

WHAT COMES AFTER THE STORM? – A Review of 2009 and Expectations for the Real Estate Sector in 2010

The economic implications of the collapse of the largest financial institutions and subsequently the largest economies is an on-going story. Extreme uncertainties, a hold on investment decisions, sharp increases in unemployment figures, tumbling stock market and asset values, loss of consumer confidence and almost no credit flow to businesses characterised much of 2009. The global financial doldrum has had a significant effect on the real estate sector – perhaps most impactful on the construction industry – a major upset for developing economies where construction projects are an essential part of its infrastructure and industrial development.

While some level of stability was achieved in the last quarter of 2009, it was a challenging year to say the least. This report takes a brief look at 2009 (vis-à-vis the expectations issued at the beginning of that year), and then attempts to answer the question “What sort of recovery will we see in 2010 in the real estate sector?”

2009 – A DIFFICULT BUT BETTER THAN EXPECTED END?

“Debt has **vanished**, value has been **destroyed**, and equity is playing a **waiting game**”ⁱ

As anticipated, the real estate sector seemed to hit rock bottom across most of the world. Locally, construction debt disappeared as banks made business decisions to discontinue ‘long term’ funding. The impact of this is best understood thus; less than a quarter of commercial projects which received approvals in the first half of 2009 commenced. In terms of new project initiatives, analysts confirm that volume of new projects (driven by private promoters) fell by half in 2009.

Construction costs also witnessed its highest year-on-year escalation (outside of currency fluctuations) in nearly a decade. The biggest contributor to this increase has been traced to the difficulties and delays in accessing funds. Quantity surveyors report that the square meter (sqm) cost of a ‘luxury’ multitenanted residential development grew by a much as 25%.

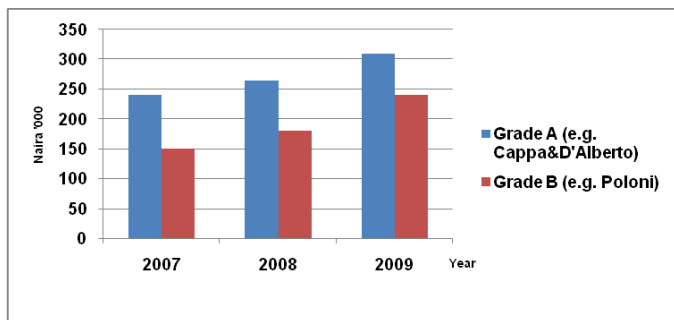


Fig. 1 – Construction cost escalation

Property values fell - the manner by which valuations adjusted in a city like Lagos by midyear was frightening, with Valuers putting all kinds of caveats on their valuations. However, one of the surprises during the year was the willingness of a fair number of promoters/owners to play the waiting game on sale/ lease transactions. This is evidenced by the increase in number of multiple “for sale” and “to let” signs on properties, for extended periods of time, contributing to the low count on consummated transactions.

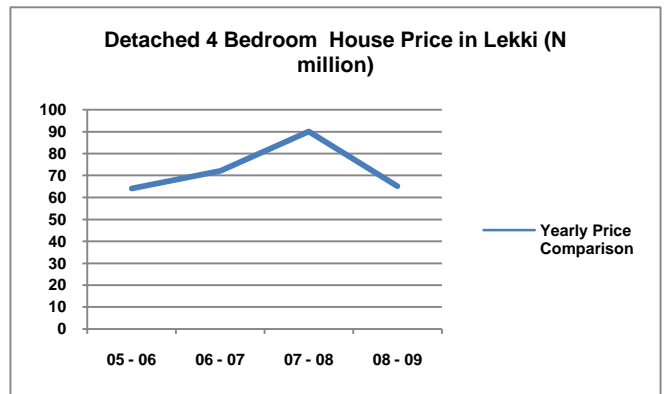


Fig.2 – Property values 2005 - 2009

Yields trekked north, not helped by the rather limited intervention from the Central Bank of Nigeria (outside of the rescue of the distressed banks) . Across Europe, interest rate cuts helped to provide some stability, although it can be argued that this only happened when property prices had fallen by as much as 30-40%.ⁱⁱ

On a positive note, as predicted, there was a notable increase for professional advice and involvement through the project life cycle, from conception to exit for those projects which were able to secure financing and those which received a variety of “rescue packages”. The need for project management expertise was heightened by the decision by most investors to explore alternative procurement routes in the delivery of projects. The employment of expertise in the area of marketing and sales, and the use of various strategies to attract buyers has also taken root and is expected to become the norm.

WHAT SORT OF RECOVERY (IF ANY) WILL WE SEE IN 2010?

The world’s economy is reported to have shrunk by between 1% and 2%ⁱⁱⁱ, with the Euro-zone contracted by nearly 4%. However, from Q3 2009, many of these economies started to show signs of stability, and by year-end were able to report marginal growth. Policy responses which led to near zero interest rates and state intervention equivalent to nearly one-sixth of Europe and America’s GDP produced the initial stabilizing effect in these economies^{iv}

Specific to the real estate sector, the response of governments across Europe and other developed markets, through a combination of rising capitalization rates and lower interest rates helped to create a positive financing gap for real estate transactions. This helped to even out the increased margins on lending rates. The resultant impact was the beginnings of a small growth, particularly in commercial real estate in prime locations, infrastructure projects and specialist properties.

Several opportunistic funds set up in the latter part of 2008 began actively picking up large real estate transactions from mid 2009 (on the belief that the market had stabilised). We therefore expect to see big ticket transactions over the next two quarters, as well as strategic alliances between investors (buyers) and sellers. In these economies, it is obvious that new development projects will continue to take a back seat, at least until the last quarter of 2010 and perhaps into 2011.

For Nigeria, recovery is likely to be painfully slow. While the economy itself may not have shrunk substantially in 2009 (Merrill Lynch in a report in Q3 2008, has ranked Nigeria as one of the least vulnerable economies in the world), the country grappled with a 30% fall in revenue, resulting in the implementation of less than 50% of the capital budget. The Naira also lost 20% of value. In addition, international trade has suffered, and so has the inflow of Foreign Direct Investment (FDI) and Aid. The banking sector witnessed a significant reduction in off-shore credit lines, threatening many projects in Oil and Gas, Telco and Infrastructure/Real Estate.

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Investment Activity: Investment activity in the real estate sector is close to a standstill. We expect that this lull to continue at least until the end of the first half of 2010. The principal reason for this is that many investors do not believe that the market has approached the bottom of the cycle. This is in addition to the continued uncertainty with the capital markets and the banking sector amid its on-going reforms. We anticipate that by mid-year, with a clearer political and economic/financial direction, activities which will drive the real estate sector in a positive direction should commence.

Encouraging a Rebound: In order for a rebound to occur, it is imperative that government, regulators and other market players agree to a plan of action; we opine that the following need to happen;

A Pricing Correction - An impasse currently exists. Still too many sellers are hanging on to their assets with the expectation that the buyer with the 'right' offer will come along. It is important that lenders and agents help distressed owners to transform into motivated sellers. The current situation where distressed assets are being sold "under cover" does not help the sector. If anything, transparency and the availability of data will help analysts provide useful information to potential investors. While we expect to see further pricing correction (i.e. a widening gap between sale and offer prices) we anticipate that "prime" real estate will not drop any further than 5%-10%.

Flow of Debt Capital – Lenders need to formulate ways around a more stringent regulatory system. Without the flow of long term debt, the real estate sector will at best stagnate.

Restoring Investor Confidence – Systemic overhauls must be carried through. Government intervention in clear and concise ways is required to encourage investors back into the sector. This includes efforts to stimulate the construction industry by embarking on large scale construction projects. Regulators must restore confidence in the capital market.

It's the Economy! – The Nigerian economy must improve. According to a recent newspaper article "A rebound will depend on how fast the larger economy recovers, complete with flow of funds from savings"^v.

News Flash

It was recently reported by a newspaper that the Federal Mortgage Bank of Nigeria(FMBN) has increased the amount an individual may receive from the National Housing Fund(NHF) toward the ownership of a residential property from N5m to N15m. It was further reported that the apex mortgage institution has released a new schedule of equity contributions by NHF applicants in the following proportions:

=N=5m and below:	10%
Above =N=5m up to 10m:	20%
Above =N=10m up to =N=15m:	30%

FMBN also indicated an expansion of mortgage loan originators to on-lend NHF loan to include Universal Banks, Insurance Firms, Pension Funds and Micro-finance Banks^{vi}.

Although this is a step in the right direction, the initiative does not guarantee reduction in house prices or that houses will be affordable to the low income earner. With the minimum wage unchanged, this effort does not help the majority at the bottom of the pyramid.

The focus should be on cheaper alternatives and research into new technologies leading to mass housing production in tandem with providing a broader choice for qualified individuals.

i Emerging Trends in Real Estate Europe 2009 Urban Land Institute/PWC
 ii CB Richard Ellis 2009 review and 2010 outlook for commercial real estate in Europe
 iii Robert Zoellick – World Bank President
 iv CB Richard Ellis 2009 review and 2010 outlook for commercial real estate in Europe
 v ThisDay Jan 16,2010 – Real Estate Prospects in 2010
 vi Source: Financial Standard, 18th January 2010