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Brian Kitheka Mulli and Mr. Samson Kaplelach

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FIXED COSTS AND THE DEVELOPMENT OF REAL ESTATE IN MOMBASA COUNTY, KENYA

[1*] Brian Kitheka Mulli
[1]Post Graduate Student: Kenyatta University
*Corresponding Author's Email: kitheka14@gmail.com

[2] Mr. Samson Kaplelach
Lecturers: Kenyatta University

ABSTRACT

Purpose: The main purpose of this study was to examine how fixed costs affect developments of real estate in Mombasa County, Kenya.

Methodology: The study adopted the explanatory research design. The target population was the real estate developing firms in Mombasa County Kenya. According to Kenya Statistical Abstracts Issues, there are 25 Property development companies in Mombasa County, Kenya. Sample size comprised of 25 finance managers and 25 marketing managers from the real estate development firms. The study used questionnaires to collect the required data. Descriptive statistics was used mainly to summarize the data. SPSS was used for analysing complex data. The descriptive analysis involved the use cross tabulation and frequency distribution tables. Regression analysis was used to establish the relationship between the independent and dependent variables.

Results: The study findings revealed that there was a positive association between financing costs, legal costs, labour costs and administrative costs and the development of real estate in Mombasa County. The study results finally indicate that only labor cost had a significant influence on the development of real estate

Policy recommendation: The study recommends that there is a need for the government to come up with policies that will reduce the cost of labour in real estate; this will help in improving the development of real estate generally and attractive to investors

Keywords: *Financing Costs, Legal Costs, Labor Costs and Administrative Costs*

1.0 INTRODUCTION

1.1 Background to the Study

Real estate plays a crucial role in all economies in the world. Its importance should not be underestimated. According to Syagga (1987), the real estate property includes rural land, which is a form of farming land, forestry, and mineral land. The urban land which consists of commercial, industrial, residential properties, petrol stations, recreational facilities such as swimming pools, hotels and restaurants, halls and places of assembly and institutional property like schools and universities. It creates employment opportunities to a large population in the form of construction workers, agents, also provides income to government inform of taxes as well as providing livable and functioning cities like Mombasa. The development of real estate accounts for a good proportion of countries GDP (IMF, 2015).

Real Estate development is one of leading investing opportunities in Kenya; this can be seconded by the debut of REITs in NSE. Property development has shown spontaneous growth with the current development of urban centers and increasing the population (CMA, 2016). Development of real estate is an expensive venture and requires a lot of money, a variety of costs are involved in its evolution. According to CFL, there is a variety of ways of financing growth of real estate: for an instant, the government can give individual loans, commercial sources which include banks as well as other financial institutions. A home buyer or builder can choose to obtain financing from savings and loan associations, commercial banks, mortgage institutions and brokers, life insurance companies, credit unions, individual investors, and builders. The real estate development involves three groups, consumer group, production group and public infrastructure group; the three groups interact in a way that there are those who pay, who benefits and those that risk.

1.1.1 Kenya's Real estate.

Real estate development in Kenya particularly Nairobi attracted global interest with the city being considered the fastest-growing real estate market in the whole world, outrunning cities like Miami and Monaco, this is according to a study by Knight Frank estate management in 2012.According to KNBS (2016) economic survey, the sector had the fourth highest contribution to countries GDP with 7.6%.According to UDSP (2014), the plans are to develop, design, and realization of 200,000 housing units annually to address the growing urban population. NHC (2016) there is 150,000 housing shortage in Kenya currently, and the government through the ministry plans to increase development and access to adequate housing by 2017, this will be by constructing 300,000 using private-public partnerships.

Some reported building works going on in main towns in February 2016 according to KNBS, was 8513, 7479 residential and 1034 business premises. According to Mombasa county government (2016), housing demand in Mombasa stands at 25,000 against supply of 4,000 units per year, and this creates a shortfall of 21,000 units. The quality of houses and estate in Mombasa is still poor, dominated by informal settlements, overcrowding, this leads to increased pressure on roads, sanitation, and drainage systems deteriorating environment.

1.1.2. Roles of real estate in the economy.

Real estate plays very important roles in all economies around the world. For example, House purchase is the largest single consumer transaction in Americans economy. Epra (2012) stated that real estate accounts for nearly 20% of economic activities of a country, the sector provides employment opportunities through construction activities, repair of buildings, as well as insurance companies. Real estate in Kenya specifically Mombasa County plays various roles.

For instance, it provides employment opportunities for property investors, property management agencies and property valuation agencies as well as construction workers. Most employment is in forms of construction and repair of the buildings. According to Tom & Neil (2013), real estate contributes to government revenues through VAT and PAYE tax, either by the purchase of construction raw materials or provision of business services. Through taxation and stamp duty, the government can generate incomes for development activities. Buildings provide living places for residents in the cities and accommodation for the growing urban population.

1.2 Statement of the problem.

Real Estate comprises not only lands but anything permanently fixed to it, includes buildings and other items attached to the structure, it's an important sector in the Kenyan economy as it plays various roles such as providing shelter to the increasing population, providing employment as well as government revenue. Kenyan market is characterized by large demand and undersupplies of a formal housing. It is without a doubt that the shortage of houses is annually increasing at a rapid rate in Kenya. According to National Housing Corporation, (2015) estimated housing shortage is two million homes.

According to Mansley (2015), the development of real estate poses challenges for investors, fund managers, regulators, and researchers. Murigu (2005) found out that commercial property in Kenya is shrinking and there is an expected disparity between expected and actual income. The disparity is a problem that needs to be addressed. According to UDSP (2014), the plans are to develop, design, and realization of 200,000 housing units annually to address the growing urban population. They should be affordable, and of quality for all Kenyans, this will be through availing appropriate building materials, technologies, and Loans. Out of these houses, the number includes the shortfall of twenty-one thousand houses in Mombasa County alone. This shows there is a need for the development of real estate in Mombasa County. Currently, there are ongoing housing projects in the area both governmental and non-governmental.

With a focus in Mombasa County, Kenya, this study was carried out to bridge the knowledge gap left by previous studies. The studies have not focused on how various costs such as the cost of financing (interest rates), taxation, legal charges, employees' salaries and wages and insurance fees have affected the development of real estate in Mombasa County. This project was carried out to address how the fixed costs affect the growth of the real estate and find out what should be done to ensure sustainable growth in the sector is achieved and the shortage of housing in Mombasa county is solved. The range of activities involved in estate development start from buying of land, at this point, the cost of buying a certain piece of land becomes the center of focus.

2.0 LITERATURE REVIEW

There are previous studies done on real estate developments**.** Syagga (1999) argued that the property markets in Kenya are significantly affected by public policy in many ways especially regarding administration, taxation, credit controls, land use controls and provision of new buildings. The interest rate is employed by the CBK to control credit and inflation, therefore, affects the price of real estate hence influencing its growth and development. This study provides advice to the stakeholders in the government and financial institutions such as the banks on how their functions affect real estate in Mombasa county as well on what could be done to promote the growth of the sector in Mombasa county.

Njiru (2008) studied the performance of real estate market at the Nairobi central business district. He argued that investment in the real estate sector is not well regulated and monitored as is the case in the financial sector. With good regulations and government participation the sector will be greatly improve, favorable tax policies and government financing will improve the real estate development. The study focused on Nairobi central district only leaving a gap for other areas within Kenya such as Mombasa county to be studied.

Aqubamicheal (2009) study on factors affecting the real estate market: the case of Addis Ababa city. It was concluded that factors that affect the market arise from the real estate companies themselves, from the demand side, the financing and from the government side, in this case, he considered taxation and other charges on the real estate transaction imposed by the government, and current economic situations mainly. According to his study, Limited mortgage financing and lending conditions that are less attractive to home buyers affect the sector. He concluded that Lack of competitive and various mortgage market affects the affordability of properties. The geographical gap its bridged here to cove local area which in this case is Mombasa county.

Anne (2012) looked at the relationship between interest rates and real estate development in Kenya. The study was done to analyze the factors that were contributing to high borrowing costs, and what can be done to control and hence increase real estate investment, she concluded that with rising interest and high inflation, banks respond to these changes and this affect investment sector as they hedge against credit risk. She recommended the government to take measures that are more active in controlling interest rates.

Nzalu (2012) conducted a study to find out factors affecting the growth in real estate investment in Kenya, the variables he focused on were namely; GDP, inflation rates interest rates and population growth. He found out that interest rates and inflation rates were the major determinants of real estate investment. He suggested that measures towards improving the economic growth and controlling the rising inflation rates and interest rates should be reformulated as they play major roles on the investment levels. Therefore, the government through the central bank should regulate the interest rates and inflation growth to promote economic growth through real estate. However, in his study, he did not advise on how other costs affect the sector as well as how the issue should be managed.

3.0 METHODOLOGY

The study adopted the explanatory research design. The target population was the real estate developing firms in Mombasa County Kenya. According to Kenya Statistical Abstracts Issues, there are 25 Property development companies in Mombasa County, Kenya. Sample size

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comprised of 25 finance managers and 25 marketing managers from the real estate development firms. The study used questionnaires to collect the required data. Descriptive statistics was used mainly to summarize the data. SPSS was used for analysing complex data. The descriptive analysis involved the use cross tabulation and frequency distribution tables. Regression analysis was used to establish the relationship between the independent and dependent variables.

4.0 RESEARCH FINDINGS AND DISCUSSION

4.1 Demographic Data

4.1.1 Experience of the Respondents

The study sought to determine the respondent's years of service in the real estate sector. Majority (40%) of the respondents indicated that they had worked for the real estate sector for a period of 6 to 10 years.20% have worked for a period of 15 to 20 years while the minority (10%) have worked in the sector for less than 3 years and more than 20 years as presented in Table 1. This, therefore shows that the majority of respondents have worked for more than five years, this indicates that the managers have enough experience in the sector and have the relevant information in the sector.

Table 1: Experience.

	Frequency	Percent
Less than 3 years	5	10.0%
3 to 5 years	2	4.0%
6 to 10 years	20	40.0%
10 to 15 years	5	10.0%
15 to 20 years	10	20.0%
More than 20 years	8	16.0%
Total	50	100.0%

4.1.2 Types of real estate

The researcher sought to determine the types of real estates, as such the respondents were asked to indicate the type of real estates they operate. The Findings from the Table 2 shows that majority (37.8%) of the participants operate the Income Properties, 33.3% Residential properties. 22.2% both residential & income while the minority (7.0%) indicated Raw Land Development. This shows that most of the firms are in the real estate industry as a form of investment to generate incomes and earn profits. They are profit oriented and hence costs it's one of the factors that they greatly evaluate in making the decisions

Table 2: Type of Real Estate Operation.

	Frequency	Percent
Residential properties	15	33.3%
Income Properties	17	37.8%
Both residential & income properties development	10	22.2%
Raw Land Development	3	7%
Total	45	100.0%

4.1.3 Source of financing.

The respondents were asked to indicate their source of financing in the company's development of real estate. The findings are as shown in table 3; A great number of the population (21.4%) sampled indicated that their main source of financing in the company development of real estate is the borrowed funds from SACCOs,17.1% Issue corporate bond and 17.1% is Cooperation with others. The minority (7.1%) shows that their main source of finance in the development of real estate is Family Inheritance and Self-funded. This shows that most of the activities are externally financed and there are costs included to get the finance.

Table 3: The main source of financing in the development of real estate

	Frequency	Percent
Self-funded	5	7.1%
Bank loan from domestic banks	10	14.3%
Bank loan from foreign banks	2	2.9%
Issue corporate bond	12	17.1%
Borrowing from SACCOs	15	21.4%
Family Inheritance	5	7.1%
Private Equity financing	9	12.9%
Cooperation with others	12	17.1%
Total	70	100.0%

4.2 Descriptive Statistics

4.2.1 The effects of changes in the development of real estate.

The study attempted to find out the level of agreement with the following statements that relate to the influence the real estate development. This was pursued by use of a structured question and the possible responses were structured as follows 1 represented strongly agree, 2= Agree, 3= Neutral, 4= Disagree and 5= Strongly Disagree, the findings were presented in the Table. Majority (43.5%, 30.8%, 45.5% and 31.3%) of the respondents indicated that Interest rates affect the development real estate, increase of interest rates decreases real estate development, decrease

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of interest rates decreases real estate development and decrease of interest rates increase real estate development respectively as the Findings in Table 4. Therefore, the change of interest influences the development of real estate either negative or positive.

Table 4: The effects of changes in real estate development

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Interest rates affects the development of real estate	21.7%	43.5%	8.7%	21.7%	4.3%
Increase of interest rates decreases real estate development	11.5%	30.8%	11.5%	26.9%	19.2%
Decrease of interest rates decreases real estate development	9.1%	45.5%	18.2%	18.2%	9.1%
Decrease of interest rates increase real estate development	25.0%	31.3%	18.8%	12.5%	12.5%

4.2.1.1 The cost of a loan.

The respondents had to indicate if they consider the cost of loan (interest), the findings are as shown below; Sixty percent of the total population sampled indicated that they consider the cost of the loan while 20% said No as shown in the Table 5. This indicates that cost of interest on loans affect the respondent's decision to take a loan to finance the development of real estate or not.

Table 5 ***considering the cost of the loan (interest rates)***

	Frequency	Percent
Yes	30	60.0%
No	20	40.0%
Total	50	100.0%

4.2.1.2 Reasons for considering the cost of loan.

The study sought to determine the reason as for why the Managers interviewed considered the cost of interest. The Figure 1 shows th++e reasons as why the managers considered the cost of loans whereby majority (44.44%) of the participants indicated that high interest rates reduce the financial freedom, 33.33% avoiding incurring financial expense loss while 22.22% avoiding high debt levels. Most of the participants avoid taking loans because they feel that they will lack financial freedom. Therefore, most of their income will be spent on repaying the loans.

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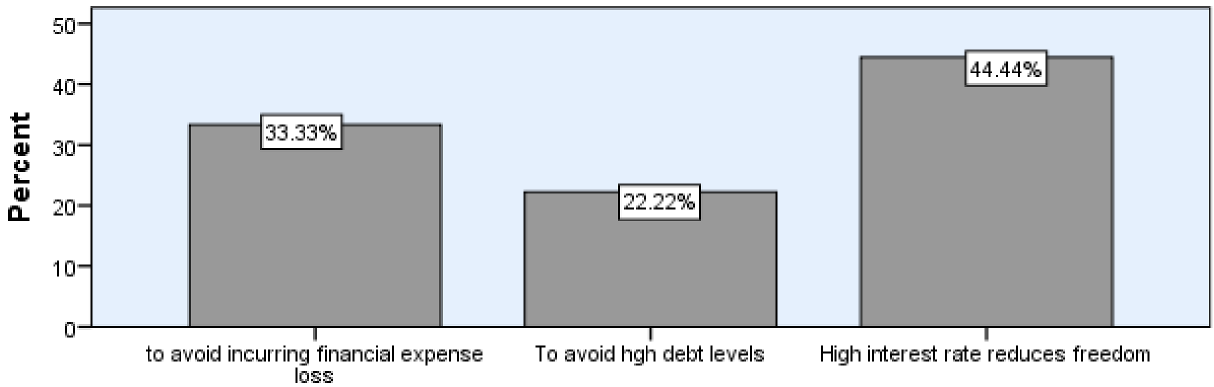

Figure 1 : Reasons for considering the cost of loan

4.2.1.3 Financial Option

The researcher sought to determine the most suitable financial option for small real estate companies in Mombasa. The Findings are as shown. From the Figure above 54.55% indicated that their financial option was partnership, 31.82% loans while the minority (13.64%) reported that their financial option was commercial loans. This shows that the management partnership as the major financial option to any other option.

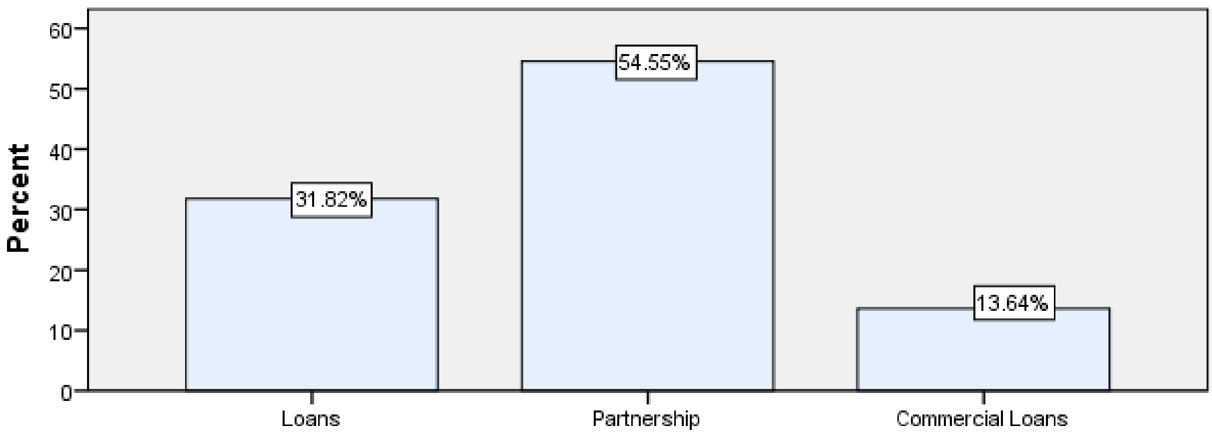

Figure 2: Financial Options

4.2.2 Effects of legal costs on the development of real estate

The study sought to determine the effects of legal costs on the development of real estate; the findings are presented in the following sections;

4.2.2.1 Legal staff

The respondents were asked if their firms had legal staff or if it outsources the services, the Figure below presents the results; The Figure 3 shows the managers responses on the presence of legal staff. 59.09% of the respondents indicated that their firms have legal staff while 40.91% reported that their firms have No legal staff. This means that most of the company sampled have legal staff to help in legal matters

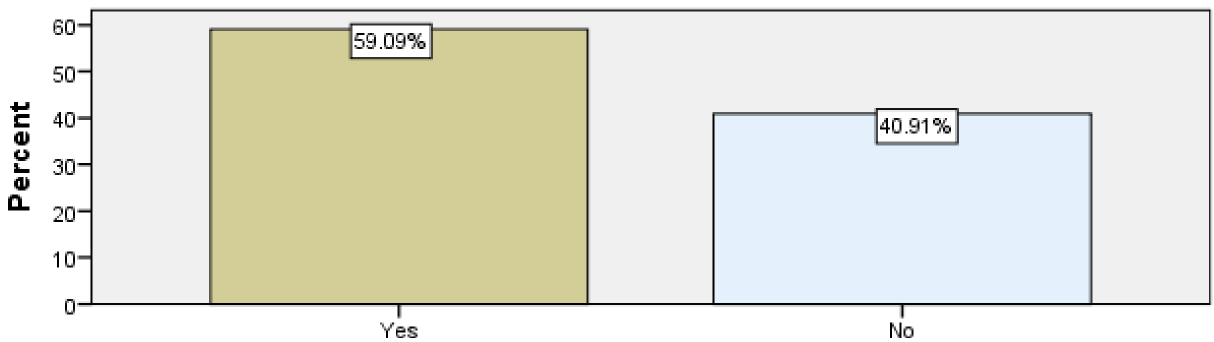

Figure 3: Legal staff employees.

4.2.2.1 Consideration of cost of service.

The researcher opts to determine if the managers consider the cost of service in buying, construction, renovation and selling of houses. The findings are as shown below; Majority (87.5%) of the total population sampled reported that they consider the cost of outsourcing services in buying, construction, renovation and selling of houses while 12.5% said No, they don't consider. The cost of outsourcing services in buying, construction, renovation and selling of houses might play a major role in reducing the total cost of acquiring a real estate property.

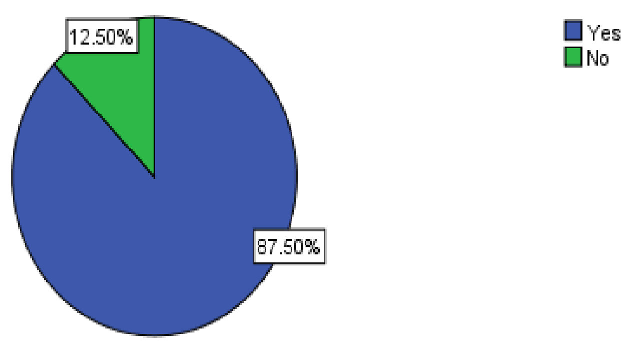

Figure 4: Considering the cost of service.

4.2.2.3 The effects of change in firm's activities.

The study sought to find out the level of agreement with the following statements that relate to the effects of the firms' activities. Majority (60.0%, 58.1% and 38.7%) of the respondents Strongly Agreed that Taxation on imported construction raw materials affects development of real estate; Kenya's rental income tax is high and affects the rate if real estate development,

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Stamp duty on property leases affects the leasing decisions respectively as indicated in the Table 6

Table 6: The effects of change in firm's activities

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Does the Taxation on imported construction raw materials affects development of real estate	60.00%	34.30%	5.70%	0.00%	0.00%
Does the Kenya's rental income tax is high and affects the rate if real estate development	58.10%	23.30%	11.60%	4.70%	2.30%
Does Stamp duty on property leases affects the leasing decisions?	38.70%	32.30%	9.70%	12.90%	6.50%

4.2.3 The effects of labor costs on the development of real estate

The below factors are involved in the determinations of the cost of labor incurred by the employer, how do the following affect the total cost of labor and the development of real estate? The Table 7 shows that majority (38.5%, 37.5% and 58.8%) of the respondents strongly agreed that total cost of labour, Increasing salaries, and wages demanded by employees affect the rate of real estate development, The cost of obtaining skills and knowledge is high hence affecting the cost of labour as well as development of real estate and There are many safety requirement measures and this increases labour cost, total costs as well as real estate development respectively.

Table 7: ***The effects of labour cost***

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Is total cost of labour, development is Increasing salaries, and wages demanded by employees affect the rate of real estate development?	38.5%	30.8%	19.2%	7.7%	3.8%
The cost of obtaining skills and knowledge is high hence affecting the cost of labour as well as development of real estate	37.5%	30.0%	12.5%	15.0%	5.0%
There are many safety requirement measures and this increases labour cost, total costs as well as real estate development	58.8%	14.7%	5.9%	14.7%	5.9%

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4.2.3 Effect of administrative costs on the development of real estate

The study sought to find out the level of agreement with the following statements that relate to the effects of the development of real estate. The Table 8 shows that majority (46.7%, 36.4%, 47.8% and 39.0%) Strongly agreed that Fees charged by property management firms affect the development of real estate, Local Mombasa council rates on property affect the rate at which the real estate is growing. Insurance rates and premiums charged on the cover for building affects greatly selling, buying and the building of houses and Office running expenses such as printing, documentation, paying of office staff affect total costs of houses, as well as the demand and supply of such survives respectively.

Table 8: ***The effects of administrative costs on the development of real estate***

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Fees charged by property management firms affect development of real estate	46.7%	35.6%	13.3%	2.2%	2.2%
Local Mombasa council rates on property affects the rate at which the real estate is growing	36.4%	33.3%	21.2%	6.1%	3.0%
Insurance rates and premiums charged on the cover for building affects greatly buying, selling and construction of houses	47.8%	21.7%	8.7%	17.4%	4.3%
Office running expenses such as printing, documentation, paying of office staff affect overall costs of buildings as well as the demand and supply of such services	39.0%	26.8%	17.1%	12.2%	4.9%

4.3 Inferential Statistics

4.3.1 Regression Model Summary

The Table 9 shows the model summary above the *R*, value represents the level of association where R is 0. 618, which indicates a strong positive association between Financing costs, Legal Costs, Labour costs, Administrative costs and the Development of real estate.

Table 9: Regression Model Summary.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.618[a]	.048	-.111	.488

a. Predictors: (Constant), Financing costs, Legal Costs, Labour costs and Administrative costs

The Coefficients Table provides a Constant (β_0) (-1.282) and the co-efficient of Financing costs variable (.305), Legal Costs (0.319), Labour costs (0.863) and Administrative costs (0.765) which helps in formulation of the linear regression equation. The regression analysis reveals that financing costs contribute 30.5%, Legal Costs 31.9%, labour costs contribute 86.3% and administrative costs 76.5% to the development of real estate. Therefore, this study confirms that there is a positive association between financing costs, legal costs, labour costs and administrative costs and the development of real estate in Mombasa County. The study results finally indicate that only labor cost had a significant influence on the development of real estate as it p values was <0.05 at 95%n confidence level.

Table 10: ***Regression Coefficients.***

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.282	.275		-4.664	.000
Financing costs	.305	.178	-.225	-1.709	.092
Legal Costs	.319	.175	.130	1.826	.072
Labour costs	.863	.148	.712	5.838	.010
Administrative costs	.765	.074	.463	10.295	.080

a. Dependent Variable: The Development of real estate

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

The study found that financing option for real estate development in Mombasa county, Kenya is the use of commercial banks loans, mortgages and partnership. Changes in interest rates have effect on the development of real estate development. The taxation too has influence on the development of real estate in Mombasa County, Kenya. The study established that labour costs have a significant influence on the development of real estate in Mombasa County

5.2 Conclusion

The study concluded that the finance managers and marketing manager financial option is commercial banks loans, mortgages and partnership. The study also concludes that the decrease in interest rates have a significant effect on the development of real estate. Taxation and other legal cost influence the development of real estate in Mombasa County, Kenya. The researcher also concludes that the total cost of labour, is increasing salaries, and wages demanded by employees affect the rate of real estate development, the cost of obtaining technical skills and competence is high hence affecting the cost of labour as well as the development of real estate in Mombasa county Kenya.

5.3 Recommendations.

The study recommends that there is a need for the government to come up with policies that will reduce the cost of labour in real estate; this will help in improving the development of real estate generally and attractive to investors.

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