

REAL ESTATE FINANCING THROUGH BANKS: THE NIGERIAN EXPERIENCE

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Abstract : The paper examined the role of banks in property development finance in Lagos State. The study administered questionnaires on all the twenty five (25) universal banks in the study area. The total response was 15 (60%). Statistical tools employed in analyzing the data were frequency tables and percentages as well as relative importance index. The findings suggest that banks engaged mainly in short and medium term loans advancement, which were inadequate for property development. It was also found out that non-liquidity of banks' capital was a major hindrance to property development. The paper concluded that there was need for Central Bank to evolve policies that would ensure steady flow of long-term funds to the banks for property development and also increase its supervisory activities on Banks to ensure their growth and development.

1.0 Introduction

The importance of finance in property development is axiomatic. This is because the financial system plays a very significant role in economic growth, development and social mobilization (Okunfolami, 2004). The profitability of most transactions is based primarily on financial arrangements designed to enlarge the returns on investment. The appropriate application of leverage may dramatically increase investor's profit margins but, often, their risks as well. In a bid to maximize returns on investment, people invest in real estate in response to the demand for some giving consideration to the type, size, design and location among others. These investments are however highly capital intensive in nature and they are mostly funded with borrowed funds. This is so because hardly can an individual provide the needed capital for funding most real estate investments.

Property or Real Estate development can be financed through various sources, namely; traditional and modern sources. However, this paper focused on the modern sources of financing real estate with particular attention on the debt finance aspect. Debt fund can be raised from different sources. Because of the colossal amount of money which real estate development

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investment requires, debt funds or credit facilities are often necessary to supplement equity in order to successfully and timely complete such investment. Financial institutions such as mortgage banks, commercial banks, insurance houses, construction companies, building societies, pension funds, corporate bodies, joint ventures among others are primarily the sources of debt finance as well as the necessary condition for economic development (Cameron, 1972).

In Lagos state however, the most patronized sources of real estate finance is commercial and mortgage banks. These funding institutions have various terms of lending. It therefore becomes necessary for real estate developers to shop for finance and negotiate good terms, which would make his goals realizable in the future. This is necessary because finance is the "live wire" of any form of development and its availability or otherwise, in required amount, may make or mar the feasibility (practicability) or viability (profitability) of any proposed real estate development.

Every country of the world must have a financial system that is made up of institutions and entities that make funds available for projects ranging from manufacturing, agro allied investments, mineral exploration, and mining construction to real estate. The World Bank has noted that the absence of formal finance systems in many countries is acknowledged to be a major constraint to the development of efficient housing markets (World Bank, 1993).

The importance of property finance from the perspective of government in Nigeria is seen in the establishment of Primary Mortgage Institutions (PMIs) and the National Housing Funds (NHF).

The problem of housing development has become an everyday discussion in all quarters of the public particularly in the developing countries of the world. This explains why it has received numerous attentions from researchers both in developed and developing nations of the world (see example Malawi Housing Corporation (MHC), 1988; Cooperative Housing Foundation, 1993; Sida, 1997; Cabannes, 1997; Boonyabancha, 2001; Phiri, 2004; Manda, 2007; Cain, 2007; Valenca, 2007; Llanto, 2007; Bôngola, 2007 etc). In Nigeria, papers that have been written on real estate development finance include that of Lawson (1997), Onyeuka (2000) and Badejo (2002). Lawson (1997) paper reported on the workings, operations and advantages of securitisation and unitisation methods over traditional source of finances while Onyenka (2000)'s work was restricted to a consideration of the role, operations and performance of Financial Institutions in Nigeria. Badejo (2000) however studied the prospects and workings of unitisation as a vehicle for real estate finance in Nigeria. Although, these papers suit their objectives, they did not however consider the role of banks in real state development finance. Ajayi (1995) and Barter (1998) also wrote on real estate development finance but did not analyse critically the roles of banks in property development finance. Okonkwo (1999) and Adegbenjo (2002) works were based on the importance of real estate finance to developers. These authors identified the requisite factors that allow for a successful financing operation to developers. They did not however venture directly on the specific roles of banks in property financing in Nigeria and the problems militating against the effectiveness of financial institutions in financing property development.

The work of Nubi (2003) and Eniade (2004) dealt with the problems of housing finance in Nigeria under the present primary mortgage system. Nubi (2003) proposed secondary mortgage market development with a detailed explanation of its types, working and advantages as a measure for solving the problem of primary mortgage institution in financing real estate. The paper though evaluated the Nigeria position/readiness for secondary mortgage operation, it used theoretical reasoning to conclude that the method might not be too strange to Nigerians, but much needs to be done for its successful operations. Eniade (2004) proposed a sound and more effective monetary policy as a means of solving the problem of real estate finance through mortgage financing rather than considering other financing institutions available in Nigeria who deals in property development.

Ojenagbo (2008) in his paper commented that the housing finance system is not without imperfections. According to the author, the loans provided by most of the banks are short-term loans of 1-2 years which the developers use to bridge the gap between when they commence their projects and when they begin to receive rents and that the banks would argue that they are in custody of short-term funds and so they cannot give out loans longer than the term of the funds they hold. Cain (2007) also commented that loans are relatively small and short term by nature and are not well adapted to housing expenditures. The foregoing is a pointer to the fact that many authors in Nigeria as well as other countries of the world have commented on the issue related to property development finance. However, the roles played by banks in property development finance in the practice have not been critically looked into. This paper thus addressed the specific roles performed by banks in Nigerian property market.

2.0 RESEARCH METHODOLOGY

The object of this study's is to investigate the role of banks in property development. This is expected to give a broader outlook of the specific roles performed by banks in property development from the present somewhat confused view point of the investors/end users.

The adopted population (sample frame) of the Banks in Lagos was 25 representing 100% of the total figure of banks in the study population (Central Bank, 2006). A sample size of 100 per cent of the sample frame (25) was considered appropriate. The total responses were 15 (60%) for the studied population. The data collection instrument employed was the self administered questionnaire and materials on the internet. Data collected were analyzed using descriptive statistics (frequency counts, percentage and relative importance index method (RII)). The relative importance index was calculated for each role using a six level of assessment with the formula.

$$RII = \frac{6n_1 + 5n_2 + 4n_3 + 3n_4 + 2n_5 + 1n_6}{6(n_1 + n_2 + n_3 + n_4 + n_5 + n_6)}$$

Where

RII = Relative index

n_1 = number of respondents who indicated '1'

n_2 = number of respondents who indicated '2'

- n_3 = number of respondents who indicated '3'
- n_4 = number of respondents who indicated '4'
- n_5 = number of respondents who indicated '5'
- n_6 = number of respondents who indicated '6'

3.0 THE RESULTS

Generally, questions focused on the roles bank in property development and problems militating against their effectiveness with respect to property development financing over the years. Tables 1-4 present the results obtained in this regard.

3.1. Granting of Loans to Individuals

The paper examines the number of years when the banks started granting loans to their customers. In doing this, questions were asked that required the respondents to state the years when the banks started granting loans to individuals. The results are indicated in Table-2.

Table-1 : Granting of Loans to Individuals

Year	Frequency Counts	Percentage (%)
1980-1989	1	6.7
1990-1999	10	66.7
2000-2004	4	26.7
TOTAL	15	100

SOURCE : Author's Field Survey 2008.

The result of the question, which was open ended, revealed that 66.7% of the banks started granting loan to individuals as far back as 1990 and 1999 while the remaining 33.3% started between the 1980 - 1989 and 2000 - 2004. This result is not unexpected because the primary aim of establishing most of these banks is for the purpose of granting loans to both individual and organization.

3.2. The Types of Loan Granted for Property Development by Banks

The results from the findings of the nature of loan granted by the Bank showed that most bank grants short and medium term loan (loan between 1 and 10 years) for property development. Some banks however did not grant more than short-term loan (loan up to 5 yrs). None of the banks (from the results) grant long-term loan (loan from 10 years and above). The table below (Table 2) shows the nature of loans granted mostly by the banks.

Table-2 : The Types of Loan Granted To Property by Banks

Type of Loan	Frequency Counts	Percentage (%)
Short term (3-5yrs)	5	33.3
Medium term (6-10yrs)	2	13.3
Long term (10 years and above)	0	0.0
Short/medium term	8	53.3
Short/medium/long term	0	0.0
Total	15	100

Source: Author's Field Survey 2008.

The implication of the results is that banks are not comfortable source of finance for property development because investment in property is a long-term investment, which requires a long-term loan.

3.3. The Nature of Interest Rate Charge on Loans Granted for Property Development by Banks

The respondents were also questioned on the manner of interest rate their banks usually charge on loans for property development. The summary of responses is as indicated in Table-3.

Table-3 : The Nature of Interest Rate Charge on Loans Granted To Property Development by Banks

Manner of Interest Rate	Frequency Counts	Percentage (%)
Fixed rate	10	66.7
Float rate	0	0.0
Float / fixed rate	3	20.0
Not indicated	2	13.3
TOTAL	15	100

SOURCE: Author's Field Survey 2008.

The results in Table-3 revealed that about two-third of the banks charge fixed rate on loans granted to property development, while less than one-third charge float / fixed rate on the same type of loan. The remainder however did not indicate the manner of interest rate their banks charge on property development.

The above shows that finance charge on property will remain constant throughout the development period since most available banks charge fixed rate. Consequently, developer may not profit from economic conditions that force down interest in the economy. However, the developers who obtain his loan from the banks will benefit greatly from hyper-inflation in the economy as his interest payable will not change regardless of how high the inflation rate is.

3.4. Direct Role of Banks in Property Development

As part of the objectives of the paper, this section assessed banks' roles in real estate development in Nigeria. The respondents were asked to prioritize the roles performed by them given a number of preconceived functions. The results were analyzed using relative important index.

The results detailed in Table 4 shows that management of pension scheme with RII of 0.91 ranked first among the roles performed by the banks in real estate development followed closely by evaluation of mortgage loan and monitoring the construction of any house in respect of which loan is granted respectively. Project consultancy service for property development ranked 4th among the roles, granting of loan for improvement of dwelling houses or for the purchase of dwelling houses ranked 5th and 6th respectively.

Table-4 : Direct Roles of Banks in Real Estate Development

Roles of Banks	1	2	3	4	5	6	RII	Ranking
1 Grant loan to individual's for property purchase	4	0	0	7	0	22	0.34	6
2 Grant loan to any person for the improvement of a dwelling house	1	7	3	0	22	0	0.45	5
3 Conduct a proper evaluation of mortgage loan	9	13	0	3	4	4	0.72	2

contd.

4	Management, of pension fund scheme	19	9	5	0	0	0	0.91	1
5	Monitor the construction of any dwelling house in respect of which loan is granted	0	4	16	9	4	0	0.63	3
6	Offering of project consultancy services for estate development	0	0	9	14	3	7	0.46	4

Source : Author's Field Survey 2008.

This above, therefore, implies that the banks did not take granting of loan for the purchase of dwellings or for the improvement of dwelling house as part of their major duties. To them, management of pension scheme, conduct of proper evaluation of mortgage loan, monitoring the construction of houses for which loan is granted are very important in that order, while project consultancy services for property development is important.

3.5. Problems Militating Against Bank's Effectiveness in Property Development.

In identifying the problems militating against the effectiveness of Banks in property development, a face-to-face interview was conducted with some of the respondents. The problems identified are summarized below, insecurity of property investment, due to the relative high risk in property development in the country, liquidity problem, inability of the banks to grant long term loan usually demanded for by property developers.

The general consensus among the respondents seems to rank inability of the banks to grant long term loan usually demanded by property developers as the utmost problems militating the banks, followed by insecurity of investment due to the relative high risk in real estate development in the country while liquidity problems followed closely the other two problems identified. Thus, it can be concluded that the high risk involved in property investment arising from its nature such as, lack of liquidity and its attendant problems; insecurity of title to land, among others were the basic factors that discouraged the banks from disbursing loan for property developments. For example, the insecurity of title to land cannot but discourage mortgage investment in real estate. The same can be said of lack of liquidity. A situation where Banks could not realize their investments may be due to wrong title to land or because buyers could not be found on time, it cannot but discourage them from investing in property development. Apart from this, there are high costs of sales transaction whenever a sale is envisaged.

4.0 CONCLUDING REMARKS AND SUGGESTIONS

In the examination of the role of banks in real estate development, the result has drawn attention to four issues that needed attention. First, it was discovered that banks engaged mainly in short and medium term loans which is inadequate for property development because it requires a long term funding, The Central Bank should continue to evolve policies that would ensure steady flow of financial resources to the Banks in a bid to making funds available for long term investment like investment in property. Second, since it was discovered that majority of the banks are suffering from lack of long term fund with which they can finance real estate, government should make policies that would be used to check on their capital base periodically and continue to increase same (capital base) when deemed fit and necessary. Third, the paper also found that banks' liquidity of capital is another major hindrance to property development,

in line with this; government should come out with enabling laws to deal with the problem of liquidity of investment by way of encouraging securitization and unitization. Finally, the Banks do not involve/engage in direct construction of real estate projects, there should be an appropriate legal and financial instrument channeled towards making the Banks realize their roles in real estate development. It is necessary for government to pursue sound macroeconomic policies aimed at sustaining high rate of economic growth. This is to reduce the high level of risk in the economy, and the property market in particular, and enhance stable and predictable climate for the banks to operate efficiently. Conclusively, Central Bank should increase its supervisory activities on Banks to ensure their growth and development.

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