

# **MORTGAGE RATES IN KENYA: IMPLICATIONS FOR HOMEOWNERSHIP**

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## **ABSTRACT**

The mortgage market in Kenya is relatively small compared to international standards having only 15,803 loans. The growth rate has been low since 2006 though with a steady growth of 14% annually but still the growth is below 50%, therefore the loan portfolio remains small. In terms of mortgage debt to GDP ratios, Kenya's ratio is low by international standards. The mortgage debt to GDP ratio is around 50% in Europe and over 70% in US. Kenya's mortgage debt compared to its GDP is better than its East African neighbors, Tanzania and Uganda at just under 2.5% this is an indication that there is still a room to grow for East African countries and more so Kenya which has low mortgage uptake. While the mortgage markets in the United States and Europe have been studied extensively by academics and other researchers around the world, markets outside the U.S. and Europe generally gain much less attention. Particularly, the structure and other institutional aspects of the mortgage markets outside the U.S. and Europe attain a very attention. This study intended to establish the factors behind the low mortgage uptake. The study had the following specific objectives: to determine the influence of mortgage interest rates on the uptake of mortgages; to establish the effect of incomes on the uptake of mortgages; to identify the effect of credit risks of borrowers on the uptake of mortgages, and; to establish the effect of availability of mortgage financiers on the uptake of mortgages. The study design was

descriptive survey. This involved surveying various respondents to find out the factors which contributed to uptake of mortgages. In this study, the population was customers who had taken or was in the process of taking a mortgage from one of the Kenyan mortgage lenders. The sampling technique employed was snowballing which started with a few mortgage borrowers who introduced others. The primary data was collected by means of self-administered questionnaire. The collected data from the questionnaires was analyzed using descriptive statistics for quantitative data and content analysis for qualitative data. Presentation of the analyzed data was in form of tables and graphs. The findings from the study indicate that income levels had the greatest effect on uptake of mortgages followed by interest rates and other mortgage costs. The third most important factor affecting uptake of mortgage was unavailability of credit data and high credit risks. The least important factor affecting mortgage uptake was availability of mortgage facilities and institutions. From the findings of the study, the following recommendations are made. First, low cost housing should be developed to cater to those who cannot afford current mortgages. Mortgagees should also lower mortgage costs to incorporate more customers into the bracket of those who can afford. The study also recommends the mortgagees and the credit risk bureau to improve risk management and efficiency in their operations. Lastly, it is recommended that the players in the market including CMA,

NSE and the various stakeholders should develop a secondary mortgage market.

**Key Words:** *Mortgage rates, Credit risks, level of income, access to mortgage*

## **INTRODUCTION**

Like all markets, the mortgage market is the totality of interactions between suppliers (investors) and consumers (borrowers) with intermediaries (mortgage lenders and brokers) in between, in a framework set by law and regulation (Gramlich, 2007). Changes affecting any of these categories affect the characteristics and effectiveness of the market. Owner-occupied housing is the major asset in many households' portfolios and across a wide span of the life cycle.

Kenya's mortgage market is dominated by the large banks, comprising 90% of the outstanding loan assets portfolio (Ndung'u, 2014). While Kenya's mortgage market is growing, the industry is dominated by the large banks indicating barriers to entry or high risk for medium and smaller banks (World Bank, 2011). However, the growth rates indicate that the small sized banks have the fastest growth rate of 38% on average, followed by medium banks which are growing at 25% on average with large banks closely following at 24% on average.

## **STATEMENT OF THE PROBLEM**

The mortgage market in Kenya has a critical role to play in the achievement of the goals envisaged by Vision 2030 (Republic of Kenya, 2007). Housing construction is a labor-intensive activity that will create jobs for the youth and the unemployed. On the other hand, construction boom has upstream and downstream activities and strong linkages with other sectors of the economy (ADB, 2011). In addition, mortgage market development supports expanding cities with the accompanying productivity gains. Only 23 per cent of the demand for housing in Kenya is being met and a mere 20% of these are affordable to low and moderate income families. According to Were (2012), affordable housing can be that stepping stone. Providing families with the viable opportunity to buy their own homes can generate a virtuous circle that takes them beyond having a roof over their heads (Abelson, 2009).

However, Quarter 1 2014, mortgage report revealed that over 50% of Kenyans cannot afford a mortgage of more than Ksh 700,000. The housing needs of this 50% of the Kenyan urban population who cannot afford a mortgage above Ksh 0.7 million are not met by the mainstream financial and microfinance institutions. In the Kenyan mortgage market, the number of new loans has been rapidly increasing. Since 2006, there has been a steady growth in new loans further validating the growing mortgage market. In 2006, new loans were approximately 1,278 whereas by 2009 the new loan portfolio has grown to over 6,000. By May 2013, the number of new loans was 3,947 which is line with the steady growth seen in the previous years. But the mortgage market is still relatively small by international standards with only 19,803 loans. While

the growth rate in mortgage loans has been rapid at just under 50% since 2006 and has been growing steadily at 14% annually, the loan portfolio remains small (Ndung'u, 2014).

In terms of mortgage debt to GDP ratios, Kenya is low by international standards but is on par with its neighboring peers. Kenya's mortgage debt compared to its GDP is better than its East African neighbors, Tanzania and Uganda at just under 2.5% but is not as developed as its developing country peers such as India (6%) and Colombia (7%). However, the mortgage debt to GDP ratio is around 50% in Europe and over 70% in US indicating there is significant room to grow (World Bank, 2011).

## **GENERAL OBJECTIVE**

To establish the factors that affect the mortgage rates and hence determine mortgage uptake.

## **SPECIFIC OBJECTIVES**

1. To establish the influence of credit rating on the uptake of mortgages in Kenya
2. To determine the effect of incomes levels on the uptake of mortgages in Kenya
3. To investigate the effect of risk profiles of borrowers on the uptake of mortgages in Kenya
4. To determine the effect of access to mortgage facilities on uptake of mortgages in Kenya

## **RESEARCH MATERIALS AND METHODS**

This study adopted a descriptive research design. A survey design as described by Mugenda and Mugenda (2008) is an attempt to collect data from members of a population in order to determine the current status of that population with respect to one or more variables. The researcher adopted this design since it was an efficient method of collecting descriptive data regarding characteristic of a sample of a population, current practices, conditions or needs. Descriptive research design was adopted to describe the state of affairs as it is at present. Descriptive research was relevant since it enabled the researcher to make a general conclusion from the findings (Cooper & Schindler, 2003). The sample of 168 respondents was used from the target population of 362.

The main research instruments that was used in this study were questionnaires. In developing the questionnaire items, the fixed choice and open-ended formats of the item were used. The researcher used questionnaires to collect primary data. The questionnaires were self-administered and distributed to the respondents and reasonable time given before they could be collected. The completed questionnaires were sorted and cleaned of errors. Content validity of the instrument will also established through piloting, where the responses of the subjects will be checked

against the research objectives. This also explains why content analysis will be used. For a research instrument to be considered valid, the content selected and included in the questionnaire must be relevant to the variable being investigated argues Mutai (2000).

According to Joppe (2000), reliability is the extent to which results are consistent over time and an accurate representation of the total population under study and if the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable. Cronbach alpha is the basic formula for determining the reliability based on internal consistency (Kim & Cha, 2002). The standard minimum value of alpha of 0.7 is recommended Malhotra (2004). The theoretical and empirical literature, however, accepts a Cronbach's alpha of 0.4 as minimum Zheka (2006), Beltratti (2005) and Abdulah (2004) in their study adopted the use of 0.4 as the minimum level for item loadings

Data collected was analyzed using both quantitative and qualitative methods with the help of (SPSS) version 20 and excel. The findings were presented using tables and graphs for further analysis and to facilitate comparison. This generated quantitative reports through tabulations, percentages, and measure of central tendency. The researcher further adopted multiple regression model at 5% level of significance and 95% level of confidence to study the strength and direction of the relationship between the independent variables (credit rating, income levels, risk profile of borrowers and access to mortgage facilities) and the dependent variable (uptake of mortgages in Kenya).

The regression equation was expressed as  $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$ , where, Y is the uptake of mortgages in Kenya,  $\beta_0$  is constant (coefficient of intercept), X1 represents Credit rating, X2 income levels, X3 risk profiles of borrowers, X4 access to mortgage facilities,  $\epsilon$  is the error term and  $\beta_1 \dots \beta_4$  are the regression coefficients of four variables.

## **RESEARCH RESULTS**

A total of 168 questionnaires were targeted for the purpose of data collection. Out of these, 150 respondents returned questionnaires giving a response rate of 89.28%. This response rate was sufficient and representative and conforms to Mugenda and Mugenda (2003) states that a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent.

### **Income levels**

The respondents indicated that income needs to be regular. Given the longer duration of a mortgage loan, lenders need to have some certainty that a regular income will be earned over the lifetime of the loan findings concur with Abelson (2009), although the formal private sector is

growing rapidly, this still represents a small proportion of the population. The most secure jobs are probably civil servant functions but there the affordability levels are more restricted.

### Risk profiles of borrowers

The respondents strongly agreed that in order to reduce the lender's credit risk, the lender may perform a credit check on the prospective borrower, may require the borrower to take out appropriate insurance, such as mortgage insurance or seek security or guarantees of third parties, besides other possible strategies. In general, the higher the risk, the higher will be the interest rate that the debtor will be asked to pay on the debt.

### Access to mortgage facilities

The study findings indicated that inaccessibility to mortgage facilities is one of the key issues which have to be addressed on the way to developing the mortgage market and improving mortgage uptake in developing countries. Most lenders in mortgage contracts are sometimes affected by liquidity constraints and struggle with the maturity mismatch brought on by long term lending (Bible & Joiner, 2009).

### Regression Analysis Model Summary

The researcher applied SPSS version 20 to code, enter and compute the measurements of the multiple regressions for the study. According to Green & Salkind (2003) regression analysis is a statistics process of estimating the relationship between variables. Regression analysis helps in generating equation that describes the statistics relationship between one or more predictor variables and the response variable.

**Table 1: Model summary**

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.861 <sup>a</sup>	.741	.731		.0301

Predictors: (Constant), Credit rating, income levels, risk profiles of borrowers, access to mortgage facilities

The coefficient of determination (R<sup>2</sup>) explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Uptake of mortgages in Kenya) that is explained by all four independent variables (Credit rating, income levels, risk profiles of borrowers, access to mortgage facilities).

**Table 1: ANOVA of the regression analysis between Uptake mortgages in Kenya and predictor variables**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	62.654	6	15.9135	24.6732	.0000 <sup>b</sup>
	Residual	18.974	143	.6198		
	Total	81.628	149			

The reports summary ANOVA and F statistic (24.6732) is significant at 0.05 confidence level. The significance value is .0000 and the value of F is large enough to F critical we conclude that the set of independent variables; Credit rating, income levels, risk profiles of borrowers, access to mortgage facilities influence Uptake of mortgages in Kenya. The table shows that the independent variables statistically significantly predict the dependent variable,  $F(4, 29) = 24.6732, p < .0005$ , this shows that the overall model was significant.

**Table 3: Regression Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.898	3.483		2.439	.002
	Credit rating	.753	.388	.002	.535	.001
	Income levels	.763	.288	.017	.311	.000
	Risk profiles	.723	.288	.017	.311	.000
	Access mortgage	.521	.446	.109	.469	.002

a. Dependent Variable: uptake of mortgages in Kenya

From the data in the above table, the regression equation becomes:

$$Y = 2.898 + 0.753X_1 + 0.763X_2 + 0.723X_3 + 0.521X_4.$$

From above regression equation; the study found out that when all independent variables (Credit rating, income levels, risk profiles of borrowers, access to mortgage facilities) are kept constant at zero the uptake of mortgages in Kenya will be at 2.898. At one unit change in credit rating will lead to 0.753 increases in mortgage uptake in Kenya. Also Further a one-unit change income levels will lead to 0.763 increase increases in mortgage uptake in Kenya while a one unit change in risk profiles of borrowers will lead to 0.723 increase increases in mortgage uptake in Kenya. increase in Supply chain performance in manufacturing sector in Kenya. Lastly one unit change in access to mortgages lead to 0.521 increases in mortgage uptake in Kenya. To test for the

statistical significance of each of the independent variables, it was necessary to test whether the unstandardized (or standardized) coefficients are equal to 0 (zero) in the population. If  $p < .05$ , we can conclude that the coefficients are statistically significantly different to 0 (zero).

## **CONCLUSIONS**

The study concludes that lack of affordability of mortgages on the part of prospective customers is a major factor contributing to low uptake of mortgages. Another conclusion from the study is that high credit risk due to absence of credit history is another factor that makes many potential mortgagors not to qualify for mortgage loans. This therefore has contributed greatly to the low uptake of mortgages. However, the study concludes that the introduction of credit reference bureaus will enable banks to access their borrower's information which is crucial at the mortgage appraisal stage.

The analysis of secondary data indicates that income levels have the greatest effect on mortgage uptake in Kenya. Not many members of the population can afford the high mortgage rates. This was followed by other mortgage associated costs. Another factor contributing to low uptake of mortgages is unavailability of credit data thus high credit risks. Availability of mortgage institutions does not seem to be a real determining factor as in the few mortgage finance institutions Kenya has, interest in mortgages is low.

## **RECOMMENDATIONS**

The study recommends that low cost housing should be developed to cater to those who cannot afford current mortgages. Mortgagees should also lower mortgage costs to incorporate more customers into the bracket of those who can afford. The study also recommends the mortgagees and the credit risk bureau to improve risk management and efficiency in their operations. The study also recommends that the players in the market including CMA, NSE and the various stakeholders should develop a secondary mortgage market.

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