions of single-family, multifamily, or commercial properties in Free Area estate and how type of property being purchased determines the type of loan obtained by investors. According to Gilbert (1993) different banks give different loans to investors. Which banks do real estate investors in Free Area rely on, and why?

Lastly, volume of investment activity affects an investor's strategy and the type of financing to be used (Nigel and David, 2002). Haight and Singer (1997) say that lenders will not extend a line of credit to anyone who does not have a solid financial statement, which includes strong cash reserves. In this respect, the study set out to find out whether money lenders require any securities for loans to finance real estates in Free Area, and if they do, which forms of collaterals are demanded from investors.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction
In this chapter, the researcher focuses on the methodology that was used in the studies, which are; study area, research design, study population, samples and sampling techniques, instruments for the study, data collection, testing the validity and reliability of the instruments, and data analysis.

3.2 Area of Study
The study was carried out in Free Area. Free Area is a sub-urban area on the outskirts of Nakuru Municipality, the headquarters of Nakuru County, 0°03’ N and 36°15’E. It is a residential area housing the middle and low income earners of Nakuru Municipality, and is preferred by residents because of its good drainage, nearness to the town and efficient transport and communication being along Nakuru – Nairobi highway and the junction to Nyahururu town.

It has a population of 51,720 in an area of 140 Km². The poverty index of the area is 38% and is characterized by a huge wealth gap between the poor and the rich people (Republic of Kenya, 2007). It is bordered by Section 58 to the west, Ngachura to the north and Pipeline to the south. Its beauty lies in the vicinity of Hyrax hill and Lake Nakuru, especially the flamingoes.

In the real estate parameters of an urban zoning, it can be classified into three distinct zones. There is a commercial area which attracts regular business like shops, open markets, bars and restaurant. There are sections with spacious and well-designed self-contained units, that are dominated by middle income earners units and others are congested low income earners, in most cases semi-permanent houses. The study was carried out in the area since it attracts many real estate agents, being one of the fastest growing estates hosting people from different ethnic, cultural and economic groups, which will be necessary for the study.
3.3 Research Design
The study was carried out using descriptive survey research design. Descriptive survey is ideal for the study because the researcher critically examined the state of affairs as they were at the time of the study (Fraenkel and Wallen, 2000).

3.4 Study Population
The population studied totaled up to 554 respondents comprising of 51 real estate agents and 503 real estate investors in Free Area estate (MCN, 2009).

3.5 Sampling Techniques and Sample Size Determination

3.5.1 Sampling Techniques
The researcher used random sampling method for real estate investors and census sampling method for the real estate agents.

3.5.1 Sample Size Determination
The researcher used random sampling method to select 217 real estate investors using Cochran equation \( n_0 = \frac{z^2pq}{e^2} \). Where \( n_0 \) is the sample size, \( z^2 \) is the abscissa of the normal curve that cuts an area at the tails, \( e^2 \) is the desired precision level, \( p \) is the estimated proportion of an attribute that is present in the population, and \( q \) is \( (1 - p) \). According to Saunders (2009) at 95% confidence level, assuming data is collected from all cases in a sample, the sample size selected is highly representative. All the 51 real estate agents were also studied using census sampling method. The method was ideal because the population was too small to be sampled (Ary et al, 2006). The sampling frame for the study is illustrated in Table 3.1.

Table 3.1: Sampling Frame

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Total</th>
<th>Sample Size</th>
<th>Sample %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate Investors</td>
<td>503</td>
<td>217</td>
<td>43.4</td>
</tr>
<tr>
<td>Real Estate Agents</td>
<td>51</td>
<td>51</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Author, 2012.
3.6 Data Collection
The researcher first secured an introductory letter from Kenyatta University to carry out the study. The letter was used to apply for permission to carry out the study in the county through Nakuru County Commissioner. The introductory letter was used to enable the researcher get permission to carry out the study in the county and to take the constructed questionnaires to the respective respondents. Questionnaires were left behind noting down the agreed time to collect them. Appointments for the interviews with the estate agents offices was made noting down the date and time agreed for each interview. Each agent was then visited on appointment to collect data.

3.7 Data Collection Instruments
The Researcher used questionnaires to collect data from the investors and interviewschedules on the real estate agents. Questionnaires with open and closed-ended questions were administered to the investors. According to Fraenkel and Wallen (2000), the instrument was ideal for the study since it was easy to collect data from a large number of respondents. An in-depth interview was administered to the agents. The instrument provided the researcher with an opportunity to observe the subjects in the total situation in which they were responding.

3.8 Validity and Reliability Tests

3.8.1 Validity of the Instruments
Instruments were first prepared and presented for expert opinion to examine their contentand face validity. The researcher then incorporated the advice and prepared the final copies of the instruments.
3.8.2 Reliability of the Instruments.
Before the actual data collection a pilot study was conducted on the questionnaires and the interview schedule, using Test Retest method in an interval of 2 weeks. Their results were then compared and their correlation coefficient calculated to be significant at a Cronbach alpha coefficient of 0.75. When the instruments were found reliable, they were administered in the actual study but the results of the pilot study were not included in the results of the main study. The pilot study was carried out to ascertain the relevance of the data to be collected, and to explore the problems that were likely to occur during the actual study.

3.9 Methods of Data Analysis
Quantitative data was analyzed using SPSS whereby the responses were tallied and summarized in frequency distribution tables using percentages. Qualitative data was analyzed using inferential statistics and the results were presented using graphs.
CHAPTER FOUR
RESULTS AND DISCUSSION

4.1 Introduction

This chapter covers the results of the data collected and discussions on the data collected. It is divided into; introduction, background information of the respondents, duration of holding of property in Free Area estate, cost of funds used in investments in Free Area estate, type of property in Free Area estate, and volume of investment activity in Free Area estate.

4.1 Background Information of Respondents

The study findings are based on data collected from 202 questionnaires that were returned out of the 217 that were issued to real estate investors which accounts to 93% response rate, and interview schedules conducted on 37 real estate agents out of the expected 51 agents which account to 73% response rate. The reasons for failure to capture all the respondents in the study was because some of the respondents don’t reside in Free Area, others did not turn up for the interview, while others did not return their questionnaires as agreed. The background information of those who responded was summarized in Table 4.1 and 4.2.

Table 4.1

Respondents by Type, 2012

<table>
<thead>
<tr>
<th>Type</th>
<th>Male</th>
<th>%</th>
<th>Female</th>
<th>%</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors</td>
<td>123</td>
<td>79</td>
<td>79</td>
<td>94</td>
<td>202</td>
<td>85</td>
</tr>
<tr>
<td>Agents</td>
<td>32</td>
<td>21</td>
<td>5</td>
<td>6</td>
<td>37</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>155</td>
<td>65</td>
<td>84</td>
<td>35</td>
<td>239</td>
<td>100</td>
</tr>
</tbody>
</table>
Table 4.1 shows that 79% of the investors and 21% of the agents which add up to 65% of all the respondents are male and 94% of the investors and 6% of the agents who adds up to 35% are female. Out of the respondents studied, 79% of the males and 94% of the females totaling to 85% of all the respondents were investors, while 21% of the male and 6% of the female summing up to 15% of all the respondents were agents. From the findings, it can be argued that real estate business is dominated by males who constitute to 65% mainly due to the nature of the investment which demands a lot of time out.

Table 4.2

<table>
<thead>
<tr>
<th>Source</th>
<th>Male</th>
<th>%</th>
<th>Female</th>
<th>%</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>93</td>
<td>60</td>
<td>45</td>
<td>54</td>
<td>138</td>
<td>58</td>
</tr>
<tr>
<td>Business</td>
<td>107</td>
<td>69</td>
<td>84</td>
<td>100</td>
<td>191</td>
<td>80</td>
</tr>
<tr>
<td>Farming</td>
<td>75</td>
<td>48</td>
<td>15</td>
<td>18</td>
<td>90</td>
<td>38</td>
</tr>
<tr>
<td>Real estate</td>
<td>155</td>
<td>100</td>
<td>84</td>
<td>100</td>
<td>239</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>23</td>
<td>15</td>
<td>2</td>
<td>2</td>
<td>25</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 4.2 shows that there were 155 male respondents who represent 65% of all the respondents while, the rest 84 who represented 35% of the respondents were female respondents. Out of these, 60% of the male and 54% of the female respondents who amounted to 58% of all the respondents raised some income from employment, 69% of the male and all the female respondents who amounted to 80% of all the respondents raised some income from business. More so, 48% of the male and 18% of the female, and therefore 38% of the respondents raise income from farming, all the respondents raise income from real estate, and only 1% of all the respondents raise
income from other sources. From these findings, it shows that while all the respondents are bound by their common interest in real estate as either investors or as agents, they also raise income from the other sources. This means that real estate investors and agents engage in other subsidiary activities, especially business and employment, which were indicated by more than 50% of the respondents each.

Figure 4.1: Source of Income by Gender
4.2 Duration of Holding Property

Data collected from the 212 respondents who were investors on duration of holding property was summarized in Table 4.3. The table was summarized by classifying the responses into 3 categories A, B and C using the following key.

Key:

Aims of investing in real estate

A. To get income.
B. To get security in old age.
C. To sustain my social status.

Ways of raising income from real estate.

A. By developing it for rental houses
B. By leasing it out to clients.
C. By selling it at a profit

Time intended to hold property before selling it

A. 0-2 yrs
B. 3-6 yrs
C. Over 7 yrs

Source of finance to develop real estate

A. Personal Savings.
B. Bank loans.
C. Mortgage.

Type of bank financing intended to develop real estate property in future

A. Floating rate loan
B. Fixed -rate loan
C. Mortgage loan
Table 4.3

Duration of Holding Property

<table>
<thead>
<tr>
<th>Issues in duration of holding property</th>
<th>A</th>
<th>A%</th>
<th>B</th>
<th>B%</th>
<th>C</th>
<th>C%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aims of investing in real estate</td>
<td>202</td>
<td>100</td>
<td>50</td>
<td>30</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Ways of raising income from real estate</td>
<td>150</td>
<td>74</td>
<td>27</td>
<td>61</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Time intended to hold property before selling it</td>
<td>23</td>
<td>11</td>
<td>56</td>
<td>67</td>
<td>33</td>
<td></td>
</tr>
<tr>
<td>Source of finance to develop real estate</td>
<td>123</td>
<td>61</td>
<td>94</td>
<td>72</td>
<td>36</td>
<td></td>
</tr>
<tr>
<td>Type of financing to develop real estate property</td>
<td>17</td>
<td>8</td>
<td>68</td>
<td>113</td>
<td>56</td>
<td></td>
</tr>
</tbody>
</table>

Table 4.3 shows that all the 202 respondents who were investor aims at investing in real estate to get income, 50% of the investors aims at getting security at old age, and 15% of them aims at investing in real estate to sustain their social status. From the findings, one can argue that different people in the estate invests in real estate for different reasons. Concerning the duration investors hold property, 11% of the respondents said they intended to hold their property for a short term of 0–2yrs before selling it, 56% of them intended to hold it for medium term of 3–6 yrs, and 33% of them intended to hold it for long term of above 7 yrs. From these findings, one can argue that majority of the investors intend to hold their property for medium term since they would like to get some profits after their property appreciates, while at the same time use the funds to invest further by not holding it for long. For investing in real estate, 61% of the investors get finance from personal savings, 94% get it from bank loans, and 36% of them from mortgage. This means that investors get finances for investment in real estate from different sources of finance, but majority as indicated by 94% of them go for bank loans. Lastly, the investors indicated different future plans of getting income for investing in real estates. Among them, 8% plans to use floating rate loans, 68% of them intend to use fixed-rate loans, and 56% of them intend to use mortgage loan.
From the study findings, one can argue that majority of the investors intend to use fixed rate loans because they are cheaper in the long term as compared to floating rate loans, while mortgage loans have higher interest rates and are influenced by the economic conditions of a country in a given time.

4.3 Cost of Funds

The data collected from the 212 investors on cost of funds of their investments in Free area estate was summarized in Table 4.4 and Table 4.5.

Table 4.4

<table>
<thead>
<tr>
<th>Funds for investment</th>
<th>Investors</th>
<th>Cost of funds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F</td>
<td>%</td>
</tr>
<tr>
<td>Shylocks Loans</td>
<td>25</td>
<td>12</td>
</tr>
<tr>
<td>Bank Loans</td>
<td>189</td>
<td>94</td>
</tr>
<tr>
<td>Mortgage Loans</td>
<td>72</td>
<td>36</td>
</tr>
</tbody>
</table>

Key: F – Frequency  ST- Short-term  MT- Medium-term  LT- Long-term

Table 4.4 shows that investors in Free Area estate use 3 types of funds for their investment in real estate. There were 25 investors who represent 12% of all the investors who get funds from shylocks, 189 of them who represent 94% of the investors go for bank loans, and 72 of them representing 36% who go for mortgage loans. Out of the 25 who go for shylocks, 52% of them go for short-term shylock loans, 28% of them go for medium-term and 20% of them for long-term shylock loans. One can therefore argue that investors prefer short term shylock financing because of their high costs of lending.
For the 189 investors who go for bank loans, 9% of them go for short-term, 22% of them go for medium-term, and 69% of them go for long-term bank loans. One can therefore argue that the longer the repayment period of bank loan, the lower the cost of the funds as preferred by the high number of investors going for long-term bank loans. Lastly, 72 investors who represent 36% of all the investors go for mortgage loans to finance their investments in real estate. Out of the 72 investors, 7% of them go for short-term, 18% of them go for medium-term and 75% of them go for long-term mortgage loans. From the findings one can argue that more investors prefer long-term mortgage funds because since the cost of funds in mortgage is high, the longer the mortgage the more the cost is distributed over the period of repayment.

Table 4.5

<table>
<thead>
<tr>
<th>Funds for investment</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Short-term</td>
</tr>
<tr>
<td>Shylocks Loans</td>
<td>30-35%</td>
</tr>
<tr>
<td>Bank Loans</td>
<td>19-21%</td>
</tr>
<tr>
<td>Mortgage Loans</td>
<td>31-35%</td>
</tr>
</tbody>
</table>

Table 4.5 shows that majority of investors in Free Area prefer to finance their investments using bank loans as compared to mortgage and shylock loans respectively. One can argue that bank loans have lower costs and are easier to obtain as compared to the other two types of financing.
4.4 Type of Property

Data collected on the type of property that is invested on in Free Area was summarized in Tables 4.6 and 4.7.

Table 4.6:

<table>
<thead>
<tr>
<th>Type of Property</th>
<th>Reasons for the property</th>
<th>F</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Family</td>
<td>• Financial constraints</td>
<td>33</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>• Need for residence</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Size of the plot</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Controlled planning</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Multi- Family</td>
<td>• Controlled planning</td>
<td>117</td>
<td>58</td>
</tr>
<tr>
<td></td>
<td>• High returns</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial Property</td>
<td>• Need for business premises</td>
<td>52</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>• High returns</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Controlled planning</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Size of the plot</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.6 shows that 16% of the real estate investors in Free Area prefer single family investment since they have low financial requirement, they need residence in the estate, sizes of their plots are small, and because their plots are located in a controlled development zones. Another 58% of the respondents preferred multifamily units because their plots are located in controlled development zones and due to the high returns to investment in such investments. Finally 26% of the respondents prefer to invest in commercial property units because of high demand and need for business premises, they have high returns, their plots are located in areas designated for commercial units or because of the size of their plot. It can be argued that investors make their investment choices based on different factors given for each type of investment.
Table 4.7 shows that the respondents identified different ways in which the type of property in Free Area estate determines the type of loans they apply for. 82% of the respondents identified overall costs of investing in their property determines, 87% of them identified the rate of returns from their investment in the property, 62% of them identified the period of loan repayment, 73% of them identified size of the investment in their plots, and 77% of them identified use of the property as collaterals to apply for loans. From these findings, it can be argued that the property one invests in is very important for one to consider and qualify for different loan packages.

### 4.5 Volume of Investment Activity

Data collected on the volume of investment was summarized in Table 4.8, and presented in Figure 4.2.

<table>
<thead>
<tr>
<th>Way</th>
<th>Yes</th>
<th>%</th>
<th>No</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall cost of investment</td>
<td>165</td>
<td>82</td>
<td>37</td>
<td>18</td>
</tr>
<tr>
<td>Rate of returns</td>
<td>176</td>
<td>87</td>
<td>26</td>
<td>13</td>
</tr>
<tr>
<td>Period of loan repayment</td>
<td>125</td>
<td>62</td>
<td>77</td>
<td>38</td>
</tr>
<tr>
<td>Size of investment</td>
<td>147</td>
<td>73</td>
<td>55</td>
<td>27</td>
</tr>
<tr>
<td>Property used as collaterals</td>
<td>156</td>
<td>77</td>
<td>46</td>
<td>23</td>
</tr>
</tbody>
</table>
Table 4.8

Volume of Investment Activity

<table>
<thead>
<tr>
<th>Source</th>
<th>Collaterals</th>
<th>Adequate</th>
<th>%</th>
<th>Inadequate</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>• Title deed</td>
<td>165</td>
<td>82</td>
<td>37</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td>• Bank statement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Pay slip</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Log book</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage firms</td>
<td>• Title deed</td>
<td>39</td>
<td>19</td>
<td>163</td>
<td>81</td>
</tr>
<tr>
<td></td>
<td>• Pay slip</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>REITs</td>
<td>• Shares</td>
<td>7</td>
<td>3</td>
<td>195</td>
<td>97</td>
</tr>
</tbody>
</table>

Figure 4.2: Volume of investment activity
Table 4.8 shows that all the three common sources of finance do not provide investors with enough funds for investment. Out of the 202 investor respondents, 18% of the respondents find banks inadequate to provide enough funds to complete their investment. For them to qualify for bank loans, they are required to produce title deed, bank statements, pay slips or log books as collateral. 81% of them say mortgage firms require title deeds and pay slips as collaterals but find them inadequate, and 97% of them say that REITs consider ones shares as collaterals for loans, but they also find them inadequate. From these findings, it can be argued that the volume of investment by real estate investors in Free Area is more than available financial institutions can handle alone. In each case, investors are forced to seek for other sources of funds for their investments, but while banks and mortgages are well established in Kenya, the high percentage of respondents who find REITs inadequate could be attributed to the fact that they are not well established in Kenya.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter covers the summary, conclusions and recommendations of the study

5.2 Summary of Findings

The following is the summary of the study findings.

5.2.1 Duration of Holding Property in Free Area Estate

From the study findings, all the investors covered by the study indicated that they were in the business since they aimed at investing in real estate for different reasons. 50% of them aim at getting security at old age, and 15% of them aim at investing in real estate to sustain their social status and 35% invested in real estate as a means to get income. 11% of them intend to hold their property for a short term of 0 - 2 yrs before selling it, 56% of them intend to hold it for medium term of 3 - 6 yrs, and 33% of them intended to hold it for long term of above 7 yrs. The study also revealed that 61% of the investors get finance from personal savings, 94% get it from bank loans, and 36% of them from mortgage. The future plans of getting income for investing in real estates for 8% of the investors is to use floating rate loans, 68% of them intend to use fixed-rate loans, and 56% of them intend to use mortgage loan.

5.2.2 Cost of Funds in Free Area Estate

The study findings show that investors use 3 types of funds for their investment in real estate. In Free Area estate, 12% of all the investors get funds from shylocks, 94% of the investors go for bank loans, and 36% go for mortgage loans. Out of those who go for shylocks, 52% of them go for short-term shylock loans, 28% of them go for medium-term and 20% of them for long-term shylock loans. Out of those who go for bank loans, 9% of them go for short-term, 22% of them go for medium-term, and 69% of them go for long-term bank loans. Lastly, out of all the investors who go for
mortgage loans to finance their investments in real estate, 7% of them go for short-term, 18% of them go for medium-term and 75% of them go for long-term mortgage loans.

5.2.3 Type of Property in Free Area Estate

Data collected on the type of property that are invested on in Free shows that 16% of the real estate investors prefer single family investment since they have low financial requirement, they need residence in the estate, sizes of their plots are small, and because their plots are located in a controlled development zones. Another 58% of the respondents preferred multifamily units because their plots are located in controlled development zones and due to the high returns to investment in such investments. The other 26% of the respondents prefer to invest in commercial property units because of high demand and need for business premises, they have high returns, and their plots are located in areas designated for commercial units or because of the size of their plot.

The type of property in Free Area estate determines the type of loans they apply for in different ways; 82% of the respondents feel that overall costs of investing in their property determines the type of loan, 87% of them identified the rate of returns from their investment in the property, 62% of them identified the period of loan repayment, 73% of them identified size of the investment in their plots, and 77% of them identified use of the property as collaterals to apply for loans.

5.2.4 Volume of Investment Activity in Free Area Estate

Banks, shylocks and REITs do not provide investors with enough funds for investment in Free Area. Out of the 202 investor respondents, 18 % of the respondents find banks inadequate to provide enough funds to complete their investment, since for them to qualify for bank loans; they are required to produce title deeds, bank statements, pay slips or log books as collateral. 81% of them find mortgage firms inadequate since they are required to produce title deeds and pay slips as collaterals, and 97% of them say that REITs consider one’s shares as collaterals for loans.
5.3 Conclusions for the Study

5.3.1 Duration of Holding Property in Free Area Estate

Real estate investors in Free Area got into it as an investment choice, to get income, for security at old age, and to sustain their social status. They hold their property for short term, medium term and long term. Finance for investing in real estate for 61% of the investors comes from personal savings, 94% get it from bank loans, and 36% of them from mortgage, therefore majority of them go for bank loans. Lastly, real estate investors in Free Area plan to get income for investing in real estate using floating rate loans, fixed-rate loans, and mortgage loan but majority of them intend to use fixed rate loans because they are cheaper in the long term as compared to floating rate loans, while mortgage loans have higher interest rates and are influenced by the economic conditions of a country in a given time.

5.3.2 Cost of Funds in Free Area Estate

Investors in Free Area estate get funds from shylocks, bank loans, and mortgage loans. Out of those who go for shylocks, some go for short-term shylock loans, medium-term and long-term shylock loans, but majority of them prefer short term shylock financing because of their high costs of lending. From banks, investors go for short-term, medium-term, and long-term bank loans, but the longer the repayment period of bank loan, the lower the cost of the funds and thus preferred by the high number of investors going for long-term bank loans. Lastly, investors who go for mortgage loans to finance their investments in real estate go for short-term, medium-term and long-term mortgage loans, but majority of the investors prefer long-term mortgage funds because the cost of funds in mortgage is high, and the longer the repayment period for a mortgage, the more the cost is distributed over the period of repayment.
5.3.3 Type of Property in Free Area Estate

Real estate investors make their investment choices based on different factors given for each type of investment. Majority of real estate investors in Free Area prefer multifamily units because their plots are located in controlled development zones and due to the high returns to investment in such investments. Others prefer single family investment since they have low financial requirement, they need residence in the estate, sizes of their plots are small, and because their plots are located in a controlled development zones, while the rest prefer to invest in commercial property units because of high demand and need for business premises, they have high returns, their plots are located in areas designated for commercial units or because of the size of their plot. The type of property one invests in is very important in Free Area estate since it determines the type of loans investors apply for, for instance investors consider the overall costs of investing in their property, the rate of returns from their investment in the property, the period of loan repayment, size of the investment in their plots, and use of the property as collaterals to apply for loans.

5.3.4 Volume of Investment Activity in Free Area Estate

The volume of investment by real estate investors in Free Area is more than available financial institutions (banks, shylocks, mortgage firms and REITs) can handle individually. In each case, investors are forced to seek for other sources of funds for their investments. While banks and mortgages are well established in Kenya, REITs are not. Real estate investors in Free Area find them inadequate in financing their investments. Investors also find banks inadequate since for them to qualify for bank loans, they are required to produce title deed, bank statements, pay slips or log books as collateral, mortgage firms require them to produce title deeds and pay slips as collaterals, and REITs consider ones shares as collaterals for loans.
5.4 Recommendations for the Study

The researcher suggests that mortgage firms should increase their financial base to be able to handle more real estate investors’ financial requirements. They should also lower their interest rates. On the other hand, financial institutions should relax their requirements for real estate investors to qualify for financing. Municipalities’ planners on their part should provide detailed information to investors who wish to invest in their areas. In the course of the study, it was clear that most real estate investors and agents do not maintain proper financial statements for their investments. The researcher suggests that real investors should be encouraged to do this. This will enable them correctly determine the returns from their investments.

5.5 Suggestions for further studies

The research can be replicated to other parts of the country. It can also be extended to factors leading to slow growth of conduit loans and REITs as ways of financing real estate investments in Kenya.
REFERENCES


UNCHS Habitat (2002). *Financing Adequate Shelter for All; Addressing the Housing Finance Problems in Developing Countries*. Washington: UNO.


APPENDIX 1

QUESTIONNAIRE FOR INVESTORS

I am a student at Kenyatta University, and I am carrying out a study on factors affecting volatility of returns in Real estate Investments. The information you will give is purely for academic purposes and no information whatsoever shall be used for other purposes or disclosed to any other purposes. Don’t indicate your name in any part of this questionnaire.

SECTION A: Background Information of the respondents

Fill in the following information in the spaces provided.

1. Indicate your gender
   - Male ☐
   - Female ☐

2. From which of the following sources do you get income
   - Employment ☐
   - Business ☐
   - Farming ☐
   - Real estate ☐
   - Others ☐

SECTION B. DURATION OF HOLDING PROPERTY.

1. What of the following are your aims of investing in real estate?
   - To get income. ☐
   - To get security in old age. ☐
   - To sustain my social status. ☐

2. In which of the following ways do you intend to raise income from your estate.
   - By developing it for rental houses ☐
   - By leasing it out to clients. ☐
   - By selling it at a profit ☐

3. If you intend to dispose it one time, for how long do you intend to hold it before you sell it?
4. If you intend to develop your estate, from which source do you intend to source for finance?

- Personal Savings.
- Bank loans.
- Mortgage.

5. Have you developed another (other) estates?

Yes ☐ No ☐

6. If Yes, did you finance its development using a loan system?

Yes ☐ No ☐

7. If you intend to go for a loan, which type of financing will you rely on, to finance your property?

- Floating rate loan ☐
- Fixed -rate loan ☐
- Mortgage loan ☐

SECTION C: THE COST OF FUNDS

1. Have you obtained funds from Shylocks Loans?

Yes ☐ No ☐

2. How long do they require one to repay a loan in;

- Short term ......................
- Medium term ......................
- Long term ......................

3. Have you obtained funds from Bank Loans?

Yes ☐ No ☐

4. How long do banks require one to repay the following loan;

- Short term ......................
- Medium term ......................
- Long term ......................

5. Have you obtained funds from Mortgage Loans?
6. How long do mortgages require one to repay the following loan;
   • Short term  
   • Medium term  
   • Long term 

7. What is the interest rate charged on your loan repayment for your property?
   • 0-5%  
   • 6-10%  
   • Over 10%  

SECTION D: TYPE OF PROPERTY

1. Would you intend to investment in real estate using a single family strategy?
   Yes  
   No 

2. If Yes, why.................................................................

3. Would you intend to investment in real estate using a multi-family strategy?
   Yes  
   No 

4. If Yes, why.................................................................

5. Would you intend to investment in real estate using a commercial property strategy?
   Yes  
   No 

6. If Yes, why.................................................................

7. Does the type of your property determine the type of loan you apply for?
   Yes  
   No 

8. If yes, in which ways?
SECTION E: VOLUME OF INVESTMENT ACTIVITY

1. Do banks alone provide you with enough credit for the development of your property?
   Yes ☐ No ☐

2. If No, do you go for finance from other financial institutions?
   Yes ☐ No ☐

3. Do mortgage firms alone provide you with enough credit for the development of your property?
   Yes ☐ No ☐

4. If No, do you go for finance from other financial institutions?
   Yes ☐ No ☐

5. Do REITs alone provide you with enough credit for the development of your property?
   Yes ☐ No ☐

6. If No, do you go for credit from other financial institutions?
   Yes ☐ No ☐

7. Which are the collaterals required by these financial institutions in order to extend credit?
   • Title deed ☐
   • Bank statement ☐
   • Pay slip ☐
   • Log book ☐
   • Others............................................................
   ............................................................
   ............................................................
APPENDIX 2

INTERVIEW SCHEDULE FOR AGENTS

I am a student at Kenyatta University, and I am carrying out a study on factors affecting volatility of returns in Real estate Investments. The information you will give is purely for academic purposes and no information whatsoever shall be used for other purposes or disclosed to any other purposes.

Guiding Questions

1. Why do your clients invest in real estate?

2. What factors determine the duration of holding property?

3. What type of funding do your clients rely on to finance their property?

4. What factors determine the interest charged on your clients’ loan repayment for their property?

5. How long do your clients take to repay their loans?

6. Which type of property do your clients invest in?

7. What is the relationship between the type of property and the type of loan that your clients apply for?

8. Which lenders do your clients rely on for the development of their property?

9. Which collaterals are they required for them to secure?