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TO ALL CHIEF EXECUTIVES OF COMMERCIAL BANKS AND MORTGAGE FINANCE INSTITUTIONS

AMENDMENT OF RISK WEIGHT FOR MORTGAGE LOANS

As at December 2020, there were 26,971 mortgage loans compared to 16,135 mortgage loans in December 2011. Although the number of mortgage loans has increased over time, the increase has been very low compared to the annual demand of housing units estimated at 200,000. Indeed, this signals that there are vast opportunities available for institutions to seize in the mortgage segment. The findings from the Residential Mortgage Surveys conducted by the Central Bank of Kenya (CBK) in 2020 and 2011 indicated that high interest rates, lack of access to long-term funds and low levels of income for potential borrowers as the major impediments to mortgage development in 2011. However, in 2020, the institutions identified high cost of housing units, high cost of land for construction and low level of income for potential borrowers as the major impediments.

As part of the Government of Kenya's effort to promote access to decent and affordable housing in Kenya, housing was included as a key pillar in the Big Four Development Agenda. Specifically, the Government of Kenya aspired to deliver 500,000 affordable homes across the 47 counties by the year 2022. To this end, notable achievements have been made by the Government of Kenya such as; completion of affordable housing units in Ngara and Park Road, completion of social housing units, completion of National Police and Kenya Prison Service Residential units. Further, there has been progressive registration of Kenyans on the *Boma Yangu* platform, a platform which allows Kenyans to contribute towards deposits to purchase homes.

With the licensing and operationalisation of the Kenya Mortgage Refinance Company (KMRC) Plc in 2020, it is envisioned that the mortgage market will be boosted further. This will be achieved through KMRC playing its key role of promoting development of the domestic residential mortgage market through availing long-term and secured funds to primary mortgage lenders.

In its endeavor to create an enabling environment for a vibrant banking sector, CBK reviewed treatment of residential mortgages under the Basel III framework as well as benchmarked with other comparator jurisdictions. To this end, it was notable that under Basel III, mortgage lending that is fully secured by residential property or that will be occupied by the borrower, or that is rented, is assigned a risk weight of 35 percent subject to strict prudential criteria by the supervisory authorities. It is against this backdrop that CBK has decided to review the capital adequacy risk weighting for all residential mortgages from the current risk weight of 50 to 35

percent. It is envisaged that this amendment will free capital for banks to increase their mortgage lending.

Currently, under the CBK Prudential Guideline on Capital Adequacy (CBK/PG/03), residential mortgages that are fully secured by first charge are assigned a risk weight of 50 percent. The proposed amendment is in line with the international best practice.

In this regard, clause 4.3.1.1(c) of CBK/PG/03 has been amended as follows:

1. The figure "50%" appearing in the clause has been amended to read "35%".

The clause will now read:

"c) 35% Weight

Mortgage loans fully secured by first legal charge over residential properties located within cities and municipalities in the Republic of Kenya that are either occupied by the borrower or rented will attract risk weight of 35%. The 35% weight will not be applied to loans granted to companies engaged in speculative residential building or property development. The underlying security held must be perfected in all respects and its forced sale value (FSV) should cover in full the outstanding debt with at least 20% margin. Any portion of the loan in excess of 80% of the FSV of the residential property should attract a risk weight of 100%. The account should neither be in arrears nor exhibit any weakness. Rescheduled facilities shall carry a risk weight of 100%."

2. Under capital adequacy computation in FORM A: CBK/PR3, the risk weight for Mortgage Loans secured by residential property (line 2.12) is amended to read "0.35".
3. Under Completion Instructions, item 2.12, the figure "50%" is amended to read 35%.

The amendments will take effect from July 1, 2021 and CBK therefore advises all institutions to comply with the new requirements.

Yours faithfully,



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