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# Relationship between Real Estate Investment Trusts (REITs) and financial performance of selected investment banks in Nairobi County, Kenya.

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## ABSTRACT

**Purpose:** To investigate the relationship between real estate mutual funds investment and financial performance of selected investment banks in Nairobi County, Kenya.

**Methodology:** The study used descriptive research design. The target population was 22 investment banks in Nairobi Kenya whose respondents were 75 investment managers, 297 investment officers, 124 risk officers, and 161 quality assurance officers. Simple random sampling method was used to obtain a sample of 7 investment banks whose 22 investment managers, 89 investment officers, 38 risk officers, 48 quality assurance officers were included. This study used a questionnaire and secondary data collection form to gather data. This study conducted a pre-test at two randomly selected commercial banks branch in Meru County. These banks were housing finance bank and Kenya Commercial Bank. Inferential analysis generated included model summary to test the level of influence, analysis of variance to test hypothesis and regression coefficients to test the study's model.

**Results:** The respondents agreed that there are reliable customer service services that boost client-bank relations which increases the confidence in investing even higher amounts of income towards REITs. (Mean-3.23). Despite that, respondents disagreed that investor's wealth is able to grow especially due to profitable returns they generate as a result of engaging in real estate investment trusts (mean-2.23). In addition, the respondents disagreed that banks promote cultural and religion inclusivity by including products such as Islamic real estate investment trusts to incorporate Islams (mean-2.45). The model summary indicated that real estate investment trusts had an R-0.589 and an R-square of 0.347. This indicated that real estate investment trusts influenced 35% of financial performance. Durbin Watson's value of 1.980 indicated a positive auto-correlation. The ANOVA analysis indicated that real estate investment trusts had an F-statistic of 7.033 and significance level of 0.009 which was below 0.05. There was a relationship between REITs and financial performance. The bank's rate of return was low due to high price volatility. Investor' high demand as compared to the supply of REITs by real estate sector played a significant effect on its prices. In addition, the study found out most real estate companies had not set out much REITs which made it tricky for investors to reap maximum returns on them.

**Unique contribution to theory, policy and practice:** Gaps were established on how real estate investment banks would incorporate diversity in their products. For example, the presence of Islamic real estate investment trusts was found to be missing in investment banks due to complicated Sharia laws on how interest should be accrued so that no party loses in the deal (both the banks and the investor). Investment banks management should develop various REITs products which incorporates diversity such as introducing Islamic products. Investment banks should develop partnership opportunities for real estate companies so that they are able to increase their investment products baskets. CMA should extend a hand to investment banks and firms so that they get appropriate prices on various REITs.

**Keywords:** *Real Estate Investment Trusts, Financial Performance, Investment Banks, Nairobi County, Kenya.*

## 1.0 INTRODUCTION

Financial performance is the measure of how an organization has used its assets in revenue generation (Central Bank of Kenya [CBK], 2020). The constant measuring the performances of the firms' operations is important in giving various clues on the status of their financial health. A healthy real estate portfolio is one of an example of a financial goal as far as real estate investment is concerned. A real estate investment in an investment bank includes the decisions made by banking management on the quantity of funds to invest in diverse real estate opportunities with investors' profit maximization goal in mind (International Finance Corporation [IFC], 2020). Real estate investment trusts are also pooled investments which are invested into real estate trusts unlike the mutual funds which invested in real estate stocks and bonds (NSE, 2021a). There are different types of REITs which are Income Real Estate Investment Trusts (I-REITs), Development Real Estate Investment Trust (D-REITs), Islamic Real Estate Investment Trusts and Property funds (NSE, 2021a). The performance of REITs was of great concern both in advanced and advancing nations.

The choice to make an investment in real estate sector is closely influenced by prices of real estate investment, mortgage interest rates, availability of funding, investor's disposable revenue and their risk tolerance. Therefore, the banks provide advice to investors on how to go about these factors. The bank then charges management fee on the services it offers to the clients. The fee charged by the bank become one of the income avenues of the bank which in turn boosted its financial performance. On the one hand, when the management fees decline as a result of low business use to missed opportunities, the bank's income level is negatively affected which in turn translated to low financial performance. On the other hand, when the management fees increase as a result of new opportunities, the bank's income level is positively affected which in turn translates to increased financial performance. This means that real estate investment trust is a major source of income to the bank and its significance cannot be dismissed.

That notwithstanding, globally, American investment bank's performance has been experiencing problems related to market risk, low equity rate; unexperienced investment officers; competition from other investment banks and firms; inflation concerns; liquidity risks; and tough regulations from the governments (Hamouri, 2020).In Europe and Asia, there have been real-time analysis of investments challenges; low returns on investments due to low demand on housing needs; low number of investors, unattractive interest on investment portfolios; rapid change of taste and preference of the clients on various investment choices; and over diversification of investments causing very low profit margins on underlying portfolios (Balfoussia & Gibson, 2016).

Regionally, in African nations such as South Africa, there have been downtime on bank's systems; complication in investment placement process; discouraging turn-around time on investment profits payments (Mukarushema et al., 2016). In Nigeria, there have been lack of timely dissemination of relevant information to clients hence missing out on investment opportunities (Commonwealth Diaspora Investor Survey [CDIS], 2018). Locally in Kenya, investment bank's performance has been experiencing challenges related to language barriers to clients who are unable to communicate using Kenyan national languages; too much documentation when registering for investment prospects; and lack of proper orientation of clients on investment rules which makes them loose huge volumes of money when they over or under trade (Cytonn, 2019).

These problems have pushed investment bank's management to restructure their investment strategies and introduce products such as Real Estate Investment Trusts [REITs] so as to remain under profitability margin (CMA, 2019). Real estate investment trusts are pooled investments which invest into trusts unlike the mutual funds which invest in stocks and bonds (NSE, 2021). There are different types of REITs which are Income Real Estate Investment Trusts (I-REITs), Development Real Estate Investment Trust (D-REITs), Islamic Real Estate Investment Trusts and Property funds (NSE, 2021). The performance of REITs is of great concern both in advanced and advancing nations. In relation to this, banks have made efforts to have low entry barriers to investors; reliable price signals, implementation of investment policies and frameworks among nations; and establishment of venture capital companies (IFC, 2020). In Kenya, CMA authority has instilled capital market unity; CBK has put up policies for integrated banking system, and allocation of annual investment allowance to investment banks (Mungai, 2016).

However, these developments in Kenyan investment banks have been encountered with challenges such as increment of investment trusts charges due to inflation risks which has caused by investors to cancel and withdraw their investments prematurely due to poor returns derived from real estate portfolios. CBK (2020) reports further that increase of non-performing loans in the real estate sector from 24.01% to 25.22 in June 2019 and 2020 respectively is to blame. This is because, in as much as investment banks have been directing clients on investing in real estate projects such as trusts, their portfolios have been accruing losses since the underlying real estate units' holders not paying monthly, quarterly, semi-annual or annual mortgage interests promptly. This has resulted to low REITs' incomes which are the sources that are used to pay back investors on their periodical interests on investments.

### 1.2 Statement of the Problem

The financial performance of investment banks has been on the rise globally. This is due to incorporation of diverse portfolios in various sectors such as real estate, manufacturing, and mining among others. In America, investment banks have incorporated real estate service delivery around a connected flow model and processes among various partners. In Asia, investment banks have boosted their performances by enhancing the utilization of financial technology, information, and analysis systems to generate differentiated insights among real estate investors. In Africa, investment banks have developed robustness by being giants in marketing various securities traded in capital markets that are linked to real estate sector. These developments have significantly enhanced profitability of these investment banks.

Nevertheless, according to CBK (2020) there has been a low profitability of Kshs 134.1 billion in June 2020 which is a 17.2% decline from the previous year of the Kenyan investment banks. This low profitability has been partly caused by decline of 8.67% value of investments made through banks by investors from Kshs 70.02 billion in June 2019 to Kshs 63.95 billion June 2020 (CBK, 2020). The investment banks have forfeited investment income from charges such as management fees charged on investment units.

Past studies such as Hussein (2017), Iregi and Okeyo (2017), and Mbogo (2016), did not investigate the relationship between real estate investment strategies and financial performance of selected investment banks in Nairobi County, Kenya. This therefore gives the need for this study to investigate the relationship between real estate investment strategies and financial performance of selected investment banks in Nairobi County, Kenya.

### 1.3 Purpose of the Study

To investigate the relationship between real estate mutual funds investment and financial performance of selected investment banks in Nairobi County, Kenya.

### 1.4 Hypothesis

$H_0 1$: There was no significant relationship between real estate mutual funds investment and financial performance of selected investment banks in Nairobi County, Kenya.

## 2.0 LITERATURE REVIEW

### 2.1 Theoretical Review

Duesenberry's Accelerator Theory of Investment (DATI) which was instituted by Duesenberry (1960) was more of an extension of accelerator theory of investment. DATI will guide Real Estate Investment Trusts (REITs). DATI states that when capital grows, investment value surpasses depreciation and any increase of income results to investment value which is higher than the savings. This means that the principal value that investors are willing to risk through buying different types of investments expands, the resultant investment will be more than its deprecation value and total savings. For example, if an investor has a way to ensure that their initial capital keeps on growing, the value of their investments will be more than the rates at which they lose their value and will be more than overall savings.

When an investor buys real estate investment trusts, they are bound to increase in value with time since the underlying real estate assets increase their value. Once the assets increase their values, the initial capital value has a positive margin as compared to the rate at which it's losing its worth. Investors may expound their capital through considering trusts like Development Real Estate Investment Trust (D-REITs), Islamic real estate investment trusts and property funds.

### 2.2 Empirical Review

Morri et al. (2021) evaluated how REITs in Europe had performed financially. To achieve this, Morri et al. (2021) included 50 REITs in Europe. Ordinal least squares model was adopted in this study to measure Green Real Estate Sustainability Benchmark (GRESB) rating on ROA, ROE. Morri et al. (2021) found out that GRESB had a positive effect on ROA and ROE. However, according to Morri et al. (2021), investors had limited information about how GRESB work and how they influenced ROA and ROE. Morri et al. (2021) used secondary data to come to this conclusion which was not enough to substantiate. It would be more realistic to get feedback from respondents such as REITs managers who would be better positioned to provide more information on why they believed the investors did not have adequate knowledge on REITs and their recommendations on how to solve the problem.

Capellán et al. (2021) examined the effects of REITs in Costa del Sol-Spain's real estate sector. To collect data, the study used reports such as statement of affairs, income and loss reports, and cashflow statements from real estate firms' websites. The real estate firms included were Idealista and Fotocasa y Obranuevaenmalaga. In addition, e-questionnaires were sent to leaders of the sale of real estate via online means. Capellán et al. (2021) found out that REITs have been leading in capital markets since they are able to market and generate huge volumes of businesses.

Menges and Moranga (2020) investigated the influence that indirect investments such as investment trusts had on Nairobi county's real estate sector performance. The study sample population was 69 real estate firms but managed to collect secondary data from 45 real estate firms due to availability of data. This secondary data was gotten from the firm's websites or directly from these firms. Menges and Moranga (2020) found out that investment trusts influenced financial performance of real estate sector. Nevertheless, the level of significance was limited on the type of real estate in question. Menges and Moranga (2020) did not substantiate and include the firm's officers who issued the secondary data in the procedure. This would make the study hard to replicate for future studies.

Nyoro (2017) conducted a study on factors that determine the Real Estate Investment Trusts (REITs) firms' performance in Kenya. The study targeted 6 REITs firms in Nairobi whose 36-management staff were selected using census technique. Questionnaires were used to collect data that were pre-tested at REITs in Nakuru county. Nyoro (2017) found out factors such as government policies, economy, interest rates and demographics of the respondents determined REITs firms' financial performances. Nyoro (2017), did not consider a factor such as inflation rate which has great effect on total cost of REITs. The current study would shift focus and expand to investment banks that offer REITs instead of only REITs firms. This would thus enable the study incorporate the effect that inflation rates affect the prices of REITs in these banks.

Njenga (2017) explores what characterized the acceptance of REITs by real estate developers in Kenya. Through the help of census method, Njenga (2017) selected 67 firms. Thereafter, the 87 respondents who were top management officials responded to the questionnaires. Njenga (2017) found out that REITs revenue system, regulations and operations attracted real estate developers. Njenga (2017) did not provide information on the location of the pre-test, the respondents of the pre-tests and their sampling method. Further on, Njenga (2017) included only real estate developers in the study as respondents and did not include investment banks who are also actively engaged in REITs development.

Sada (2016) reviewed the state of Kenyan REITs. The study assessed the benefits and risks associated with REITs to enable their existence thrive better in Kenya. The sampled population included 20 REIT portfolio managers. Sada (2016) indicated benefits to include more avenues for diversification paybacks on investor's wealth in real estate; liquidity and increased revenues; tax exemptions; and professional services in managing the REITs. However, the risks include uncertainty in valuation; political interference; low growth rate; uncertain investment durations. In addition, investors were not knowledgeable on REITs generally, and their valuation. The number of sampled REITs managers was twenty which was very low. This number was below the 30 limits for purposes of effective results in a study. Sada (2016) did not explore various policies and regulations that were in place to facilitate further development of REITs.

## 3.0 RESEARCH METHODOLOGY

The study used descriptive research design. The target population was 22 investment banks in Nairobi Kenya whose respondents were 75 investment managers, 297 investment officers, 124 risk officers, and 161 quality assurance officers. Simple random sampling method was used to obtain a sample of 7 investment banks whose 22 investment managers, 89 investment officers, 38 risk officers, 48 quality assurance officers were included. This study used a questionnaire and secondary data collection form to gather data. This study conducted a pre-test at two randomly selected commercial banks branch in Meru County. These banks were housing finance bank and Kenya Commercial Bank. The pre-test respondents were 2 investment managers, 9 investment officers, 4 risk officers, and 5 quality assurance officers equally distributed between the two banks. Validity was measured through three types which were content, criterion and face validity. It analyzed both quantitive and qualitative data collected. Under the quantitive data, the study analysis provided descriptive statistics such as frequencies, percentages and median. Inferential analysis generated included model summary to test the level of influence, analysis of variance to test hypothesis and regression coefficients to test the study's model. The study results were presented using tables

## 4.0 RESULTS

### 4.1 Reliability Statistics

This study conducted a pre-test at two randomly selected commercial banks branch in Meru County. These banks were housing finance bank and Kenya Commercial Bank (KCB). These two banks were actively engaged in real estate sector with issuance of construction loans and home financing. The respondents were 2 investment managers, 9 investment officers, 4 risk officers, and 5 quality assurance officers equally distributed between the two banks as shown on Table 1.

**Table 1:** *Reliability Results*

| Instrument | Cronbach's Alpha | N of Items |
|---|---|---|
| Questionnaire | .841 | 20 |

Table 1 indicates that questionnaires had a Cronbach Alpha coefficient of 0.841. According to Cooper and Schindler (2014), values of Cronbach Alpha Coefficient range from 0 to 1. Therefore, 0.7 is the minimum point which is most suitable for an instrument to be termed as reliable.

### 4.2 Response Rate

The study issued questionnaires to 22 investment managers, 89 investment officers, 38 risk officers, 48 quality assurance officers hence making a total of 197 respondents. Nevertheless, the returned questionnaires were 146. This was 74% response rate. According to Fincham (2008), when a study's response rate is above 70%, it is considered excellent and it can be relied upon to answer the study's problem.

### 4.3 Descriptive Statistics of Financial Performance

The dependent variable which was the financial performance had indicators such as return on investment, equity growth on cash flow, operating ratio, rate of return and cash yield. The study analyzed various reports such as profit and loss statements, cashflow statements and policy statements using horizontal analysis technique. This was an analysis method that related two or more years of an individual organization's financial information which was articulated in percentage form. Horizontal analysis technique was used for 3 years beginning from the year 2018 to 2020 of investment banks. Later on, the study derived the mean on each indicator as shown in Table 2.

**Table 2:** *Descriptive Statistics of Financial Performance*

| Financial Indicators | Mean |
|---|---|
| Return on investment | **2.11** |
| Return on asset | **3.67** |
| Return on equity | **3.88** |
| Operating ratio | **4.12** |
| Rate of return | **4.42** |

Table 2 shows that rate of return and operation ratio had a mean of 4.42 and 4.12 respectively. Despite that, return on investment had a low mean of 2.11. These results pointed out that generally investments had generally made substantial profits, however, real estate investors' portfolios failed to register any significance growth at the end of the financial years 2018-2020. This demotivated investors hence many of them withholding further investments prospects due to high loss risk. Withholding investments led to decline on investment's value. According to Commonwealth Diaspora Investor Survey (2018), Nigerian investors in diaspora withheld too much of their wealth and avoided investing in areas such as real estate due to poor returns and risk of loss. This definitely played a deconstruction role towards building investment portfolios in financial institutions.

### 4.4 Descriptive Statistics of Real Estate Investment Trusts

This was the independent variable which had indicators such as Income Real Estate Investment Trusts (I-REITs), Development Real Estate Investment Trust (D-REITs), Islamic real estate investment trusts and property funds. The study inquired several questions whose response is indicated on Table 3.

**Table 3:** *Descriptive Statistics of Real Estate Investments Trusts*

| Statements N=146 | 1 | 2 | 3 | 4 | 5 | Mean |
|---|---|---|---|---|---|---|
| Presence of income, development and Islamic real estate investment trusts. | 27(19%) | 59(40%) | 0(0%) | 60(41%) | 0(0%) | **2.64** |
| Frequent marketing initiatives made on how REITs work | 26(18%) | 59(40%) | 5(3%) | 52(36%) | 4(3%) | **2.65** |
| Growth of investor's wealth due to profitable returns | 66(45%) | 28(19%) | 22(15%) | 12(8%) | 18(13%) | **2.23** |
| Promotion of cultural and religion inclusivity by including products such as Islamic real | 61(42%) | 28(19%) | 6(4%) | 32(22%) | 19(13%) | **2.45** |

| | | | | | | |
|---|---|---|---|---|---|---|
| estate investment trusts | | | | | | |
| Reliable customer service services | 4(3%) | 55(38%) | 0(0%) | 77(53%) | 10(6%) | **3.23** |

(1-Strongly agree; 2-Agree; 3-Neutral; 4-Disagree; 5-Strongly agree)

Table 3 shows respondents agreed that there are reliable customer service services that boost client-bank relations which increases the confidence in investing even higher amounts of income towards REITs. (Mean-3.23). Despite that, respondents disagreed that investor's wealth is able to grow especially due to profitable returns they generate as a result of engaging in real estate investment trusts (mean-2.23). In addition, the respondents disagreed that banks promote cultural and religion inclusivity by including products such as Islamic real estate investment trusts to incorporate Islams (mean-2.45). The results indicate that REIT's rate of return was low due to high price volatility. Investor' high demand as compared to the supply of REITs by real estate sector played a significant effect on its prices. In addition, the study found out most real estate companies had not set out much REITs which made it tricky for investors to reap maximum returns on them. Gaps were established on how real estate investment banks would incorporate diversity in their products. For example, according to Njenga (2017), the presence of Islamic real estate investment trusts was found to be missing in investment banks due to complicated Sharia laws on how interest should be accrued so that no party loses in the deal (both the banks and the investor).

### 4.4.1 Model Summary of Real Estate Investment Trusts

The study conducted a model summary to examine the influence of real estate investment trusts on financial performance as indicated in Table 4.

**Table 4:** *Model Summary of Real Estate Investment Trusts*

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|---|
| 1 | .589[a] | .347 | .340 | 2.937 | 1.980 |

a. Predictors: (Constant), Real Estate Investment Trusts

b. Dependent Variable: Financial Performance

The model summary on Table 4 indicates that real estate investment trusts had an R-0.589 and an R-square of 0.347. This indicated that real estate investment trusts influenced 35% of financial performance. Durbin Watson's value of 1.980 indicated a positive autocorrelation. Sada (2016) also established that investment trusts' influence was less than 50% in bank's performance.

### 4.4.2 ANOVA of Real Estate Investment Trusts

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The study conducted an analysis of variance to validate the status of the null hypothesis that there was no relationship between real estate investment trusts and financial performance as indicated in Table 5.

**Table 5:** *ANOVA of Real Estate Investment Trusts*

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 60.657 | 1 | 60.657 | 7.033 | .009[b] |
| | Residual | 1242.000 | 145 | 8.625 | | |
| | Total | 1302.658 | 146 | | | |

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Real Estate Investment Trusts

The ANOVA analysis on Table 5 indicates that real estate investment trusts had an F-statistic of 7.033 and significance level of 0.009 which was below 0.05. The study thus rejected the null hypothesis. There was a discovery that REITs were not common among investment banks hence their profitability was affected. According to Sada (2016), banks had not made efforts to include REITs such as Islamic ones in their portfolios which did not augur well in diversifying tastes and preferences of their clients such as those from Islamic religion.

### 4.4.3 Regression Coefficients of Real Estate Investment Trusts and Financial Performance

The study conducted regression coefficients to elaborate and develop further the general model of the study as indicated in Table 6.

**Table 6:** *Regression Coefficients of Real Estate Investment and Financial Performance*

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | 9.841 | 2.468 | | 3.988 | .000 |
| Investment Trusts | .177 | .081 | .174 | 2.172 | .031 |

a. Dependent Variable: Financial Performance

Table 6 indicates that real estate investment trusts' β was 0.177 with a p-value of 0.031. The model of the study was:

$Y = C + \beta 1X1 + \hat{e}$

Where: Y was financial performance; $\beta i$ was Coefficients to be estimated**;** C was constant; XI was real estate investment trusts**;** and ê was error.

When equated with the coefficients, financial performance = 9.841C+0.177X1+2.468e. This meant that by adding one unit of X1, financial performance increased or decreased by 9.841+0.177. What these results meant was that real estate investment trusts were important building blocks when an investment bank would wish to improve its financial performance.

## 5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

### 5.1 Summary of the findings

The respondents agreed that there are reliable customer service services that boost client-bank relations which increases the confidence in investing even higher amounts of income towards REITs. (Mean-3.23). Despite that, respondents disagreed that investor's wealth is able to grow especially due to profitable returns they generate as a result of engaging in real estate investment trusts (mean-2.23). In addition, the respondents disagreed that banks promote cultural and religion inclusivity by including products such as Islamic real estate investment trusts to incorporate Islams (mean-2.45). The model summary indicated that real estate investment trusts had an R-0.589 and an R-square of 0.347. This indicated that real estate investment trusts influenced 35% of financial performance. Durbin Watson's value of 1.980 indicated a positive correlation. The ANOVA analysis indicated that real estate investment trusts had an F-statistic of 7.033 and significance level of 0.009 which was below 0.05. The study thus rejected the null hypothesis hence rejecting the null hypothesis.

### 5.2 Conclusion

There was a relationship between REITs and financial performance. The bank's rate of return was low due to high price volatility. Investor' high demand as compared to the supply of REITs by real estate sector played a significant effect on its prices. In addition, the study found out most real estate companies had not set out much REITs which made it tricky for investors to reap maximum returns on them. Gaps were established on how real estate investment banks would incorporate diversity in their products. For example, the presence of Islamic real estate investment trusts was found to be missing in investment banks due to complicated Sharia laws on how interest should be accrued so that no party loses in the deal (both the banks and the investor).

### 5.3 Recommendations and Contributions of the Study

Investment banks management should develop various REITs products which incorporates diversity such as introducing Islamic products. Investment banks should develop partnership opportunities for real estate companies so that they are able to increase their investment products baskets. CMA should extend a hand to investment banks and firms so that they get appropriate prices on various REITs.

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