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Problems of Financing Real Estate Development in Nigeria

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INTRODUCTION

Proper financing is all-important to successful property investment and development. Various forms of finance on varying terms from diverse investing agencies are available to the property market. The principal field where various forms of investment finance are employed is that of development where every loan has to be specially tailored for an individual scheme and the particular stages within the scheme.

Since property development in particular involves huge capital expenditure, finance is therefore an essential input, the nature of which is to provide capital to enable the enterprise operate commercially. The cost and availability of finance for real estate development can influence the viability of such project.

Inspite of the importance of development finance in property development, there is dearth of information on the amount of funding that takes place, by whom, or the method used. Though this is not unexpected given the general characteristics of development funding: there is no central agency or institution to co-ordinate the business of property funding.

THE PROBLEM

In the hierarchy of man's needs, housing has been ranked second and as a result of this; housing provision has become a paramount conerstone of the policies of various governments both at federal and state levels since independence in Nigeria. The consequences of the rapid rate of urbanisation are most visible in the rapid deterioration of urban housing resulting in urban housing poverty especially as there is no proportionate increase in the number of housing stocks.

The house occupies a very unique position in the life of all human beings and stands out as one of the basic necessities of human beings after food as there is the innate desire of every man to own a decent house. It is the most single non-commercial investment or consumer of income. For most working Nigerians, the earning capacity is generally low and makes it practically impossible for the average Nigerian to save towards owning a house. In addition, the dwindling economic fortunes in Nigeria which dims the capacity of individuals to own a house.

The economic boom periods of the 1970s also contributed to the housing problems in Nigeria. During this period, there was surplus capital, the economic climate then was favourable for the development of real estate and the prospect of gain was over blown and so were the rate of development. The oil boom brought in an era of urban development, which was beyond all expectation and thus led to a massive surge in property development. Financial houses readily obliged developers' loans, as they perceived minimum risks.

However, with the crash in oil prices in the early 1980s, the economy was thrown into crises and recession thus set in which badly affected the real estate sector. Since real estate development requires huge capital outlay, there is always the need for real estate developer to source for fund. This capital is usually higher than the equity capital of such a developer and the only way out of this predicament is to source for found through other means apart from his personal savings.

Which other sources of finance apart from equity capital are available to the real estate developer? What problems are being encountered in getting funds through these various sources? These and other problems are what the study tries to solve.

LITERATURE REVIEW

Concept of Real Estate/Property

Property connotes land or immovable as it is sometimes called and other objects known as chattels or movables (Megarry, 1982). Legally, these are known as real property and personal property respectively. Property is the exclusive right to possession, enjoyment and disposition of anything which can be the subject matter of ownership; and it also includes the exclusive right to the future benefits of an economic good, be it material or non-material, as determined by law. The above rights constitute a bundle of rights (Denman, 1968). Real property refers to the interests, benefits and inherent right in the ownership of the physical land (real estate).

But for the purpose of this study real property means land and buildings, which are categorised into different types according to the various uses to which they are being put and for which they are designed. These include residential, commercial, industrial, agricultural, recreational properties etc.

CONCEPT OF DEVELOPMENT

Development is the process of carrying out works involving a change in the physical use or in the intensity of an existing use of land or buildings (Balchin et al., 1988).

The term 'development' as defined in section 2(1) of the Nigerian Town and Country Planning ordinance 1948, states that "development in relation to any land includes any building or rebuilding operation and any use of land or any building thereon for a purpose which is different from the purpose for which the land or building was previously being used".

In his own view, Lichfield (1956) pointed out that among the Architects, Planners, Engineers and Surveyors, the word development generally means "the process of carrying out construction involving a change in the intensity of the use of land or with a re-establishment ranging from the humble addition of a bedroom or a garage to a private house or the ambitious re-development of a city centre".

Development can also be seen as the application of capital, labour, managerial skill and entrepreneurial ability to land resources for the purpose of improving its productive capacity.

Forms of property development include residential, commercial, industrial and office properties. The development of a particular piece of land is a process, which involves much than the mere carrying out of constructional works. It starts before, perhaps many years before, works and buildings are designed; and lasts, perhaps well beyond the time when the new works are completed, until the new accommodation is fully occupied and used.

Development generally means the process of carrying out the constructional works, which are associated with a change in the use of land or of land with its buildings, or with a change in the intensity of the use of land, or with a re-establishment of an existing use.

REAL ESTATE FINANCE

Real estate finance can be looked at, as the fund needed to Cary out real estate development and other related operations. It is an essential ingredient in modern day real estate development and most large-scale development would not take their present scale without substantial credit. The housing finance system in Nigeria is not viable and this makes mobilization of finance and credit for housing development difficult.

Finance constitutes a fundamental centrepiece in any real estate development; the ability of a developer to mobilize enough funds for the project determines largely, the success of the project. Finance is an all-important factor, a sine-quanon and very crucial ingredients to projects, no matter their nature. It is basically the fulcrum, which sustains the lever for development projects.

The performance of any housing finance system will depend primarily on the volume and nature of funds within the economy and the proportion of it that can be spread, mobilized or even dedicated for housing. Real estate finance can be viewed as the borrowing of money to carry out real estate development.

METHODOLOGY OF STUDY

This study requires information on the problems that are being encountered in mobilising funds for real estate development in Nigeria. In order to get this information, the firms and individuals that are involved in the mobilisation of funds for real estate development need to be contacted.

Accordingly, some practising firms of estate surveying and valuation in Abuja that involve in real estate development and some private real estate developers all of which totalling 54 in number were examined through the use of questionnaires to get information on funds mobilisation for real property development. In addition, officials of some of these financial institutions were also contacted in order to elicit more information on this funding.

The data gathered were analysed and presented using simple descriptive statistical methods.

SOURCES OF REAL ESTATE FINANCE IN NIGERIA

As a result of the huge capital outlay needed for real estate development, developers usually source for fund in order to complement their equity capital. Large developers will usually have multiple funding arrangements with a variety of financial agencies. Nevertheless, the field is becoming so complex and competitive that effective project management is increasingly concerned with the way in which control over a particularl scheme will be influenced by the origin and nature of development finance. There are various sources through which the developer can get fund to finance real estate development.

1. Equity Capital

This is the fund realised from personal savings and family savings. It is usually low because of low per capita income, unequal distribution of income and high population in each family unit resulting in excessive consumption, low savings and low investment in Nigeria.

Since this equity capital is usually small, it is prudent for him to decide on a mixture of equity and debt capital which will not only quarantee the highest expected return but also not impair the viability of the development. A developer's ability to borrow will be enhanced by the size of equity capital at his disposal.

2. Direct Loans

These are the loans got directly from the various lenders such as banks and other financial institutions for a specific period. They are classified according to their duration, short, medium and long terms.

*(a) Short Term Loans:*The conventional method of raising funds for the acquisition of land and the subsequent development of potential investment property over a two to three year period is by way of short-term finance. The traditional sources of short-term finance are the commercial and merchant banks as well as finance houses. The terms on which these loans are provided are usually very stringent and the interests charged are usually on variable interest basis and 2 percent to 6 percent above basic rate. In the past, joint stock or clearing banks have also been involved in this kind of loan.

One advantage of loans in commercial banks is that a substantial proportion tends to mature, within 1-5 years. Most times, the forms of collateral security demanded by the banks are not quite satisfactory and prospective borrowers are deterred by these rather inflexible demands. Merchant banks too have the same maturity pattern as commercial banks but are even more concerned with liquidity.

In an effort to mobilise funds into residential housing sector, commercial and merchant banks were directed by the central bank of Nigeria to treat the residential sector as a preferred sector and allocate at least 7 percent of their loanable funds into the sector. The guidelines further stipulated that where the total housing loans granted by the banks in any given year is lower than the level prescribed by the central bank, the short fall will be taken from the banks and on-lend through the central bank to the federal mortgage bank. Loans for residential building construction were for a minimum period of 15 years. However, these guidelines have not been strictly complied with as the banks are structured to accommodate comfortably short term lending. Property companies also provide short-term loans to developers.

(b) Medium Term Loans: These are loans granted for periods not exceeding 10 years. They are normally obtained by direct loan or overdraft from the commercial banks. Such loans are frequently raised while arrangements are being made for long-term loans. The banks are free to lend to whom they choose. Loans are repaid in a lump sum or by arrangement, and are subject to recall by the bank at anytime.

(c) Long Term Financing: Long-term development finance as its name implies is finance that is redeemable within 20 to 30 years or even more and usually at a relatively lower rate of interest. The greater equity participation providers in Nigeria are the federal mortgage Bank of Nigeria, various states' property Development Corporation and Insurance and Assurance Companies etc. Their lending activities are concentrated mainly in the residential housing sector.

Long-term development finance has traditionally been raised either by mortgage or particularly in terms of credit squeeze by sale and leaseback. Another aspect of long term financing is the forward sale, which is normally provided by the insurance companies and pension funds. These companies tend to exercise extremely tight control over the entire project, including land acquisition, design, construction and sale or letting of the project.

DATA ANALYSIS AND DISCUSSION

The data gotten from the administration of questionnaires on some practising estate surveying and valuation firms that engage in real estate development and some private developers in Abuja together with the interview conducted with the officials of some of the financial institutions form the bases of this analysis.

Table 1: Sources of finance for real estate development

Source	*Frequency*	*Percentage of response*
Internal funds	22	40.7
Funds from private investment	1	1.9
Commercial banks	14	25.9
Merchant banks	5	9.2
Mortgage banks	10	18.5
Insurance and pension funds	1	1.9
Government bonds	1	1.9
Total	54	100

Source: Field Survey, June 2002

Table 1 shows the various sources of finance that the real estate developers utilise in Nigeria. Internally generated fund otherwise referred to, as equity capital takes as high as 40.7 percent of the total respondents. This shows that majority of the real estate developers rely more on their equity capital than any other source. 25.9 percent of the respondents derive their real estate finance from commercial banks while 9.2 percent get their finance from merchant banks. Mortgage banks take as high as 18.5 percent of the total respondents, with insurance companies and pension funds taking 1.9 percent and Government bonds accounting for 1.9 percent also.

The table 2 shows clearly that most of the developers concentrate more on their internally generated revenue than the other sources partly because of the problems they encounter in an attempt to utilise the other sources and also the high interest rate that these other sources are associated with.

The table 2 shows the plethora of problems that real estate developers face in trying to arrange for development finance from other sources apart from equity finance (personal savings). High interest rate together with the associated excessive protocol and bureaucracy are the problems that are more alarming in the quest for development finance. They account for 31.5 percent each out of the total problems. Other problems that were discovered include loan ceiling and duration, government policies and collateral security taking 16.7 percent, 9.2 percent and 11.1 percent, respectively.

Table 2: Problems encountered in securing development finance from the financial institutions

Type of problem	*Frequency*	*Percentage of response*
Excessive protocol and bureaucracy	17	31.5
Collateral security	6	11.1
Restriction of government policies	5	9.2
High interest rate	17	31.5
Loan ceiling and duration	9	16.7
Total	54	100.0

Source: Field Survey, June 2002

Table 3: Ranking the various requirements for loan in the various financial institutions

Condition	*Frequency*	*Percentage of response*
Certificate of occupancy	39	72.2
Approved building plan	35	64.8
Survey plan	23	42.6
Bill of quantities	22	40.7
Feasibility and viability report	17	31.5
Evidence of past performance	13	24.1
EIA	9	16.7
Tax clearance	9	16.7
Development levy receipt	6	11.1

Source: Field survey, June 2002

Table 3 shows the various requirements as demanded by the various financial institutions for granting loans. Out of all these requirements, certificate of occupancy ranks highest taking 72.2 percent, which shows that virtually all the financial institutions require it as a condition for loan disbursement. This is closely followed by approved building plan as a condition for granting loans to developers, it takes 64.8 percent. Survey plan and bill of quantities take 42.6 percent and 40.7 percent respectively. The feasibility and viability report of the proposed development and evidence of past performance of the developer are also required taking 31.5 percent and 24.1 percent respectively. The problem emanating from this past performance is with new developers who don't have this record meaning they will not be granted loans. Some financial institutions request for development levy receipt from the state as a condition for granting loans. This ranks lowest with 11.1 percent.

From table 4, certificate of occupancy has been discovered to be the most difficult condition for developers to meet in getting loan from these institutions. It takes 22.2 percent of the total respondents. Evidence of past performance is another condition that the developers find difficult to meet. This takes 16.7 percent of the total respondents

Table 4: Difficulties in meeting these conditions for loans

Condition	*Frequency*	*Percentage of response*
Certificate of occupancy	12	22.2
Approved building plan	5	9.25
Survey plan	4	7.4
Bill of quantities	4	7.4
Feasibility and viability report	6	11.1
Evidence of past performance	9	16.7
Environmental impact assessment	6	11.1
Tax clearance	5	9.25
Development levy receipt	3	5.6
Total	54	100

Source: Field Survey, June 2002

The table 5 shows the lending rates in the Nigerian financial institutions. As a result of these high lending rates coupled with the excessive and stringent requirements from developers, some of them are discouraged from sourcing for fund from these institutions thereby making them to rely on their meagre equity capital.

Table 5: Savings and lending rates in Nigeria (Reviewed 15th Sept. 2001)

Year	*Saving rates*	*Lending rates*
1998	14.29	20.8
1997	16.1	31.2
1996	16.66	38.1
1995	12.61	21
1994	12.61	21
1993	10.11	21
1992	6.1	20.25
1991	5.2	21.4

Source: Federal Office of Statistics Nigeria 2002

The table 6 shows the rate of inflation in Nigeria between 1991 and 2001. This has also contributed to the problem of financing real estate development in the country.

Empirical Findings

The study reveals that the interest rates being charged by the lenders (financial institutions) are usually very high as shown in table 5. Other sources of finance for real estate development apart from the equity capital include insurance companies and pension funds, Government Bonds and the various commercial, merchant and mortgage banks in Nigeria. The problems being encountered by real estate developers in the quest for fund include bureaucratic bottlenecks in the financial institutions thereby making funds

Table 6: Nigeria-monthly inflation rate: 1991-2001 (in %) (Reviewed 15th Sept. 2001)

Month/Year	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
January	5.9	15	46.3	57.7	59.1	69.7	26.8	8.1	10.4	5.2	8.6
February	4.8	16.6	48.8	58	60	66.5	24.4	7.7	10.9	3.9	10.3
March	4.3	18.7	50.3	57.4	63.5	63	22.4	7	11.6	2.7	11.9
April	4.4	21.3	51.6	56.8	66.5	58.3	21	6.5	11.9	1.8	13.9
May	4.8	23.6	53.6	55.1	70.3	53.5	19.2	6.3	12.2	1.1	15.7
June	5.9	26.8	54.3	53.5	74.2	48.7	17.5	6.4	12.1	0.9	16.6
July	6.7	30.4	54.5	52.6	77.1	44.7	15.6	6.6	11.6	1.2	17.7
August	7.7	33.7	54.7	52.8	78.2	41	13.6	7.3	10.6	2.2	18.1
September	8.7	37	55	53.2	78.5	37.4	11.6	8.2	9.8	3.3	18.4
October	10	39.8	55.6	54	77.6	34.7	9.9	9	8.8	4.5	-
November	11.3	42.6	56.2	55.3	75.5	32.2	8.7	9.8	7.6	5.8	-
December	13	44.5	57.2	57	72.8	29.3	8.5	10	6.6	6.9	-

Source: Federal Office of Statistics, Nigeria 2002 difficult to reach the developers on time. Collateral security and certificate of occupancy as demanded by most of these financial institutions are source of problems for developers in getting finance for real estate development.

As a result of inflation as shown in table 6, the real value of loan collected normally reduced making it impossible for the project to be completed with the arranged finance. The conditions under which loans are given particularly the short-term loans are usually too stringent and atimes developers find it difficult to meet such terms. There is always dearth of information on the amount of funding that takes place, by whom, or the methods used. This is because there is no physical focal point where the funding business can be transacted, the market is an abstract aggregation of separate, unrelated and uncoordinated funding transactions and the market is diverse and complex. The resultant effect of these is problem of getting real estate finance.

There is always non-availability of fund to finance real estate development partly because of inflation and the huge capital required. Loan repayment is always very difficult due to the high cost of servicing the loan by the developers. The dwindling economic situation in the country is taking its toll on the construction industry thereby reducing the availability of loanable funds for real estate development. As a result of long gestation period for the development of real estates, most investors and lending institutions are normally discouraged.

RECOMMENDATIONS AND CONCLUSION

It is hereby recommended that record of past transactions regarding borrowing and lending of finance for real estate development should be kept so as to assist others who would want to go into such transactions in future.

Many problems plaguing the success of real estate financing in Nigeria can be solved if our economic problems are solved since most of these problems are due to the inflationary economy that Nigeria faces.

Government should intervene in this financing by instructing these financial institutions to slack their stringent rules for lending loan to developers. From the foregoing discussion, it can be concluded that finance plays a vital role in real estate development hence; it should not be handled with levity by both government, financial institutions and the real estate developers.

KEY WORDS Real Propety. Finance Development. Problems. Inflation

ABSTRACT The focus of this study is to examine the problems that are associated with real property development finance in Nigeria. The study attempts to explore the various sources of finance that are available for real property development with a view to determining the problems that hamper effective flow of fund. To achieve this, some estate surveying and valuation firms in Abuja that engage in real property development, some financial institutions that fund property development and some developers were examined through the use of questionnaires in order to identify some of the problems that confront real estate development in terms of fundings. Simple descriptive statistical methods were used for the analysis and presentation of the data. The study shows clearly those problems ranging from high interest rates to that of the numerous requirements from applicants for loan, which in most cases they find difficult to meet, bedevilled the financing of real properties in Nigeria. Besides, the inflationary rate in the country also contributes to the problems of financing real property development in Nigeria. It recommended among others that the Nigerian government should try to solve its economic problems such as inflation in order to minimise the problems that plague the financing of real estate development.

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