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PROPERTY SWAPS IN KENYA: LEGAL, TAX AND REGULATORY CONSIDERATIONS

What Landowners, Investors, Developers, Companies, Trustees and Lenders Need to Know

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EXECUTIVE SUMMARY

Property swaps in Kenya are increasingly being considered as an alternative to conventional cash-funded acquisitions. They may enable landowners, investors and developers to unlock illiquid assets, consolidate landholdings, diversify or rebalance real estate portfolios and facilitate development joint ventures without relying entirely on cash consideration.

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

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

The parties may therefore agree a pure property-for-property exchange, a property-for-several-properties exchange or a mixed-consideration transaction involving property and money or other value.

The commercial flexibility of a property exchange can be attractive, but its apparent simplicity is deceptive. Each party may simultaneously dispose of one or more properties and acquire one or more other properties or proprietary interests. Every property forming part of the exchange requires separate legal and technical due diligence, independent valuation and coordinated transfer and completion arrangements.

A property swap may trigger land-registration requirements, stamp duty, the applicable income-tax treatment (including capital gains tax, where applicable), VAT, financing and security considerations, corporate approvals, Land Control Board consent, matrimonial-property rights, beneficial-ownership disclosure and anti-money-laundering and due diligence obligations. The absence of a conventional cash purchase price does not remove these legal, tax or regulatory consequences.

The structure should therefore be settled before the parties enter binding agreements. Each property should be independently valued and subjected to full due diligence, the tax consequences of each leg should be modelled separately, and the documents should ensure that neither party completes its transfer unless the corresponding property, payment, discharge or joint-venture entitlement is simultaneously deliverable.

KEY TAKEAWAYS

- A property swap is ordinarily both a disposal and an acquisition.
- One property may be exchanged for one or several properties of the same or different characteristics.
- A swap may involve properties of equivalent value or property together with money, debt assumption, shares, development rights or other consideration.
- Each property requires separate legal, technical and valuation due diligence.
- Stamp duty, capital gains tax and VAT consequences should be analysed separately for each leg and every component of consideration.
- Agricultural land, charged property, matrimonial property, estate property, development property and sectional property require additional transaction-specific analysis.
- Completion should be simultaneous and supported by a detailed protocol controlling the release of documents, funds and securities.

WHAT IS A PROPERTY SWAP?

A property swap is a transaction under which two or more parties exchange interests in real property instead of completing a conventional 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. A property swap may, however, involve a more complex package of assets and consideration.

One property may be exchanged for several properties. The properties received may be similar or may have diverse characteristics, uses, tenures and locations. For example, a landowner may exchange a single parcel of undeveloped land for several apartments, townhouses or commercial units. A commercial building may be exchanged for a combination of agricultural land, serviced plots and residential units. A developer may acquire development land in return for several completed or future units within the resulting development.

The relevant commercial comparison is ordinarily between the agreed value of the property or property package transferred by one party and the aggregate value of the properties and other consideration supplied by the other party.

A property swap may therefore involve one property in exchange for one other property; one property in exchange for several properties; several properties in exchange for one property; or several properties in exchange for several other properties.

It may also involve one or several properties together with a cash equalisation payment, the assumption or discharge of debt, shares, developed units, development rights, revenue participation, profit participation or another legally recognisable form of consideration.

Where money or another form of consideration is included, the transaction remains a property exchange but assumes the character of a mixed-consideration arrangement. The agreement should clearly distinguish the property consideration from the cash, debt, equity, development or other consideration.

A PROPERTY SWAP IS BOTH A DISPOSAL AND AN ACQUISITION

For Kenyan property and tax purposes, a property exchange should not be treated as a transaction without consideration. Each party should proceed on the basis that it disposes of the property it gives and acquires the property, shares, developed units or other interest it receives.

The same principle may apply where land is contributed to a joint venture or special-purpose vehicle. The fact that the landowner receives equity, developed units or profit participation instead of money does not necessarily prevent the contribution from constituting a disposal.

The transaction documents should identify every property and legal interest being transferred by each party, the agreed market values, the valuation date, any cash equalisation payment, any debt being assumed or discharged, and every other form of consideration.

They should also establish 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, developed units, shares or other consideration promised by the counterparty.

SELECTING THE APPROPRIATE TRANSACTION STRUCTURE

The legal structure should follow the parties' commercial objectives and not merely the label attached to the transaction.

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

Before definitive agreements are prepared, the parties should adopt a structure paper or detailed term sheet. It should record the title, tenure, acreage or unit size and nature of each interest being transferred; the values assigned to the properties; the form and timing of consideration; and any financing, discharge or equalisation arrangements.

The structure paper should also identify all required consents and approvals, the allocation of transaction costs and taxes, the proposed completion sequence, the long-stop date and the remedies available if one property or entitlement cannot be delivered.

PURE AND MIXED-CONSIDERATION EXCHANGES

A pure property exchange arises where the parties exchange property interests without additional monetary or non-property consideration. The exchange may involve one property on each side or a package comprising several properties.

The properties do not need to be identical in character. What matters commercially is whether the parties accept the relevant properties or property packages as equivalent consideration.

For example, a single parcel of land valued at KES 150 million may be exchanged for several apartments whose aggregate agreed value is KES 150 million. Although the assets differ in type, location, physical characteristics and income potential, the parties may agree that their aggregate values are equivalent.

Where the agreed values are not equal, the party receiving the higher-value property or property package may pay a cash equalisation amount. Land valued at KES 200 million may, for example, be exchanged for apartments with an aggregate value of KES 170 million together with a cash payment of KES 30 million.

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The difference in value may also be addressed through non-cash consideration. A party may assume or discharge a mortgage or other liability, issue shares, grant development rights, allocate additional completed units or adjust revenue or profit participation.

Each component of the consideration should be separately identified, independently valued and clearly documented. The parties should avoid using a composite figure that obscures the value attributed to each property, payment, liability or other entitlement.

DEVELOPMENT AND JOINT-VENTURE STRUCTURES

Where the 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 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 circumstances, 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. A party should not apply a lower level of scrutiny merely because it is transferring another property instead of paying a conventional cash purchase price.

Due diligence should establish the registered proprietor, tenure, remaining lease term, acreage, survey position and historical ownership of each property. 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 other statutory outgoings. They should investigate occupation, tenancies, encroachments, access, adverse-possession indicators and any discrepancy between the physical property and its registered or surveyed description.

Planning and development due diligence is equally important. The parties should verify zoning, permitted use, change-of-user approvals, building approvals, occupation certificates, environmental approvals, infrastructure reservations and any enforcement notices or 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 does not establish all these matters and should not be regarded as sufficient due diligence.

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

The review should be adapted to the characteristics of each asset. Agricultural land, sectional units, development property, commercial property and income-generating residential property may each require a different diligence workstream.

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 proposed transaction constitutes a controlled transaction under the Land Control Act.

A property exchange should not be assumed to fall outside the consent regime merely because no substantial cash consideration is paid. The same caution applies where agricultural land is contributed to a joint venture, development company or special-purpose vehicle.

Where Land Control Board consent is required, obtaining the consent should be an express condition precedent. The transaction timetable should accommodate the statutory process and the consequences of failing to obtain consent within the applicable period.

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 the unit.

Where the property has not yet been sectionalised, the transaction documents should clearly address the process, responsibility and timeframe for creating and registering the sectional title.

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 property 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.

The parties should also establish whether infrastructure obligations, planning conditions, sectionalisation requirements or outstanding statutory payments may delay or prevent delivery.

Where the landowner is to receive completed units, the transaction documents should regulate construction milestones, inspection rights, completion standards, handover, defects, warranties and remedies for delay. They should contain meaningful protections against non-completion, developer insolvency or diversion of project proceeds.

INDEPENDENT VALUATION

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

Unless otherwise agreed, 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 diverse 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 upon completion. The valuation should state the assumptions concerning construction, approvals, specifications, delivery dates and market conditions.

The parties should agree whether the 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.

Where the agreed values depart materially from independent market evidence, the parties should document the commercial rationale. This is particularly important for corporate, institutional, related-party and financed transactions.

In a development joint venture, the land valuation may determine equity participation, profit-sharing ratios, allocation of developed units, dilution and buy-out rights. The valuation methodology should therefore be transparent and capable of application throughout the project lifecycle.

CORPORATE AUTHORITY AND FOREIGN OWNERSHIP

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

The parties should verify the company's constitutional capacity, board approval, shareholder approval where required, 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. Where the ownership structure involves multiple corporate layers, offshore shareholders, trusts or nominee arrangements, enhanced corporate and anti-money-laundering due diligence may be required.

Where a non-citizen or a body corporate that is not wholly owned by Kenyan citizens is involved, the proposed landholding structure should be reviewed against Article 65 of the Constitution of Kenya. Non-citizens may hold land only on the basis of leasehold tenure for a term not exceeding 99 years.

A property swap or corporate structure should not be used to circumvent constitutional or statutory restrictions on land ownership.

MATRIMONIAL PROPERTY, ESTATES AND TRUSTS

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

If the registered proprietor has died, the transaction should proceed only through a duly appointed personal representative with the requisite authority. The transaction must comply with the restrictions imposed by the Law of Succession Act which prohibits the sale of immovable property forming part of a deceased's estate before confirmation of the grant, as well as any court approvals, consents or other requirements applicable under the terms of the grant or the succession proceedings.

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

A defect in legal capacity or authority may undermine not only the transfer but also any wider joint-venture or development structure dependent upon the land contribution.

STAMP DUTY ON PROPERTY SWAPS

The Stamp Duty Act specifically addresses conveyances on exchange. The relevant instruments, property values and any cash or other consideration should therefore be reviewed before execution.

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

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

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

The transaction documents should allocate responsibility for stamp duty and related costs. However, a private contractual allocation does not displace a statutory liability imposed by law.

CAPITAL GAINS TAX ON A PROPERTY EXCHANGE

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 capital gains tax is charged at 15% of the net gain. It is payable by the transferor at the earlier of receipt of the full consideration or registration of the transfer instrument.

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

Related-party and non-cash transactions require defensible market-value evidence. Where land is contributed to a joint venture or special-purpose vehicle in exchange for shares, units, development rights or profit participation, the parties should determine whether the contribution constitutes a taxable disposal and how the non-cash consideration should be valued.

VAT CONSIDERATIONS

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' business activities, their VAT-registration status and applicable exemptions.

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

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

Failure to address VAT expressly may result in a significant and unexpected liability at completion.

TAX MODELLING BEFORE SIGNING

Tax analysis should be completed before the parties sign binding agreements. Each party should understand the stamp duty, capital gains tax and VAT treatment applicable to its leg of the transaction and to every form of consideration.

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

Where the structure involves a joint venture or property-holding company, the tax model should extend beyond the initial transfer. It should consider the issue or transfer of shares, allocation of completed 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 the application of 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. It should identify the sequence for releasing security documents, transfer instruments and funds.

Where land is contributed to a financed development, the documentation 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 sale proceeds.

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

CASH EQUALISATION PAYMENTS

Where the exchanged properties have different values, the parties may agree that the party receiving the higher-value property or property package will 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 using an advocate-controlled completion account, escrow account or another agreed controlled-release mechanism.

A joint venture may equalise value through adjustments to equity, unit allocations or distributions instead of cash. Such adjustments 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.

The agreement should identify the parties and every property forming part of the exchange. Where several properties are involved, they should be listed in schedules stating their title or unit descriptions, tenure, acreage or unit size, registered owner, agreed value and applicable completion documents.

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

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

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

Each party should provide appropriate representations and warranties concerning ownership, authority, encumbrances, litigation, occupation, tenancies, planning compliance, environmental matters, taxes and undisclosed third-party interests. These warranties should be supported by disclosure and enforceable remedies.

The agreement should regulate completion, registration, possession, risk, insurance, rent, deposits, service charges, land rent, rates, utilities and other outgoings. It should also provide for default, indemnities, termination, restitution, dispute resolution and the long-stop date.

SIMULTANEOUS COMPLETION

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

Neither party should be required to release its transfer or completion documents unless the counterparty is simultaneously ready, willing and able to complete the corresponding transfer and pay or 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 of documents and state what happens to funds and completion documents if registration of any leg fails or is delayed.

Any professional undertakings should be clear, conditional and enforceable. The transaction documents should reflect the parties' commercial intention that the transaction constitutes 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. It should identify whether each property is transferred with vacant possession or subject to existing tenancies.

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

The agreement should regulate the apportionment of rent, rates, land rent, utilities and other outgoings as at completion. It should also provide for delivery of tenancy records, deposits, keys, access devices, management information and other handover materials.

POST-COMPLETION OBLIGATIONS

Completion does not end with the execution and lodgement of transfer documents.

The parties should allocate responsibility for following up registration, obtaining and releasing original documents, notifying tenants and counterparties, changing utility accounts and handing over property-management arrangements.

Where the transaction involves a company, the parties should update the relevant corporate and beneficial-ownership records. Where deferred development obligations remain, the parties should maintain an effective monitoring and enforcement framework until those obligations have been discharged.

HOW WE 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 also collaborate with the Firm's Corporate, Projects and Dispute Resolution practices to provide an integrated service.

We advise on transaction structuring, legal and regulatory due diligence, valuation coordination, tax modelling, regulatory and third-party approvals, acquisition and project financing, Property Exchange Agreements, joint-venture and development agreements, completion protocols, registration, post-completion implementation and transaction-related disputes.

PRACTICAL PROPERTY-SWAP CHECKLIST

Before committing to a property swap, the parties should:

1. Select and document the appropriate direct-transfer, joint-venture or corporate structure.

2. Identify every property and every monetary or non-monetary component of consideration.
3. Complete legal, survey, planning, environmental, occupation and technical due diligence on every property.
4. Obtain separate independent valuations using a consistent valuation date.
5. Model stamp duty, capital gains tax, VAT and lifecycle tax consequences before signing.
6. Obtain all corporate, spousal, probate, lender, Land Control Board and other required consents.
7. Negotiate integrated transaction documents containing appropriate conditions, warranties, indemnities and default remedies.
8. Implement a simultaneous completion protocol and controlled release of documents, funds and securities.
9. Complete registration, handover and all required post-completion actions.

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