

NIGERIA'S BANKING CRISIS - A FRESH WAVE OF CHALLENGES AND OPPORTUNITIES FOR THE REAL ESTATE SECTOR

The unfolding events in the banking sector following the Central Bank of Nigeria (CBN) intervention and the subsequent sacking of CEOs of 5 major banks, amongst other corrective directives will for some time to come continue to have far-reaching effects on the economy. This edition of Real Estate Insight examines how the real estate sector is impacted with a focus on two key areas - funding and property valuation.

It is reported that the five banks together provided forty percent of the loans (valued at N2,802bn) in the entire banking systemⁱ. Forty percent of this has been defined as "non-performing" by the CBN. The bad loan portfolio consists largely of margin loans and facilities to the Oil and Gas sector. It is not clear what proportion of the loan portfolio is related to the real estate sector.

The actions taken by the CBN has undoubtedly sent warning signals to the entire banking system (including other financing institutions such as mortgage banks). This has led to aggressive debt recovery, better compliance with "rule books" and more stringent lending requirements, which borrowers say are designed to frustrate commercial activities and confirms the banks' unwillingness to lend medium and long term.

A FURTHER TIGHTENING OF THE FUNDING PURSE STRINGS

Finance linked to construction and real estate ownership became a dynamic element of loans and credit granted by Nigerian financial institutions from about 2003. It is believed that more than 20% of credit granted to the private sector is related to activity in the real estate sector.



Over-valuation of property prices and increasing interest rates, increasing difficulty in the attainment of project viability, growing debt as well as the global financial crisis from the end of 2007 together put a stop to the period of rapid growth of the sector. Fortunately, even through the global crisis, the slow-down has been relatively smooth, that is until Nigeria's latest banking crisis.

The recent action of the CBN has set off a re-evaluation of the credit risk and brought about a tightening of the terms of granting credit to the sector in what can be best described as a knee jerk reaction. This rather rapid contraction almost guarantees that the sector has commenced a roller coaster fall. Banks are retrospectively correcting the imbalance of loan to collateral. First Bank of Nigeria Plc (FBN) recently stated, amongst other strategies to recover non-performing loans that it would 'obtain alternative/additional collateral (up to 150% coverage on new transactions) and pursue gradual work-out plans.'ⁱⁱ

Construction Finance: There is a noticeable slow down/lack of activity on many project sites as financiers re-evaluate project risks

and make further demands on promoters. There is no doubt that fewer projects will be actualized in 2010 and even less funding will be available to real estate sector related businesses such as building materials manufacturers. The lending behaviour of the banks has far-reaching implications for real estate pricing.

Financing Institutions already indicate a reluctance to lend to developers. Many developers are caught between a rock and a hard place – escalating construction costs, uncompleted projects, and a lack of funding. Developers with several properties within their portfolio have chosen to sell down, in order to finance on-going or new projects rather than approach banks.

Off-Take (Mortgage) Financing: The increased paucity of mortgage finance means fewer and more expensive mortgage products. The new vista in the financial system will lead to a review of existing mortgage terms and portfolios, with pending evaluations taking longer as banks embark on a tidy-up of existing 'bad' transactions.

As anticipated, the Federal Mortgage Bank (FMBN) recently published its list of debtors (Real Estate Developers) and has begun to recover its portfolio of bad loans. The knowledge that the FMBN has a bad loan portfolio of N12bn further exposes the weakness of the apex mortgage institution and pushes the overdue re-structuring of the sector forward. Earlier in the year CBN officials expressed concern that the mortgage sector may witness a backlash due to its under-trading activities. A review of the money lending activities of the mortgage firms in 2007 showed that liquidity ratio (mortgage assets to total assets) is low (30%, instead of the stipulated 60%) and placements in commercial banks stood at N118.1 billionⁱⁱⁱ.



It is expected that more than a third of major real estate projects may end up being foreclosed. Some banks are already working with real estate expertise to review, develop and implement strategies to deal with pools of real estate assets to which the banks are exposed.

REAL ESTATE ASSETS RE-VALUATION – A Roller Coaster Ride

Sophisticated investors see the current upheaval as the perfect opportunity to grow their portfolio by positioning to acquire distressed assets. According to the Chairman Skye Shelter Fund; 'the recent asset recovery drive by financial institutions following provisions for troubled assets, provides a great opportunity for the Skye Shelter fund, as it seeks to invest in the distressed assets at a reasonable price'. 'Reasonable price' refers to the downward valuation expected of most real estate assets.

Between July and August 2009 the real estate values in Lagos (fell by up to 30% on the average. In severe cases, particularly in the suburbs prices have fallen by up to 50% of previous quotes^{iv}). There is a lull in trading activities and many Real Estate Managers/Agents report a drop in volume of business by more than half.

Bank debtors have besieged the Economic and Financial Crimes Commission (EFCC) following the announcement that defaulters will be arrested and prosecuted. With the on-going liquidity crisis, many have resorted to debt re-scheduling agreements with the Commission, depositing title documents of owned properties with the EFCC^v.

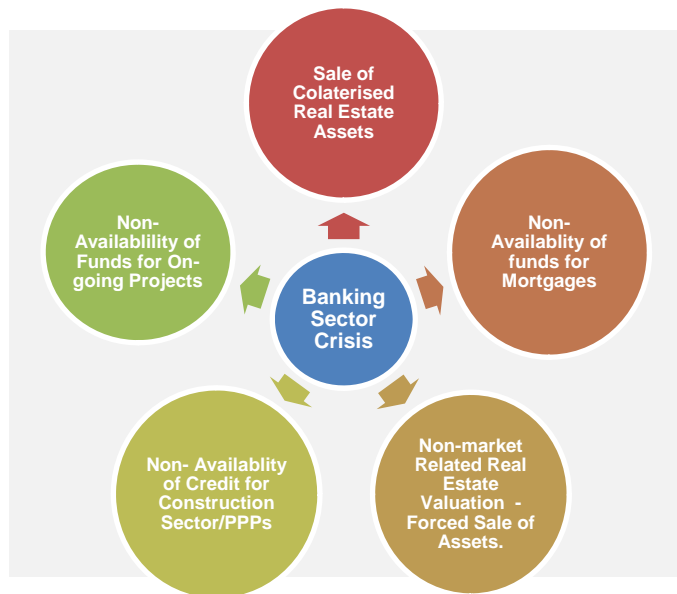


Figure 1: For the foreseeable future, the real estate sector will be juggling several balls.

While the real estate market is not awash with news of major disposals, several projects have quietly exchanged hands between Promoters and Financiers in what we predict will become a common trend over the next six months.

PROGNOSIS

The challenge for the real estate sector lies in the ability of the various stakeholders to respond quickly and effectively to the evolving imbalances. The real estate sector is a significant contributor to the financial position of financial institutions in terms of asset holdings and mortgage loans; therefore real estate pricing is critical to the financial sector and is an indicator of the wealth of a country.

A decade ago, the IMF commenced work on the development of Financial Soundness Indicators (FSIs) in an effort to help policy makers identify financial system strengths and vulnerabilities ahead of crisis situations. Several of the core indicators are real estate indices - pricing and size of deposit takers exposure to the sector. Sector stakeholders must revisit with the urgency it deserves the case for the development of property indices as a contribution toward an understanding of the soundness of local financial institutions.

The CBN and Nigeria Deposit Insurance Corporation (NDIC) announced the commencement of a re-tooling exercise in order to become more proactive regulators and supervisors of financial institutions. Banks are expected to embrace new risk management disclosure and policies and also build capacity for risk management. The Federal Mortgage Bank of Nigeria as regulator of the mortgage subsector must embark on a similar exercise of self diagnosis and corrective action.

The mortgage sector reform is expected to kick off in Q4 2009, with the recapitalisation of both the Apex Mortgage bank and the Primary Mortgage Institutions (PMIs). This is expected to attract some FDI funding into the mortgage industry. It is also expected that some of the PMIs owned by commercial banks will be sold in part or in full as commercial banks focus on their core businesses.

The CBN's Asset Purchase Facility Fund - a special purpose vehicle for the acquisition of the liabilities of the troubled banks will help maintain the needed stability in the system. It should be possible to further create vehicles for the real estate related liabilities. These should be managed by asset managers with a mandate which includes the preservation of value.

Government's role in stemming the current slide requires creative thinking and incentivising. Developers must be encouraged to continue to build "more for less cost". Infrastructure created by developers at their own expense (in pursuance of technical specifications) should be transferred to the relevant government agency on a compensatory basis and not free of charge as is the case. Buy out schemes (for unsold units) of low income/professional workers housing schemes by Government using special "stabilisation" funds will encourage residential construction. Specific incentives for infrastructure projects and real estate related companies should be developed.

In spite of the gloomy outlook, we expect that there will be positive effects in the long term, on the sector. The overhaul of the apex mortgage bank, the development and strict supervision of regulations especially in the sphere of residential construction, and financing will perhaps be the most significant contribution to the well being of the sector. We also expect that the market will be rid of unprofessional developers, operators and other market participants who have over the past decade taken over the industry

This latest crisis will hopefully, strengthen the real estate sector, make it more effective as a contributor to the wealth of the country, and ensure some transparency.

NEWS FLASH

PINNACLE POINT GROUP LIMITED (PPGL) LAUNCHES \$676M LAGOS KEYS, SHOPS FOR \$33 M.

In the midst of the financial and economic crisis, a South African based Property and Leisure company listed its shares on the Nigerian Stock Exchange (NSE) and is set to commence construction activity on a N105bn (US\$676m or R5.13bn) development that will include an 18-hole golf course, a 5-star hotel and 420 villas along Tarkwa Bay in Lagos.

The company hopes to convert some of its existing debt to equity through a US\$33m Rights Issue in October 2009.

This Lagos Keys project is expected to compliment the Eko Atlantic City project - a N405bn project on a 8km² reclaimed land along the Bar beach, Victoria Island (a Public Private Partnership initiative).

The launching of this project at a time like this confirms the attractiveness of the Nigerian real estate market. PPGL should however ensure that the land rights issues are proactively resolved to avoid the kind of tussle on the Banana Island. Critical areas of dispute such as development control and physical planning should also be resolved ahead of the commencement of sale.

ⁱ Address by Governor of the CBN, Mallam S. L. Sanusi, on Developments in the Banking system in Nigeria, August 14, 2009.

ⁱⁱ Risk Management Disclosure, First Bank of Nigeria Annual Report & Accounts, June 2009,

ⁱⁱⁱ Reform looms as mortgage sector placements in banks hit N118.1b, Guardian Newspaper, January 12, 2009.

^{iv} Property Market in forced sales as bank loans shrink, Chuka Uroko, Business Day, 02-09-09

^v Castle Weekly Magazine, August, 2009.