A STRATEGIC APPROACH TO REAL ESTATE FINANCING: CHALLENGES & OPPORTUNITIES IN REAL ESTATE FINANCING IN NIGERIA

Lucy Ogbenjuwa, Professor Charles Egbu and Professor Herbert Robinson

Department of Built Environment & Architecture, London South Bank University

ABSTRACT:

This study examined some of the challenges and opportunities in real estate financing in Nigeria. This was done through the examination of four (4) salient factors which are the economic factors, legal framework, policy environment and private sector developers. The residential loan of which mortgage loan forms the bulk, accounts for 70% of the GDP of the developed economies; however, it is less than 1% to Nigerian GDP. The causative underlying factors for this gross comparative underperformance has to be understood to influence policy changes that will create a more sustainable real estate environment in Nigeria. The focus of the paper is on residential real estate. A number of studies have been done on real estate financing in Nigeria but none has looked at it from these four (4) focal points. This study contributes to the field by presenting some of the challenges and opportunities in real estate financing in Nigeria to facilitate the provision a platform for possible solutions. The chosen methodology is desk based through a comprehensive review of literature. The findings show that real estate financing in Nigeria is plagued by challenges that can be mitigated. The study proffers recommendations for policy makers and managers.

Key words: housing finance, legal framework, policy environment, private sector developers, economic factors

INTRODUCTION

There is a significant shortfall in housing supply for the fast growing Nigerian population. The demand for housing especially in the urban regions is continually on the increase because of massive influx of people to urban settlements (Awofeso, 2010). Available statistics from the World Bank and the National Bureau of Statistics indicated that there is an estimated 17million housing deficit in Nigeria (Simire, 2017).

The world is going through an acute housing crisis with the United Nations statistics showing that about 1.6 billion people live in substandard housing globally while 100 million are homeless. Nigeria appears to account for a large percentage of this statistics, with about 100 million Nigerians considered to be presently living in substandard housing (Simire, 2017). The former Nigerian Minister of finance and previously Managing director of the World Bank, Mrs. Ngozi Okonjo-Iweala, at the sixth Global Housing conference in Washington (2014) emphatically stated that several mortgage-financing initiatives by successive governments in the country failed. This is evident by the fact that mortgage financing and real estate financing as a whole does not constitute a significant part of the GDP as is the case with some emerging and developed economies.

According to the World Bank, this perennial housing problem can only be addressed through large–scale investment in housing production (Simire, 2017). Furthermore, with the prevailing financing problems in the real estate sector in Nigeria, there is a need to understand the nature of the challenges and opportunities available. This will provide a platform to ameliorate the effect of the challenges, mitigate the risks, to explore a strategic approach to real estate financing that is holistic and sustainable, and to facilitate the development of the Nigerian economy. Furthermore, a good understanding of the prevailing challenges will guide investor’s, policy makers and other interested parties or parties with vested interest on avoiding pitfalls and hence provide a platform for sustainable real estate financing in Nigeria.

Email: ogbenjul@lsbu.ac.uk

There is a need to develop a strategic approach to address this problem. This paper evaluates the challenges and opportunities for real estate financing in Nigeria from four (4) standpoints, which are economic factors, legal framework, policy environment and private sector developers to give a holistic view of the current situation.

STUDY METHODOLOGY

This study is part of a PhD research on strategic approach to real estate financing in the developed and emerging economies using a comparative analysis. This paper is based on an initial review of the literature and the findings will contribute to the development of a strategic approach to real estate financing. The review of literature covered various academic journals, reports and other publications sourced from different databases, which include Sprngerlink, Elsevier, Emerald and Science direct.

LITERATURE REVIEW

Nigeria is a fast growing emerging economy. It has the highest population growth rate and the largest economy in African. It is the 13th largest oil-producing nation in the world (The Trading economies, 2017; Ukpevbo, 2016). This makes Nigeria a force to be reckoned with by investors despite some of the negatively prevailing circumstances such as civil and political unrest in some parts of the country. The real estate sector has very high potential for profitability especially in commercial and residential properties in high- demand areas such as Lagos, Abuja and Port Harcourt (Ubosi, 2017).

The Nigerian real estate market

The property market in Nigeria can be classified into primary and secondary markets. The primary markets have high rental and capital value that is very active. This market includes the major commercial hubs of Nigeria, which are Abuja, Lagos and Port Harcourt. They have about 61% of the real estate practitioners and 60% of real estate transactions in Nigeria (Olaleye, 2008). The secondary market includes the low rental and capital value markets of Ibadan, Ondo, Enugu, Kano and Minna.

The residential loan of which mortgage debt forms the bulk contributes to about to 70% GDP ratio in the developed economies but contributes about 1% in Nigeria (Nubi, 2010; CESIFO, 2014). Arguably, the poor performance of the real estate sector in Nigeria could be said to be fundamentally responsible for its poor contributions to the GDP, when compared to developed economies. For example, the residential loan to GDP ratio of Norway, USA and UK is 75%, 67% and 75% respectively (CESIFO, 2014). This substantial contribution to the economies of these countries shows that there is a positive correlation between the mortgage sector performance and the GDP of any nation.

Real estate finance is considered the prime mover of a national housing delivery framework (Bustani et al, 2014). The shortfall in housing stock is massive as compared to the population growth of Nigeria.

Challenges and opportunities in real estate financing in Nigeria

Given the current situation in Nigeria, there is a need for better understanding of the factors affecting the real estate sector. Drawing from the literature review, there are a number of factors that are critical in the development of a strategic approach to real estate financing. For example, Ubosi (2017) identified damand and supply, inflation, interest and exchange rates volatility,

Email: ogbenjul@lsbu.ac.uk

and weak financing policies. Decision maker (managers) in the real estate sectors encounter constraints while sourcing funding for their projects, which could be internal or external constraints (Kam and Hamid, 2000). This paper looks at the challenges and opportunities from four (4) different aspects, which are; Economic factors, legal framework, policy environment and private sector developers, which are indicated in figure 1.

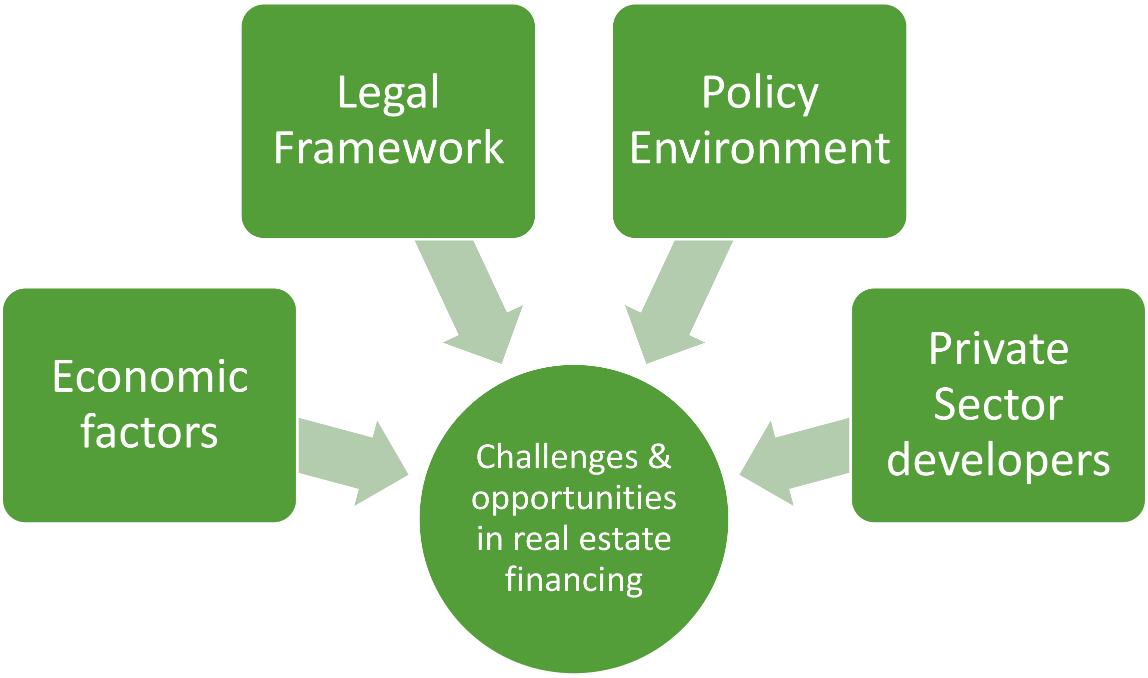

Figure 1: Challenges & opportunities in real estate financing. Sourced from various review of literature such as (Nubi, 2010; Rittenhouse, 2012 & Simire, 2017).

Economic factors

Notable economic opportunities for real estate financing in Nigeria is the increasing demand for housing and the increasing middle class (Matsiele, 2015). Nigerian population is about 173 million with an annual growth rate of 2.8% and an urban population growth of 4.7% (Simire, 2017). The increase in middle class in Nigeria emerged along with the growth in other sectors such as the banking, telecommunication and oil and gas servicing sectors. The growth in the middle class could also be attributable to the rise in the countries national income / GDP through sales of crude oil. According to the African Development Bank (AFDB), the middle class accounts for 23% of the population of Nigeria with the majority living in Urban centres (Onuzo, 2016). The growth in middle class and increase in population has significantly created a viable market and demand for real estate consequently, creating financing opportunities.

The large bank network and liberalisation of the banking sector in Nigeria could also be considered as economic opportunity for real estate financing (Edo, 2012). There is a great expansion in deposit liabilities by the Nigerian banks through sales of their shares on the stock market. They used these deposits to expand their profits mainly through oil and gas financing (Erebo, 2010). It is an opportunity for real estate financing that is still not optimally harnessed because of the uncertainties in the economy and the bank's risks assessment criteria.

The GDP of Nigeria could be said to be an opportunity because its growth in recent years has enhanced the real estate's sector as well as other parts of the economy. The GDP of Nigeria is

Email: ogbenjul@lsbu.ac.uk

driven by crude oil revenue and it was at its highest in 2014 at 568.50 billion and lowest at 4.2 billion in 1960. (The trading economics, 2017). The crude oil price plays a major part in shaping the economy. The price dropped to a record low of $26 per barrel in February 2016 (Ubosi, 2017). There was also reduction in production as mandated by the Organisation of Petroleum Exporting Countries (OPEC) where it was agreed to cut production by 1.20 million barrel per day. To aggravate this reduction in production was militancy activities in the oil rich Niger Delta, which further dropped production and the resultant revenue from oil (Bloomberg, 2017). The oil revenue is the major driver of the economy as a whole and the real estate sector in particular. The drop in oil revenue led to shortage in foreign exchange and the economy went into a recession in first quarter of 2016 and came out in the second quarter of 2017 (Olawoyin, 2017). All of this affected every segment of the economy including the banking sector who reduced lending to the real estate sector and other arms of the economy. The fall in oil prices led to a fall in the GDP and strains on companies leading to losses of jobs and outright closures of some companies from 2015 to date. A rise in GDP increases income and purchasing power of the people; as purchasing power increases, demand for housing increases. Therefore, there is an increase property prices and hence motivation to fund projects by both internal and external financiers (Singh, 2017). However, the fall in GDP constituted a challenge to real estate financing because it affected consumer confidence both internally and externally and this acted as a deterrent to both internal and external financiers of the real estate sector (Feyen, 2016).

Inflation is also a very evident challenge to real estate financing in Nigeria. Inflation rate is determined by fluctuations in price of goods and services in the economy. Higher inflation can lead to reduction in purchasing power of the populace. The IMF has said it expects inflation in Nigeria to remain on an elevated figure next year. This is because of the persistent effect of past inflationary shocks coming from sharp currency depreciations, high cost of power (electricity) and fuel prices (Asu, 2017). Inflation in Nigeria presently stands at 16% (National Bureau of Statistics, 2017) and this can be considered too high for any economy and discomforting for potential investors and buyers as the case may be. Inflation in Nigeria is double digit as compared to the developed economies that have single digit inflation and this has greatly increased the cost of goods and services (The Trading Economics, 2017).

Exchange and interest rate volatility also constitute an economic challenge to real estate financing in Nigeria because it has contributed to making the economy weak and unstable thereby discouraging investment in the real estate sector (Kelilume, 2016).

The legal framework

The legal framework in this context is the structure in the Nigerian constitution that has been put in place to support real estate financing. The elements or various components of the legal framework are meant to create opportunities that will enhance real estate financing. The Nigeria government has put in place legal instruments that support the real estate through the pension funds and establishments of an Association of Real Estate Developers (Raji, 2017).

Nigeria has a robust pension fund because of the pension reforms and this fund presently stands at about $80 billion. The legal instrument allows 40% of the fund to be invested in real estate but strictly through real estate investment trust (REIT) and mortgage backed security (Nubi,2010). Forty percent (40%) of this fund is about $36 million and this could be seen as a great opportunity because it could potentially enhance residential real estate financing in

Email: ogbenjul@lsbu.ac.uk

Nigeria. However, the challenge here is that it is difficult to harness this opportunity because only 6% of property development companies are listed on the stock exchange hence their inability to float REIT. Most of the pension funds consequently were invested in government bonds instead of the real estate sector necessary to create sustainable environment (Nubi, 2010). Comparatively, the pension funds in Malaysia and Singapore have more impact on their real estate sector than that of Nigeria because in addition to the various benefits, individuals are allowed to borrow money from their contributions to buy houses (Lindeman, 2002). Access to the pension funds would have provided mass housing for those who cannot afford mortgages and would have provided lease-to-own options of home ownership in Nigeria if optimally utilised.

Furthermore, the establishment of Real Estate Developers Association (REDAN) in 2002 is an opportunity to enhance real estate financing in Nigeria. This is because it provides platform to route funding for major real estate projects (Nubi, 2010). However, the challenge here is that most of these companies are small and too fragmented often associated with low level of skills at all levels. This makes it risky to finance their projects because performance cannot be guaranteed. About 60% of these firms do not have in-house experts such as architects, civil engineers, builders and estate surveyors. Most of them do not have up to 100 employees and cannot take-on large projects that require significant funding. There is great influx of foreigners into the Nigerian construction sector but it has not solved the skill deficiency challenge (Lawal et al, 2016).

Policy Environment

The Nigerian government has come up with policies to ensure adequate housing is provided for all but these policies have not been effective, as the desired results were not achieved. Some of those schemes, which the government introduced, include, the Federal Housing Authority Act, 1990, National Housing Funds Act, 1992, Urban and Regional Planning Act 1992, and National Urban Development Policy 1997, the Nigerian Housing Policy 2006, (NMRC) The Nigerian mortgage refinance company (Bustani, 2014). The National Housing Fund Scheme of 1992, which is still in effect, mobilises funds at a compulsory contribution of 2.5% of worker's basic earnings. This could be seen as a financing opportunity; however, it is a herculean task for workers to get funds from these funds for their housing. The national housing funds has underperformed and this arguably can be attributable to stagnation of housing finance sector. The federal government hitherto was involved in direct construction of real estates in Nigeria but has now stopped operating in that capacity. They are now enablers and facilitators to the housing industry. This policy has a created a major gap because it still leaves the developers with the responsibilities and challenges of sourcing funding (Nubi, 2010|).

Government monetary and fiscal policies could be seen as opportunity as well as sometimes constituting challenges to real estate financing. These policies are strong stimulant to the aggregate demand and supply of housing. Government monetary policies in recent years such as stoppage of dollar cash deposits into bank accounts, pooling of government deposits from commercial bank into the treasury single account with the central bank and stoppage of dollar denominated loans are all policies that negatively affected demand and supply of housing (Wallace & Onu, 2015; Udo, 2016). These monetary policies made some investors to divert their funding to other countries (Ubosi, 2017).

Email: ogbenjul@lsbu.ac.uk

According to Okonga Iweala (Nigerian former minister of finance & former director at the World Bank), different governments have come up with different policies which have failed. Arguably, it can be said that this is a fundamental reason why real estate financing in Nigeria has not yet made substantial contributions to the real estate sector. Achieving the goals of sustainable real estate financing requires policy interventions (Musa et al, 2014) and there is a need for Nigeria to draw from the lessons learnt from other successful emerging economies.

Private sector participation

The Nigerian government through its policies has created an enabling environment for the private sector to flourish in the real estate sector. The private sector controls over 70% of the total housing stock in Nigeria (Nubi, 2010).

Real estate developers in Nigeria are fundamentally private entrepreneur who are committed to making available mass housing production. Establishment of Real Estate Developers' association (REDAN) which was incorporated in 2002 provides a comprehensive list of developers in Nigeria. There are about 450 developers on REDAN (Establishment of real estate developer's association) list. The Nigerian government through the Nigeria Mortgage refinance company (NMRC) is in partnership with the private sector. The initiative was aimed at lowering the funding cost of mortgages and providing mortgage-lending banks with increased access to liquidity and longer-term funds in mortgage market (Rust, 2014). Investment in the Nigerian property market is mostly direct property and sometimes through investment in property company shares as there are not many REITs (Olaleye et al, 2008). It is witnessing an upsurge involvement of institutional investors in property development and acquisition. However, because of funding constraints, over fragmentation of small developers and shortage of skills substandard housing are continually being built causing housing collapse and slums. Notably is the fact that the Nigerian property market is yet to be fully integrated into the Capital market and this has reduced its access to enhanced sources of funding (Olaleye et al, 2008).

CONCLUSIONS

In looking at the challenges and opportunities for real estate financing in Nigerian, it is obvious that the challenges presently, outweighs the opportunities. The challenges have to be addressed in order to attract both internal and external funding for the real estate sector. Governmental policy interventions are needed to create a more robust stock market that will facilitate creation of more viable REITs in Nigeria. This will enable access to the existing savings of over $80 billion in the pension funds, which can transform the real estate sector (Nubi, 2010) . Access to this will facilitate availability of financing for resale estates projects that will engender provision of more decent housing for the populace in order to reduce the shortfall of 17 million.

Appropriate fiscal and monetary policies will also help to reduce the exchange rate volatility, to better manage the unprecedented inflationary trends that constitute a major risk to both internal and external investors. This will improve business confidence in the real estate sector. Furthermore, diversification of the economy from oil will create a more stable economic environment and a more balanced economy with foreign exchange inflow.

The next stage of the research is to develop questionnaires for surveys for examining issues raised and to explore solutions to the problems. This will be based on different stakeholders in Nigeria such as policy makers, banks, estate's agent associations and REITs.

Email: ogbenjul@lsbu.ac.uk

The outcome of the survey will contribute to the development of the Strategic Approach to Real Estate Financing, taking into account the experience of a number of countries in developed and emerging economies.

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Email: ogbenjul@lsbu.ac.uk

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Email: ogbenjul@lsbu.ac.uk