CM ADVOCATES LLP



PROPERTY SWAPS IN KENYA: A STRATEGIC ALTERNATIVE TO AN OUTRIGHT PROPERTY PURCHASE

Legal, tax, financing and regulatory considerations for landowners, investors, developers, companies, trustees and lenders

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EXECUTIVE SUMMARY

Property swaps are emerging in Kenya as a flexible alternative to an outright property purchase. Instead of paying the entire purchase price in money, a purchaser may satisfy all or part of the consideration by transferring another property, several properties or a combination of property and money or other value.

A property swap is not confined to a one-property-for-one-property exchange. It may involve one property in exchange for several properties of the same or different character. A parcel of land may, for example, be exchanged for apartments, townhouses, maisonettes, commercial units, serviced plots or a combination of property interests whose aggregate agreed value corresponds to the value of the land.

The transaction may involve properties of equivalent value, in which case no additional consideration is required. Where the values differ, the exchange may be supplemented by a cash equalisation payment, the assumption or settlement of debt, shares, developed units, development rights, revenue participation, profit participation or another legally recognisable form of consideration.

Property swaps may enable landowners, investors and developers to preserve liquidity, reduce reliance on acquisition finance, consolidate or diversify real estate portfolios and unlock development opportunities. A landowner may prefer completed or income-generating units to an outright cash payment, while a developer may use existing property or future units to acquire strategically located development land.

These potential benefits should not obscure the transaction's legal and fiscal complexity. A property swap ordinarily involves a disposal and an acquisition by each party. Every property forming part of the exchange requires separate due diligence, valuation, tax analysis and transfer documentation.

A property swap may trigger land-registration requirements, stamp duty, capital gains tax, VAT, lender and security considerations, corporate approvals, Land Control Board consent, matrimonial-property rights, beneficial-ownership disclosure and anti-money-laundering obligations. The absence of a conventional cash purchase price does not remove these requirements.

The transaction should therefore be structured before the parties sign binding documents. The values and tax consequences of every property and every other component of consideration should be established, and completion should be genuinely simultaneous.

WHY THIS MATTERS

Property transactions in Kenya have traditionally been structured as outright sales for money or as land contributions to development joint ventures. A properly structured property swap provides a third route that may better align the parties' commercial interests.

A swap can allow a purchaser to acquire property without deploying the entire purchase price in cash. It may also allow a seller to move directly into another property or diversified portfolio without first selling, receiving cash and subsequently undertaking a separate acquisition.

The exchange may combine elements of an outright sale, asset reorganisation, portfolio diversification and development joint venture. Its legal form, however, must reflect its commercial substance. Calling a transaction a "swap" does not remove the ordinary rules governing the transfer, taxation and registration of property.

KEY TAKEAWAYS

- A property swap may be used as an alternative to an outright cash purchase.
- One property may be exchanged for one or several properties of the same or different characteristics.
- A swap may involve land, apartments, townhouses, maisonettes, commercial units, serviced plots or other property interests.
- Properties may be exchanged at equivalent values or together with money, debt assumption, shares, development rights or other consideration.
- Each property should be separately identified, valued and subjected to appropriate due diligence.
- Stamp duty, capital gains tax and VAT must be considered for each transfer and every component of consideration.
- Agricultural land, charged property, matrimonial property, estate property, sectional units and off-plan property require additional analysis.
- The documents should prevent one-sided or partial completion unless partial completion is expressly intended and fully regulated.

WHAT IS A PROPERTY SWAP?

A property swap is a transaction under which two or more parties exchange interests in real property rather than completing an acquisition funded entirely by money.

In its simplest form, Party A transfers Property A to Party B in consideration for Party B transferring Property B to Party A. The commercial value of the two properties may be equal, or the party receiving the higher-value property may pay a cash amount to equalise the transaction.

A swap may also involve a package of properties. One party may transfer a single parcel of land in exchange for several apartments, townhouses, commercial units or serviced plots. Several smaller properties may be exchanged for one

strategically important property, while several properties may also be exchanged for another portfolio of properties.

The properties do not need to have the same physical or commercial characteristics. What matters is whether their values and other attributes satisfy the parties' respective commercial objectives.

A property swap may therefore involve:

1. One property in exchange for one other property;
2. One property in exchange for several properties;
3. Several properties in exchange for one property;
4. Several properties in exchange for several other properties;
5. Property together with a cash equalisation payment;
6. Property together with the assumption or settlement of debt;
7. Land in exchange for completed or future development units;
8. Property in exchange for shares, development rights, revenue participation or profit participation; or
9. A combination of land, buildings, sectional units, money, debt and other legally recognisable consideration.

Where money or other value is included, the transaction remains a property exchange but assumes the character of a mixed-consideration arrangement. Each component of the consideration should be separately identified, valued and documented.

A STRATEGIC ALTERNATIVE TO AN OUTRIGHT PURCHASE

An outright property purchase ordinarily requires the purchaser to pay the agreed purchase price in money. Depending on the value of the transaction, the purchaser may need to deploy substantial cash reserves or obtain bank, private-credit or shareholder financing.

A property swap provides an alternative acquisition structure. The purchaser may satisfy all or part of the agreed consideration by transferring property that is acceptable to the seller.

This structure may be particularly suitable where the seller wishes to remain invested in real estate, acquire income-generating property, diversify a concentrated landholding or receive completed units in a development.

For example, a developer seeking to acquire a substantial parcel of land may offer the landowner completed apartments or townhouses, units to be constructed within the proposed development, or a combination of units and money. An investor seeking a commercial building may offer residential units, serviced plots or other investment property together with a cash equalisation payment.

A swap may therefore provide an alternative to an outright cash purchase, a fully debt-financed acquisition, a deferred purchase-price arrangement, vendor financing or a land sale followed by a separate reinvestment.

The appropriate structure will depend on the parties' objectives, the nature and value of the properties, financing arrangements, tax consequences, required consents and ability to complete all the transfers simultaneously.

POTENTIAL COMMERCIAL ADVANTAGES

Preservation of liquidity

A purchaser may acquire property without paying the entire purchase price in cash. This may preserve working capital or allow available funds to be applied to construction, refurbishment, infrastructure or other investment requirements.

Cash may nevertheless be required to meet taxes, transaction costs, lender requirements and any equalisation payment.

Reduced reliance on acquisition finance

Where property forms a substantial part of the consideration, the purchaser may require less external acquisition finance. This can reduce borrowing costs and exposure to interest-rate and refinancing risks.

The transaction may still require lender consent, discharge of existing security or replacement-security arrangements.

Portfolio consolidation or diversification

Several smaller properties may be exchanged for one strategic asset to consolidate ownership, improve operational efficiency or simplify management.

Conversely, one large property may be exchanged for several properties of different locations, uses or income profiles, allowing the transferor to diversify risk and improve liquidity.

Development facilitation

A developer may acquire land by allocating completed or future units to the landowner instead of paying the entire land value upfront in money.

The landowner may benefit from the value or income associated with apartments, townhouses, commercial units or other developed property. The landowner also assumes construction, completion and market risks that must be addressed in the documentation.

Alignment of different commercial objectives

A seller may prefer income-generating property to cash. A landowner may prefer completed units or participation in a development. A company may seek to replace a non-core property with an asset required for its operations.

A flexible property-swap structure may accommodate these different objectives through a combination of property, money, debt assumption, equity and development entitlements.

A Swap Is Still a Disposal and Acquisition

For Kenyan property and tax purposes, a property swap should not be treated as a transaction without consideration.

Each party should proceed on the basis that it disposes of the property or properties it transfers and acquires the property, shares, units or other interests it receives. A land contribution to a joint venture or special-purpose vehicle may likewise constitute a disposal even where the contributor receives equity, units or profit participation instead of money.

The transaction documents should identify every property and legal interest being transferred, the agreed values, valuation date, cash equalisation amount, liabilities being assumed or discharged, and all other forms of consideration.

They should also specify the conditions precedent, completion deliverables, allocation of taxes and transaction costs, long-stop date and consequences of a failure to deliver one side of the bargain.

The documentation should avoid a situation in which one party transfers its property but becomes an unsecured creditor for the property, units, shares or other consideration promised by the counterparty.

Structuring the Transaction

The legal structure should follow the parties' commercial objectives rather than merely the label attached to the transaction.

A direct exchange may be appropriate where the properties are complete, transferable and capable of simultaneous registration. A development or joint-venture structure may be required where land is being exchanged for future units, equity or participation in project revenue or profits.

Before preparing definitive documents, the parties should adopt a detailed term sheet or structure paper. It should record the titles, tenure, acreage and nature of the interests being transferred; the agreed values; the form and timing of consideration; any financing or discharge arrangements; the required consents; tax and cost allocation; completion sequence; long-stop date; and available remedies.

Where several properties form part of the consideration, the documents should state whether the properties are transferred as one indivisible package or whether partial completion is permitted.

If partial completion is permitted, the agreement should regulate the resulting valuation adjustment, tax allocation, completion mechanics and remedies. These matters should not be left for determination after one property has already been transferred.

Development and Joint-Venture Structures

Where a property swap forms part of a development joint venture, the documentation should extend beyond ordinary transfer provisions.

The joint-venture or development agreement should regulate governance, reserved matters, capital contributions, project financing, cost overruns, procurement, construction, project accounts, sales, distributions, deadlock, default, dilution, change of control and exit.

Where developed units constitute part of the landowner's consideration, those units should be identified with sufficient precision. The agreement should address their location, size, specifications, finishing standards, parking allocations, sectionalisation, construction milestones, completion date, handover and defects regime.

The landowner should also consider the security available if the developer fails to complete or deliver the promised units. Depending on the transaction, appropriate protections may include guarantees, escrow arrangements, controlled project accounts, restrictions on dealings with the land, step-in rights or security over project assets.

Legal and Technical Due Diligence

Every property forming part of the exchange should undergo comprehensive legal and technical due diligence.

Due diligence should establish the registered proprietor, tenure, remaining lease term, acreage, survey position and historical ownership. It should identify any charges, cautions, restrictions, inhibitions, easements, wayleaves, leases, options, overriding interests or other third-party rights.

The parties should confirm the position on land rent, county rates, taxes and statutory outgoings. They should investigate occupation, tenancies, access, encroachments, adverse-possession indicators and discrepancies between the physical property and its registered or surveyed description.

Planning and development due diligence should verify zoning, permitted use, change-of-user approvals, building approvals, occupation certificates, environmental approvals, infrastructure reservations, enforcement notices and outstanding development obligations.

The review should also consider litigation, compulsory-acquisition exposure, matrimonial-property rights, succession authority, trusts and other beneficial interests. An official title search alone is not sufficient.

Where the consideration comprises several properties, due diligence should be conducted separately on each property. A clean title for one apartment, townhouse, commercial unit or land parcel does not establish the status of the other properties within the exchange package.

Agricultural Land and Land Control Board Consent

Where any property included in the exchange is agricultural land situated within a land-control area, the parties should determine whether the transaction constitutes a controlled transaction under the Land Control Act.

A swap should not be assumed to fall outside the statutory consent regime merely because no substantial cash consideration is paid. The same applies where agricultural land is contributed to a joint venture or development vehicle.

Where Land Control Board consent is required, obtaining that consent should be an express condition precedent. Failure to secure the required consent within the applicable statutory framework may invalidate the transaction.

Sectional Property

Where the transaction concerns an apartment, office, shop, maisonette or other sectional property, due diligence should extend beyond the parent title.

The parties should verify the sectional title, registered sectional plan, unit entitlement, common-property rights and the registration and governance of the corporation established under the Sectional Properties Act, 2020.

They should review the applicable by-laws, service-charge accounts, insurance arrangements, management contracts, outstanding arrears, disputes and restrictions affecting the transfer or use of each unit.

Where several sectional units form part of the consideration, each unit should be separately identified and reviewed. The analysis should address unit size, floor level, parking entitlement, common-property rights, occupation, tenancy arrangements and service-charge liabilities.

Development and Off-Plan Property

A swap involving development or off-plan property presents additional delivery and completion risks.

The parties should review approved development plans, building and environmental approvals, contractor and consultant appointments, project financing, existing securities and purchaser commitments. The construction status and development programme should be independently verified.

Where the landowner is to receive completed units, the documents should regulate construction milestones, inspection rights, specifications, completion standards, sectionalisation, handover, defects, warranties and remedies for delay.

They should also contain meaningful protections against non-completion, developer insolvency, diversion of project proceeds and lender enforcement.

Independent Valuation

Independent valuation is central to a property swap because the transaction may not contain a conventional cash price against which value can readily be tested.

Each property should be valued by an appropriately qualified valuer using a consistent valuation date and methodology. The valuation should address tenure, remaining lease term, location, permitted use, condition, improvements, comparable transactions, income potential, development potential, marketability, restrictions and material assumptions.

Where one property is exchanged for several properties of different characteristics, each asset should be valued separately before the values are aggregated.

Where land is exchanged for future apartments, townhouses or other units, the parties should distinguish between the present value of incomplete or off-plan units and their anticipated value on completion. The valuation assumptions concerning construction, approvals, specifications, completion dates and market conditions should be expressly recorded.

The parties should also agree whether values are fixed at signing or may be adjusted before completion. A price-adjustment mechanism may be necessary where construction, sectionalisation or delivery will occur over an extended period.

Corporate Authority and Foreign Ownership

Where a property is company-owned, the transaction should be supported by the necessary corporate approvals.

The parties should verify constitutional capacity, board and shareholder approvals, conflicts of interest, compliance with directors' duties, related-party requirements and restrictions contained in financing or investment documents.

Current beneficial-ownership information should be obtained and verified. Complex corporate structures, offshore shareholders, trusts and nominee arrangements may require enhanced corporate and anti-money-laundering due diligence.

Where a non-citizen or foreign-controlled entity is involved, the landholding structure should be reviewed against Article 65 of the Constitution. Non-citizens may hold land only on leasehold tenure for a term not exceeding 99 years.

Matrimonial Property, Estates and Trusts

Where a property constitutes matrimonial property, the parties should establish whether spousal consent is required and whether an unregistered matrimonial interest may affect the transfer.

If the registered proprietor has died, the transaction should not proceed merely because the deceased remains named on the title. The personal representative must hold the appropriate grant of representation and authority to transfer or exchange the property.

Where property is held in trust, the trustee's powers should be reviewed together with the trust instrument, the interests of beneficiaries and any required approvals.

A defect in capacity or authority may undermine both the transfer and any wider development structure dependent on the property contribution.

Stamp Duty

An exchange of properties is treated as a conveyance on sale for stamp duty purposes in respect of each property transferred. The relevant instruments, property values and any cash or other consideration should be reviewed before execution.

In a multi-property exchange, the analysis should identify every conveyance or transfer instrument required to implement the transaction and the value attributable to each property.

The parties should not assume that stamp duty applies only to a cash equalisation payment or is calculated only on the net difference between the aggregate values.

A valuation may be required for stamping purposes. An unstamped instrument may face registration and evidential consequences.

The agreement should allocate responsibility for duty and related costs. A private allocation does not, however, displace statutory liability.

Capital Gains Tax

An exchange constitutes a transfer for capital gains tax purposes. Each transferor should calculate separately the gain arising from every property it disposes of.

The calculation should take account of the applicable transfer value, adjusted acquisition cost, enhancement expenditure, allowable incidental acquisition and disposal costs, and available exemptions or exclusions.

The Kenya Revenue Authority currently states that CGT is charged at 15% of the net gain. KRA also expressly recognises an exchange as a transfer for CGT purposes. The tax is payable by the transferor at the earlier of receipt of the full consideration or registration of the transfer instrument.

Where properties are exchanged for several assets or mixed consideration, each disposal should be reviewed separately. The tax consequences should not be calculated only by reference to the exchange package as a whole.

Related-party and non-cash transactions require defensible market-value evidence. A land contribution in return for shares, development rights, units or profit participation also requires transaction-specific analysis.

VAT

VAT should be considered independently from stamp duty and capital gains tax. Its application depends on the nature of the property, the legal character of the supply, the parties' activities, VAT-registration status and applicable exemptions.

A multi-property transaction may combine land, residential units, commercial units, construction services and monetary consideration with different VAT consequences. Each supply should therefore be characterised separately before the parties agree the final values and tax allocation.

The agreement should expressly state whether the property values and equalisation payments are VAT-inclusive or VAT-exclusive and identify the party responsible for issuing any required tax invoice.

Tax Modelling Before Signing

Tax analysis should be completed before the parties sign binding documents.

The model should address market value, acquisition cost, allowable expenditure, exemptions, reliefs, filing deadlines, payment dates, invoicing and any equalisation or gross-up mechanism. Appropriate tax warranties, covenants and indemnities should be included.

Where the structure involves a joint venture or property-holding company, the analysis should extend beyond the initial transfer to the issue or transfer of shares, allocation of units, project distributions, debt assumption, buy-outs and exit arrangements.

Cross-border or foreign-investor structures may require additional review of indirect transfers, permanent-establishment exposure, withholding obligations and any relevant double-taxation agreement.

Charged Property and Project Finance

A charged property cannot ordinarily be treated as freely transferable. The transaction may require lender consent, redemption statements, discharge or partial discharge, replacement security, debt assumption, refinancing, tripartite agreements and professional undertakings.

Where several properties are charged, the completion protocol should coordinate the respective lenders, advocates and registries and prescribe the sequence for releasing security documents, transfer instruments and funds.

Where land is contributed to a financed development, the documents should regulate whether the land may be charged, the priority of project security, lender step-in rights, conditions for enforcement, release of completed units and application of project proceeds.

The land contributor should understand and mitigate the risk that the land may become subject to lender enforcement if the development fails.

Cash Equalisation and Other Consideration

Where the exchanged properties have different values, the party receiving the higher-value property or property package may pay a cash equalisation amount.

The agreement should characterise the payment, specify its amount and currency, state the approved payment route and confirm whether it is tax-inclusive or tax-exclusive. It should also address interest, set-off, default and third-party payments.

For high-value transactions, the parties should consider an advocate-controlled completion account or another controlled-release mechanism.

Value may also be equalised through debt assumption, shares, additional units, development rights or adjustments to revenue or profit participation. Every component should be independently valued and precisely documented.

The Property Exchange Agreement

A property swap should ordinarily be documented through a comprehensive Property Exchange Agreement, supported where necessary by joint-venture, development, financing, escrow and security documents.

Every property should be identified in a schedule setting out its title or unit description, tenure, acreage or unit size, registered owner, agreed value and applicable completion documents.

The agreement should state whether the properties form one indivisible package or whether partial completion is permitted.

Where the commercial intention is to complete one integrated exchange, neither party should be required to complete unless every property, payment, discharge and other item of consideration is simultaneously deliverable.

If partial completion is permitted, the agreement should prescribe the valuation adjustment, tax allocation, completion mechanics and remedies.

The agreement should also contain appropriate representations, warranties, disclosures, indemnities, tax covenants, default remedies, termination rights, restitution provisions and dispute-resolution arrangements.

Simultaneous Completion

The central protection in a property swap is a genuinely simultaneous completion mechanism.

Neither party should release its transfer or completion documents unless the counterparty is simultaneously ready, willing and able to complete the corresponding transfer and deliver every additional component of consideration.

The completion protocol should list every registrable instrument, original title, consent, clearance, discharge, corporate approval and tax deliverable.

It should regulate lodgement, rejection, correction and re-lodgement and state what happens to funds and documents if registration of any leg fails or is delayed.

Professional undertakings should be clear, conditional and enforceable. The documentation should reflect one integrated exchange rather than a series of unrelated transfers.

Possession, Tenancies and Income

The agreement should specify when possession, risk and insurance responsibility pass and whether each property is transferred with vacant possession or subject to existing tenancies.

For income-generating property, the parties should agree a schedule identifying tenants, rent, deposits, arrears, service charges and management arrangements.

The agreement should regulate the apportionment of rent, rates, land rent, utilities and other outgoings and provide for the delivery of tenancy records, deposits, keys, access devices and management information.

HOW CM ADVOCATES LLP CAN ASSIST

The Real Estate, Development & Built Environment Practice, within the Real Estate, Banking and Finance Department, leads CM Advocates LLP's property-swap advisory work.

The Practice works closely with the Tax & International Business Advisory (TIBA) Unit on stamp duty, capital gains tax, VAT, transaction structuring and cross-border considerations. Depending on the transaction, the teams collaborate with the Firm's Corporate, Projects and Dispute Resolution practices to provide an integrated service.

We advise on structure selection, comparative assessment against an outright acquisition, due diligence, valuation coordination, tax modelling, regulatory approvals, financing, Property Exchange Agreements, joint-venture and development agreements, completion protocols, registration, post-completion implementation and transaction-related disputes.

Practice Contacts:

Real Estate, Development & Built Environment Practice:
E: REDBE@cmadvocates.com

Real Estate, Banking and Finance Department
E: RBF@cmadvocates.com

Tax & International Business Advisory (TIBA) Unit
E: taxadvisory@cmadvocates.com

CM Advocates LLP – Contact Details

Head Office Nairobi
I&M Bank House, 7th Floor, 2nd Ngong Avenue
T: +254 20 2210978 or +254 716 209673
P.O. Box 22588 – 00505, Nairobi Kenya
E: law@cmadvocates.com

Mombasa Office
Links Plaza, 3rd Floor, Links Road, Nyali
T: +254 041 447 0758 / +254 41 447 0548
P.O. Box 90056 – 80100, Mombasa Kenya
E: mombasaoffice@cmadvocates.com

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