



RETHINKING REAL ESTATE CAPITAL: HOW RCSLNS CAN REPLACE RELIANCE ON OFF-PLAN SALES

INTRODUCTION

For over a decade, off-plan sales have served as the backbone of real estate financing in Kenya. Developers' pre-sold units often before the first brick was laid and relied on deposits from early buyers as quasi-equity to fund construction. The model was practical, even innovative, in a market where bank credit was expensive and institutional capital scarce.

However, the economic terrain has shifted. Rising interest rates, tighter banking regulation, and waning consumer confidence driven by years of delayed and abandoned projects have exposed the fragility of the off-plan model. Developers now face liquidity constraints, while increasingly sophisticated buyers demand completed units or legally protected escrow structures before committing funds.

In response, structured capital instruments are emerging as viable alternatives.

The Redeemable Convertible Subordinated Loan Note (RCSLN) blends debt stability with equity upside, enabling developers to build first, sell later and re-establish institutional credibility in project financing.

THE PROBLEM WITH OVER-RELIANCE ON OFF-PLAN SALES

At its peak, the off-plan model offered a bridge between concept and completion. Developers collected deposits of 10–30%, funded early works, and relied on progressive buyer payments to advance construction. When timelines held and markets remained buoyant, the model functioned. But when projects stalled or market conditions tightened, the weaknesses became evident.

Over-reliance on off-plan sales exposes developers to volatile cash flows, heightened litigation and consumer disputes, and erosion of market trust. Critically, buyers who provide upfront capital bear disproportionate risk while exercising minimal control over project governance.

Recent years have seen an increase in stalled developments, trapping purchasers between delayed delivery and lost deposits. In response, lenders and regulators have demanded stronger governance, escrow protections, performance security, and clearer risk allocation before supporting such projects.

Kenya's maturing real estate market can no longer treat buyer deposits as de facto construction finance. The sector must transition from speculative pre-sales to structured private capital, where risk, return and control are contractually allocated.

THE RISE OF STRUCTURED CAPITAL IN REAL ESTATE

Globally, developers are increasingly adopting layered capital stacks that combine senior secured debt with mezzanine and hybrid instruments designed to bridge the gap between traditional bank lending and sponsor equity.

Within Kenya, the Redeemable Convertible Subordinated Loan Note has emerged as a particularly effective instrument for this purpose. Properly structured, RCSLNs provide developers with patient, flexible capital while offering investors contractual certainty and downside protection without the uncertainties inherent in off-plan sales.

Typically, the structure involves incorporation of a Special Purpose Vehicle to hold project assets, ring-fence liabilities, and serve as the issuing entity. Private or institutional investors inject capital through RCSLNs that sit contractually between senior debt and equity in the project capital stack.

FEATURES OF AN RCSLN

a) Redeemable Instruments

The instrument is redeemable, allowing the SPV to buy back the notes after a defined tenor deliberately aligned to the development lifecycle. In most Kenyan real estate projects, construction, completion, and sales are typically achieved within 24 to 36 months, with an outer horizon of up to 48 months for larger or more complex developments. RCSLNs are therefore structured with a corresponding medium-term tenor, ensuring redemption is closely tied to project completion, unit sales, or refinancing once cash flows crystallize.

b) Convertible Instrument

The instrument is convertible, enabling investors to convert outstanding debt into equity often preferred shares upon achievement of agreed valuation thresholds, completion milestones, or performance triggers. This conversion feature allows investors to participate in project upside following completion while preserving debt-like protections during the construction phase.

c) Subordinated

The RCSLN is subordinated, ranking below senior secured lenders but ahead of sponsor equity. This positioning balances risk and return, provides comfort to senior lenders, and preserves the overall bankability of the financing structure. In effect, RCSLNs offer a middle path—combining the certainty of debt, the optionality of equity, and the discipline of structured finance.

WHY RCSLNS FIT KENYA'S REAL ESTATE MARKET

Kenya's property sector is at a structural inflection point, shifting away from consumer-funded construction toward institutional capital models aligned with global best practice. RCSLNs are particularly well-suited to this environment for several reasons: -

a) Predictable Cash Flow

RCSLNs provide developers with upfront capital, enabling uninterrupted construction throughout the typical 24–36 month build phase. This reduces reliance on incremental buyer deposits, helping projects stay on schedule and lowering execution risk.

b) Investor Downside Protection

Investors benefit from structured contractual safeguards. RCSLNs rank after senior lenders but before sponsor equity, offering repayment priority and fixed or structured returns during construction.

Conversion rights into equity upon project completion or stabilization provide potential upside while preserving initial downside protections.

c)Developer Control and Flexibility

Throughout construction and sales, RCSLNs function as debt instruments, allowing developers to maintain governance and decision-making authority. Redemption or conversion is timed to milestones such as project completion, bulk sales, or refinancing events, providing flexibility without compromising operational control.

d)Market Credibility

Financing through structured private capital signals institutional discipline to the market. Visible progress funded by reliable capital reassures buyers, improves absorption rates, and restores public confidence, reducing reliance on speculative pre-sale activity.

e)Efficient Exit and Refinancing

Upon project completion typically within 24–48 months the SPV redeems the notes, settles investor returns, and distributes residual value to shareholders. This structured exit avoids pre-sale pressures and ensures a clean, predictable conclusion to the financing cycle.

REPLACING PRE-SALES WITH STRUCTURED PRIVATE CAPITAL

Consider a mixed-use development in Nairobi with a total project value of KES 3 billion. A commercial bank provides KES 1.5 billion in senior secured debt.

A private investor contributes KES 800 million through RCSLNs bearing a fixed return of 9 percent per annum, structured for redemption or conversion upon completion within an anticipated 36-month horizon. The developer contributes land and equity valued at KES 700 million.

Construction commences immediately, without reliance on off-plan sales.

Upon completion and unit sales, cash flows follow a clear repayment waterfall. First, the senior lender is repaid in full. Second, the RCSLN investors are redeemed or elect to convert into preferred equity. Third, residual profits are distributed to the developer.

This layered structure reduces speculative risk, enhances bankability, and transforms development from a transactional exercise into an investment-grade asset class.

LEGAL AND REGULATORY FRAMEWORK OF RCSLNS IN KENYA

RCSLNs are firmly grounded in Kenyan corporate, insolvency, and capital markets law and are widely used in structured finance and private credit transactions.

a)Corporate Law Compliance

Under the Companies Act, 2015, Kenyan companies may raise capital through debt instruments, including debentures and loan notes, which can be structured as redeemable and convertible with shareholder approval. The Act permits conversion of debt into equity in line with constitutional documents and approved terms, while redemption remains subject to a solvency test, ensuring creditor protection at exit.

b)Insolvency Recognition

The Insolvency Act, 2015 explicitly recognizes contractual subordination. Section 472 allows parties to vary the priority of debts by agreement, giving full legal effect to intercreditor arrangements and subordinated instruments.

This underpins the enforceability of RCSLNs ranking below senior lenders but ahead of sponsor equity in the capital stack.

c)Capital Markets and Securities Law

RCSLNs are typically issued via private placements rather than public offers.

Under the Capital Markets Act (Cap. 485A) and related regulations, offers made to a limited number of sophisticated or institutional investors qualify as private placements and are exempt from full prospectus requirements.

Disclosure is provided through an information memorandum or private placement document.

d)Legal Enforceability and Market Compatibility

When properly structured, RCSLNs are legally enforceable, regulatorily compliant, and fully compatible with Kenyan frameworks for project finance, private credit, and hybrid capital.

Terms including investor rights, conversion mechanics, redemption, ranking, and risk allocation are clearly documented, ensuring certainty for both developers and investors.

e)Investor Protection Meets Developer Flexibility

RCSLN terms are tailored to project risk and investor appetite, with tenors aligned to anticipated construction and sales cycles.

Typical parameters include a tenor of 24 to 36 months, extendable up to 48 months where required, fixed or structured returns of eight to ten percent per annum (paid or capitalised), conversion into preferred equity at completion-linked or milestone-based valuations, redemption from unit sales proceeds or refinancing, and ranking below senior debt but above equity.

These terms are embedded in integrated documentation, including the Loan Agreement, Instrument of Note, Intercreditor Agreement, and Shareholders' Agreement, ensuring enforceability, clarity, and alignment across all stakeholders.

THE BROADER IMPACT: A NEW MODEL FOR KENYAN REAL ESTATE

The shift from pre-sales to structured private capital reflects the maturation of Kenya's real estate sector.

While off-plan sales may remain relevant for smaller or affordable housing projects, mid-scale and large developments increasingly require institutional funding frameworks anchored on defined construction timelines, disciplined governance, and credible exit mechanisms.

In a market once driven by buyer faith, RCSLNs introduce institutional trust, predictability, and bankability—laying the foundation for Kenya's next generation of resilient, investor-ready urban developments.

CONCLUSION

Kenya's real estate sector is entering a new financial era—one that prizes structure over speculation.

Redeemable Convertible Subordinated Loan Notes are not merely financing tools; they are frameworks for confidence, credibility, and sustainable growth.

By aligning hybrid capital instruments to actual construction and sales cycles, developers can unlock scale without mortgaging trust, and investors can fund progress with clear, enforceable rights.

The era of relying on off-plan sales to bridge funding gaps is giving way to a more professional, transparent, and legally grounded model of project finance—one that reflects both the ambition and the maturity of Kenya's urban future.

CONTACT US

The Real Estate, Banking & Finance Unit (RBF) and the Hybrid Capital & Structured Finance (HCSF) Practice at CM Advocates LLP advise landowners, developers, financiers, private credit funds and institutional investors on the design and execution of hybrid capital strategies, capital stacks and development financing arrangements that reflect Kenyan law and enhance long-term value.

The firm regularly advises on revenue-based financing, structured credit, private capital deployments, and bespoke financing solutions across real estate, infrastructure, technology and growth sectors.

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