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Is the Storm Over? - A Review of 2010 and Expectations for the Real Estate Sector in 2011

Will The RE Landscape Change in 2011?

The growth and sustainability of the global financial economy remains widely unpredictable as economic recovery differs across regions.[1] Asia is leading the economic recovery, the United States is showing steady improvement, and in other parts, recovery remains fragile and uneven.[2] Financial experts report that in general, volatilities in financial, currency and commodity markets increased substantially in 2010.[3] Emerging markets showed more resilience achieving an average of 7.1% growth in GDP when compared to the average GDP growth of 3.0% for advanced economies.[4]

In the Real Estate (RE) sector, Commercial Real Estate (CRE) activities is troubled with uncertainties as the downturn defies expectations. Investors, developers and lenders, await signs to indicate that economic and industry fundamentals have hit rock bottom. These remain elusive hindering strategic plans for the future.[5] This report takes a brief look at RE activities in 2010 (in relation to projections for that year) and attempts to proffer expectations for the year 2011.

NIGERIA - 2010 Financial Market Review

In Nigeria, economic stability and growth was achieved in second half of 2010, with increased growth in the non oil and oil sector. Growth was attributed to increases in activities of the wholesale and retail trade sector and the Federal Government's amnesty development programme for the Niger Delta which fostered investment in the oil sector. GDP grew to 7.41% compared to 6.7% in 2009 while inflation remained at an average of 12% throughout the year.[6] Foreign Direct Invest (FDI) fell by 60% from $6 billion in 2009 to $2.3 billion in 2010.[7]

2010 - Real Estate Sector Review

In the real estate sector, activities on both the demand and the supply side came to a stand still, overall growth of the sector stood at 10.48% in the second quarter of 2010 compared to 10.46% in the corresponding quarter of 2009.[8] Marginal growth was achieved as a result of activities in the low end of the market, characterised by small commercial and residential developments. With limited bank lending to major developers and investors, large scale high end commercial and residential developments were stalled. Real estate valuers report that in high end residential locations in the city of Lagos (Ikoyi and Banana Island), property values fell by as much as 40%. In emerging middle income areas of the city such as Lekki, values fell by up to 20% (see figure 3). Property owners now accept a year's rent in advance compared with the demand of up to 3 years at the top of the property boom. The value of properties in the "regeneration neighbourhoods" of the city continue to appreciate and by year end had seen a nearly 10% rise.

In Q3 of 2010, the Federal Government embarked on several initiatives to encourage economic performance and improve investor confidence; the restructuring of the Nigerian Stock Exchange (NSE), continued reformation to stabilise, enhance the quality and ensure healthy growth of financial institutions fundamentally to encourage long term funding to the real sector.[9] It is hoped that by mid 2011 dividends of these initiatives will become obvious. For now, credit flow for RE developments remain limited and new infrastructure and construction projects are almost non-existent.

The impact of the financial reform is expected to be widespread. The real estate sector will benefit from the availability of competitively priced medium long term funding and investors/ developers are poised to take advantage of this. However, the current exercise appears to ignore the need for a virile mortgage system.

The Economy in 2011 - Despair doused with hope?

The International Monetary Fund (IMF) project that economic rebalancing will be critical to global recovery in 2011. High unemployment rates, fiscal tightening and the failure to arrive at more coordinated policy responses may hinder economic growth for developed countries. Global activities is forecast to shrink by almost 0.5% from 4.8% in 2010,[10] as advanced economies slash their budgets. FDI inflows are expected to improve and lending in international capital markets will stabilize.

Nigeria's GDP is expected to average 7.4% between 2011 and 2014. Economic experts opine that weak global demand, infrastructural inadequacies, little or no growth in bank credits to the real sector of the economy and the general elections[11] all pose down side risks to economic growth in 2011.

Projected Impact on the Real Estate Sector

Market analysts in Europe and America project that major activities in the real estate sector will remain limited.[12] However, as capital markets

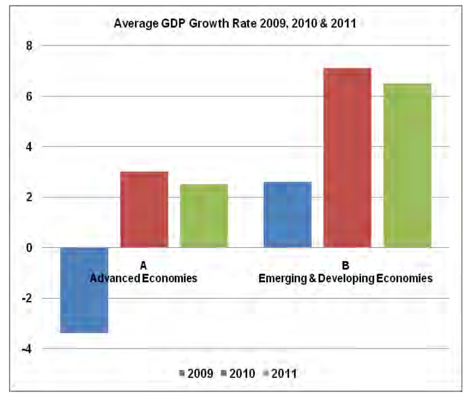

Figure 1: Global Growth Rate and Forecast (percent year-over-year annual growth rates of real GDP, 2009, 2010 & 2011)
Source: IMF World Economic Outlook, 2011

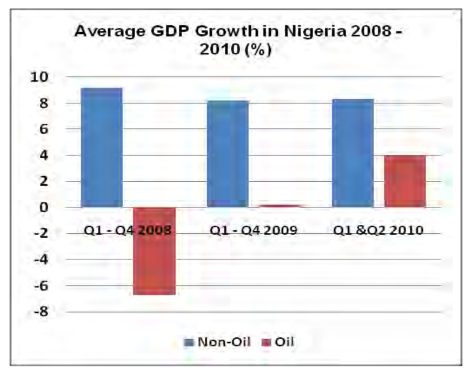

Figure 2— Nigerian GDP Growth Rate % (Non - Oil and Oil) (Q1 - Q2 2008, Q1 - Q4 2009 & Q1 and Q2, 2010)
Source: Federal Republic of Nigeria Report - GDP for Nigeria, Revised 2009 and Q1 –Q2 2010

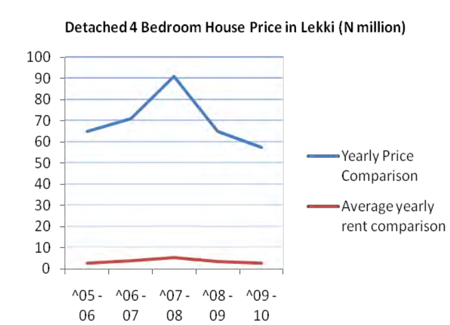

Figure 3 - Nigerian Property and Rent Values from 2005—2010 (Yearly price and average yearly rent)

stabilize, increased liquidity could present additional drive for investing in emerging market real estate. As an example, the flow of capital into Hong Kong and Singapore is encouraging investor interest in other Asian property markets.[13]

The Asset Management Corporation of Nigeria (AMCON) has injected a second tranche of funds into several financial institutions with the aim of improving liquidity. This injection should enable financial institutions resume lending activity. It is hoped that the real estate sector and other users of medium to long term funds will benefit, spurring activities in infrastructure and construction.

The Federal Government has allocated N347 billion (US$2.38 billion) for the development of critical infrastructure in 2011.[14] This is in support of the plan to accelerate real sector reform and address infrastructure and institutional impediments to a more competitive and business friendly investment environment.[15] If effectively implemented, the initiative is expected to be one of the main catalysts for the rejuvenation and growth of the real estate sector.

Overall, the combined efforts of the government, regulators and other market stakeholders will be required to kick start and achieve some level of growth in the sector in 2011. Some initiatives include:

Incentives for inflow of capital: Government need to create a more attractive environment for foreign investments in real estate products on the Nigeria Stock Market (NSE). This will help improve investors' confidence, expand access to long term funds and help in creating effective partnerships needed to embark on large scale projects.

Effective Mortgage Structure: Through the recent restructuring of the financial institutions, it is imperative that Federal Mortgage Bank of Nigeria (FMB) through its Primary Mortgage Institution's (PMI's) create a more robust mortgage system which allows access to long term lending and assist mortgagors and mortgagees in meeting their objectives. As soon as developers and homebuyers can access mortgages to develop or buy houses, demand will be stimulated and this will lead to increased momentum for the sector.

Reduction in Construction Material Taxes: A reduction in taxes for housing development projects can help reduce construction cost. Imposition of the Value Added Tax (VAT) at various levels of housing development process constitute as much as 35% of the cost of a house. Tax holidays, deferrals or tax exemptions on materials or home sales, or similar tax-related provisions are common and have helped to reduce housing development costs in other countries.[16]

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Global Commercial Real Estate Value Change in 2011		
Capital Values	Rental Values	Value Change
Moscow	Hong Kong	+20%
Tokyo, Hong Kong, Singapore, London, Paris, Sao Paulo, Shangai, New York, San-Francisco, Toronto, Washington DC	Moscow, Singapore, Tokyo, London, New York, San-Francisco, Washington DC	+ 10-20%
Frankfurt Chicago, Los Angeles	Shangai, Sao Paulo, Paris, Toronto, Sydney	+ 5-10%
Mumbai, Mexico City, Amsterdam, Sydney, Brussels	Mumbai, Frankfurt, Amsterdam, Brussels, Chicago, Los Angeles	+ 0-5%
	Mexico City	- 0-5%
Madrid	Madrid	- 5-10%
Dubai	Dubai	- 10-20%

Figure 4: Projected global commercial real estate value change in 2011
Source: Jones Lang LaSalle, November 2010

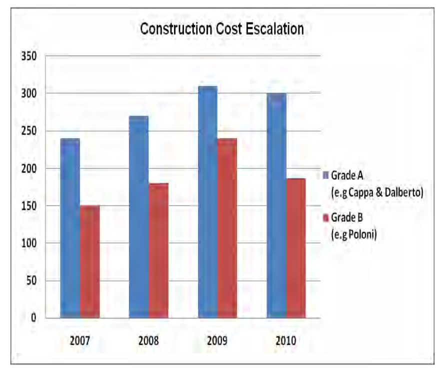

Figure 5: Construction cost escalation ($) in Nigeria 2007—2010
Source: Grade A and B construction firms

Figure 6: The Lagos CBD