

## REFINANCING REAL ESTATE ASSETS IN NIGERIA

Shelter is one of the three basic needs of man and a major focus of most nations. However, statistics show that Nigeria currently has a housing deficit of 16 million units with a mortgage finance gap of approximately 56 trillion Naira. The country also has a home ownership rate of 25 percent as against the US which has 70 percent. According to World Bank estimates, Nigeria would need to produce about 720,000 housing units annually for the next 20 years to be able to close the housing gap in the country. The numbers also show that since its inception in 1973 up to 2006, the Federal Housing Authority (FHA) had built only 30,000 housing units. The contribution of real estate to the nations' GDP is 0.38 percent against an average of between 30 percent and 40 percent in other emerging countries and 60 percent in developed countries.

Several institutions and vehicles have been created by the Federal Government of Nigeria to stem the low development of this sector including the Federal Mortgage Bank, the National Housing Fund and more recently the launch of the Nigerian Mortgage Refinance Company (NMRC).

### A BRIEF HISTORY OF MORTGAGE REFINANCING IN NIGERIA

The Nigerian Building Society was transformed to the Federal Mortgage Bank of Nigeria in 1977 with a vision to operate as a viable, robust and dynamic mortgage institution able to meet the challenges of developing the nation's mortgage industry by supplying mortgage and housing markets with sustainable liquidity for the advancement of home ownership among Nigerians. It is expected to deepen the mortgage market by leveraging on the capital market for sustainable long tenured funding and become a prominent capital market operator through issuance of debt and Mortgage Backed Securities (MBS). The Federal Mortgage Bank of Nigeria had so far disbursed loans worth N121.2 billion to mortgage banks and estate developers between 1992 and February 2011. The Board of the FMBN was recently reconstituted by the Federal Government, a step the industry practitioners see as a positive one in the right direction.

The National Housing Fund (NHF) scheme, which was established by Decree 2 in 1992, was put in place to address the cumbersome shortfall in the housing sector through the FMBN. It was to achieve this through a mechanism whereby an inexpensive pool of funds would be available for those persons in paid employment and civil servants who are desirous of owning their own decent homes to gain access to mortgage facilities, through Primary Mortgage Institutions at long tenors unlike those available through the commercial banks. National Housing Fund provides that 2.5% of the income of workers be paid to the fund as mandatory savings. The percentage of total number of contributors to the total number of beneficiaries is infinitesimally small and this can be attributed in significant part to the problem of accessibility.

Other problems are the stringent conditions required to access the fund, inability of PMIs to fund 20 percent of loan to individuals as statutorily prescribed in the 1996 terms and conditions for granting NHF loans and low capacity of beneficiaries to meet the prescribed 10 percent personal stake on their own projects. Recently, N50.7 billion was approved as NHF loans for PMIs, while N70.4 billion worth of Estate Development Loans (EDL) were given to developers. The FMBN also disbursed N24.8 billion to 16,469 NHF contributors for the construction of 16,469 houses through PMIs, while N36.7 billion was disbursed as EDL to estate developers. These are still insufficient as they have been unable to deal with the issues in the sector

### THE ISSUES

In Nigeria, the acquisition of houses through mortgage loans, a task taken for granted in most developing countries remains a major challenge as the data shows. Government has put the institutions required in place and made concerted efforts to improve their operations this has not yielded fruit so far. This is really because the emphasis is not being placed on the right issues which are the systemic inadequacies that prevent the realization of the potential in the industry. Most of the issues plaguing the sector are identified below:

The low earnings potential of the average Nigerian compared with the cost of home ownership as a result of the high cost of mortgage financing. This is the primary objective of the FMBN as it should access cheap funds from various sources to refinance the mortgage loans created within the system. Past capacity deficiencies and bureaucracy were responsible for this and have been ameliorated with the constitution of a new management.

Unavailability of competitively priced refinancing windows through which mortgage banks and regulatory bodies like the FMBN can refinance current assets and make way for new ones.

Limited investments in the NHF by local banks as a result of poor returns. This requires an overhaul of the NHF guidelines.

| MARKET UPDATE    |          |          |          |
|------------------|----------|----------|----------|
|                  | 15/01/13 | 15/12/13 | 15/01/14 |
| Naira/US\$       | 154.1    | 155.2    | 155.75   |
| Brent,US\$/BBL   | 109.78   | 107.84   | 109.9    |
| COCOA, US\$      | 1487.82  | 2685.47  | 2760.56  |
| MPR%             | 12.00    | 12.00    | 12.00    |
| INFLATION RATE % | 10.3     | 7.9      | 8.0      |
| MORTGAGE RATE %  | 22.0     | 23.0     | 23.0     |

| STOCKS CONSTITUTING GMA INDEX |                       |                       |                     |
|-------------------------------|-----------------------|-----------------------|---------------------|
| STOCKS                        | 31/12/13<br>Price (N) | 15/01/14<br>Price (N) | %Change<br>in Price |
| OANDO                         | 24.25                 | 18.20                 | -24.95              |
| GTBANK                        | 27.02                 | 24.73                 | -8.48               |
| OKOMU                         | 44.00                 | 40.61                 | -7.70               |
| STANBIC                       | 21.35                 | 19.05                 | -10.77              |
| DANGSUGAR                     | 11.70                 | 11.13                 | -4.87               |
| FIDSON                        | 2.79                  | 2.94                  | 5.38                |
| TRANSCORP                     | 4.35                  | 3.79                  | -12.87              |
| CCNN                          | 11.75                 | 9.05                  | -22.98              |

|          | PRICE(N)<br>31/01/14 | NAV (N)<br>14/02/14 |
|----------|----------------------|---------------------|
| UHOREIT  | 50.00                | 55.58               |
| UPDCREIT | 10.00                | 10.17               |

| Index        | 31/12/13  | 17/01/14  | %<br>Change |
|--------------|-----------|-----------|-------------|
| NSE<br>ASI   | 41,329.19 | 38,767.29 | -1.34       |
| GMA<br>Index | 1.50      | 1.34      | -10.79      |

### Source: CBN, DMO and NSE

Difficulty in accessing Land and secure title to Land due to the shortcomings in the provision and implementation of the Land Use Act of 1978.

Inadequate Legal Framework and Housing Infrastructure. Lack of institutional depth.

Inadequate incentives, concessions and taxes and non-availability of Insurance Framework

Insufficient production and high cost of building materials as well as inadequate skilled labor

### ENTER THE NIGERIAN MORTGAGE REFINANCE COMPANY (NMRC)

The Federal Government has very recently established a Mortgage Refinance Company (NMRC) for the sole purpose of supporting mortgage originators such as Primary Mortgage Banks (PMBs) and Deposit Money Banks (DMBs) to increase mortgage lending by refinancing their mortgage loan portfolios. The NMRC is to act as an intermediary between originators of mortgage loans and capital market investors who typically are looking for long-dated high quality securities. It is expected to be private sector led and will be established as a PPP arrangement between the Federal Government, local banks and savings & loans institutions, and the multilateral institutions, especially the World Bank which is providing concessional credits of \$300million. Subsequently, the MRC would be able to access the capital markets to raise long-term funds via bond

issues. The MRC is expected to increase mortgages in the country from 20,000 to 200,000 in five years and offer these mortgages at between 13 and 14 percent.

NMRC is coming in as an integral part of the country's financial system. The activity of the organization is expected to boost and deepen the financial market, particularly the mortgage segment as the primary mortgage institutions, who are currently hamstrung with illiquidity will have a leverage for boosted performance in housing delivery. But this will depend largely on the type and structure of refinancing to be implemented by the NMRC. However, mortgages must pass the underwriting standards set by the NMRC to qualify for refinancing and this may pose a restriction to the extent the NMRC can go in solving our mortgage industry problems.

### A PEEK AT OTHER REGIONS

Before delving further into an analysis of the issues, it is needful to explore similar organizations in developed countries and how they have fared in accomplishing this task. We will focus on the United States, and lay emphasis on characteristics not directly linked to the real estate bubble burst as this will be easiest to relate to the Nigerian situation.

The US Government's role in the mortgage market dates to the Depression, when Fannie Mae (officially the Federal National Mortgage Association) and the Federal Housing Administration (FHA, which is part of the Department of Housing and Urban Development, HUD) were created. As government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac (which Congress created as the Federal Home Loan Mortgage Corporation in 1970) have special privileges and obligations, though they are corporate entities with shareholders. Broadly speaking, the GSEs' role is to ensure appropriate availability of mortgages to creditworthy households. By law, the GSEs purchase mortgages from lenders, and either hold the mortgages as investments or pool the mortgages into MBS, which are sold to institutional investors. The GSEs guarantee that investors in these MBS will receive timely payment of principal and interest even if the borrower becomes delinquent. Their congressional charters give them a close relationship to the federal government that is widely (but not universally) viewed as providing an implicit federal guarantee of their bonds and MBS. To finance the MBS that they keep, the GSEs sell bonds to investors. This ability to borrow relatively inexpensively allows the GSEs to be more profitable.

Fannie Mae and Freddie Mac issued 78% of the mortgage-backed securities (MBS) in the third quarter of 2012. In the third quarter of 2012, combined with Ginnie Mae (officially, the Government National Mortgage Association) the three entities guaranteed virtually all of the MBS issued. The business models of Fannie Mae and Freddie Mac are similar and involve the following: they both sell bonds to purchase mortgages; purchase single-family mortgages that other companies have originated; guarantee investors that the mortgages will be paid and pool the mortgages to create MBS; charge sellers a fee to guarantee these mortgages; sell the MBS to institutional investors, or keep them in their own investment Portfolio. If the GSE decides to keep the MBS, it uses the money raised by selling the bonds to finance these MBS, otherwise it uses the proceeds from selling the MBS to purchase more mortgages.

In September 2008, the GSEs individually agreed with their regulator, the Federal Housing Finance Agency (FHFA), that unexpected mortgage delinquencies and resulting losses jeopardized their solvency. The GSEs agreed to direct government control, known as voluntary conservatorship, which is the equivalent of bankruptcy reorganization for a financial company. As part of the agreement to conservatorship, Treasury contracted to provide financial support to keep the GSEs solvent. Pursuant to this agreement, which has been amended three times, the federal government has purchased more than \$187 billion in special stock from Fannie Mae and Freddie Mac. In addition, the government holds \$821 billion in MBS issued by Fannie Mae and Freddie Mac. The agreement requires Treasury to provide up to \$274 billion of additional funds, if necessary. In return for this support, Treasury receives special stock and other considerations.

### UNEXPLORED WINDOWS FOR REFINANCING REAL ESTATE ASSETS

While the advent of the NMRC and revamp of the Federal Mortgage Bank of Nigeria are applauded by the industry and most welcome, there still exist other windows for refinancing real estate assets which are yet to be explored in full by mortgage banks and other players in the real estate practitioners. These are especially apparent because the mortgage banks currently rely on the money market to fund their assets and this comes with issues: mismatch of short term funds with long term real estate assets and high interest rates amongst others. These alternative window sources rely on the capital market which is the best source of long term funds at competitive rates (depending on the structure of the instruments). They include but are not limited to the following:

Bonds: Long-term debt finance through the issuance of long-term bonds;

Mutual Funds: This comes in form of unit trust schemes;

Mortgage-Backed-Securities: These are securities which are pooled and guaranteed through existing mortgage loans and re-issued to potential investors by financial/mortgage intermediaries.

Real Estate Investment Trusts (REITs): Provision of equity funds for housing and real estate development by pooling of investors monies through a trust administered fund.

In subsequent articles, we will focus on these options, particularly the Real Estate Investment Trust (REIT).

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