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Issues on Foreign Real Estate Investment in Nigeria

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ABSTRACT: *This paper examines major issues in Nigerian real estate sector which foreign investors into the market must note to safeguard against losses. Chief among the issues include political insecurity, bribery and corruption, inflation, devaluation of the naira compared to dollars, multiple developmental charges and fees, multiple real estate taxes, financial sector risk, currency purchasing power disparity, legal risk, illiquidity of invested capital, poor and inadequate infrastructures, high construction cost compared to neighboring countries and naira exchange rate. The paper advises that the Federal Government should work on the macro economy indices to stem most of the risk factors to make the investment arena conducive for international investors to operate profitably. Furthermore foreign investors need to partner with reliable domestic investors and estate surveyors and Valuers who are more familiar with the economy terrain to safeguard against losses.*

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I. Introduction

Foreign real estate investment is necessitated by real estate investors seeking to diversify risks inherent in such investments in their domestic markets. Risks here encompass both variability in expected returns from investment (Byrne and Cadman, 1985) and expected uncertainties (unknown occurrences) inherent in such investments (Kalu,2001). Some of the risks are specific to the class of investment while others are in the macro economy of the country or the area where the investment is undertaken. Specific risks can be diversified while risk inherent in the macro economy (the systematic risks) cannot be diversified. Investors are compensated by the market for bearing systematic risks but not unsystematic risks. In going international investors hope to diversify their domestic market risks and tap into the benefits of going international (Solnik, 1993). To this end investors must seek to enter countries with low systematic risks. Christner (2009),Solnik (1993) and other eminent scholars advise that there exist certain factors the foreign investors must note in the destination market they intend to explore and adequate precautions taken in order to avoid pitfalls and failure. The country and continent chosen for investment matter so much as expected returns can be affected either negatively or positively (Christner, 2009). This paper x-rays these factors generally and particularly as they affect foreign investors hoping to invest in Nigerian real estate market.

Statement of the Research Problem:

The globalization of economy activity through deregulation and liberalization and advances in information and communication technologies present an appetizing environment for world real estate investors to go international. Advantages abound for international real estate investment and include risk reduction by eliminating non-systematic volatility, higher expected returns and large size of international markets. Again most countries of theworld have limited properties for overwhelming domestic demand and yet there exist investors having huge funds but lack avenues to invest. Nigeria is one of such countries. Domestic investors battle with country systematic risks which cut down on their returns on investment yet there exist prospects internationally to better their investment outcomes through international diversification. The benefits of international real estate investment are not automatic as some authors studying results of US international property market between 1973 - 87 discovered that high level of taxes within the market and volatility in exchange rates created so much risk in returns that the additional risk completely eroded any possibilities of increased return for the investors (Hoesli and Macgregor, 2000).In order to benefit in international market investment certain criteria must be studied and handled appropriately. This paper is poised to alert foreign investors intending to invest in Nigeria real estate sector some issues they must of necessity note to avoid pitfalls in their prospective investments.

II. Literature Review

Factors or issues in international real estate investments which constitute obstacles to success are well researched and documented by several authors including Christner, R.(2009), Solnik, B. (1993), Shapiro, (1996), (Hoesli and Macgregor 2000) etcetera.

These factors include:

1. The local laws – are they tenant/landlord friendly?
2. The relative size of transfer and the related costs
3. The level of rents and rental yields
4. The rules for taxing capital gains, rental income and inherited properties.
5. Familiarity with foreign cultures, languages, times, zones and markets
6. Country regulations regarding who are allowed to purchase, develop and hold what quantity of land.
7. Market efficiency regarding ease of conversion of properties into cash (illiquidity problem) and price manipulation.
8. Risk perception, particularly currency risk; that is the variability of the purchasing power of the currency across the two countries

Viv Investment cost. Domestic investment costs tend to be lower than international investment. Many variables contribute to this, including transport cost, exchange rate, importation of capital (movement of investment capital etc.).

Other factors posited by Solnik(1993) include political risk and the threat of nationalization or restriction on the repatriation of investment proceeds (profits). Shapiro(1996) posits that differing lease structures and legal frameworks, relative relationship between inflation rates and changes in exchange rates should be viewed seriously. Countries with high inflation rates will experience erosion in their exchange values whereas countries with low inflation rates will have stronger currency values.

Purchasing power parity of the operating currency – (Hoesli et. al., 2000) posits that this should be identical worldwide. This means that one dollar or pound should be able to purchase an equivalent item of goods anywhere in the world. That is, it should have the same purchasing power around the world. As a general rule countries with high inflation should bear higher interest rates by way of compensation while countries with low inflation rates should bear lower interest rates.

The property type, the country and continent chosen and the volatility of its currency value, the source of investment fund and the time of investment would generally change investment outcomes considerably (Christner, 2009).

To go international, Christner (2009) further suggests that an investor requires minimum knowledge on:

1. Taxation rates relating to income, purchases, rentals and sales
2. Local property management services availability and cost
3. Local representative and relationship with banker, real estate agent, insurance and property tax experts.

Summarily therefore all the authors reviewed have the same opinion on the factors which a foreign investors must consider in choosing the country of his investment destination. These factors either enhance investment successes or depress same. Hereunder therefore is presented issues in Nigerian real estate sector to be considered by foreign investors seeking to invest in Nigeria real estate sector.

Nigerian Profile

Nigeria is often referred to as the giant of Africa by reason of her land mass, population(above 170 million) and lately economy. It is the 7th most populous country in the world and the most populous in Africa (Lovells, 2013). Its economy rests on a mono product - oil. When the global oil prices are strong, her economy booms and radiates. With the tumbling of global oil prices, the economy caves and concentration is now shifted to telecommunications and real estate. 14% of the country's investment capital goes into the real estate sector (fDi, 2015)

In 2014, Golden Sachs Economy Group ranked Nigeria as one of the next eleven (N – 11) economies after the BRICs countries (Alfred, 2014; Lovells,2013). The BRICs and the N-11 countries are countries experiencing rapid economic growth. That same year Nigeria was ranked the 26th best economy in terms of her GDP and the largest in Africa (Alfred, 2014) with a potential to becoming one of the largest in the 21st century alongside Brazil, Russia, India China and South Africa. In 2015 her GDP (US$594.3bn) outshone that of South Africa (US$341.2bn)(Favela,2015). As said above, she has one of the most dynamic populations in the world. Her population experienced a growth rate of 60% between 1990 and 2008 indicating a vibrant market capable of supporting any investment. (Enghbal,2008). Favela (2015) prospects that by 2021 Nigeria's population will be 40% of the world's and wonders where this enormous population will be accommodated.

One of the problems which come with large populations is deficiencies in infrastructures like housing, electricity, road networks, water, etcetera and Nigerian infrastructure is failing (Todd, S. 2015). These present a ready platform for foreign investors to invest in these sectors.

Background to Foreign investments in Nigeria:

Nigeria Enterprises Promotion Decree(1972) was promulgated to allow Nigerians sole control and ownership of certain businesses in Nigeria to the exclusion of foreign investors in those businesses. Changes occurred and this policy was changed in 1995 by the enactment of NIPC, Act which opened up all the sectors to the participation of global investors except those on the negative list (Lovells, 2013). This and the current global quest for real estate investors to invest internationally for market diversification has propelled local investors to partner with their international counterparts to invest in Nigeria (Agtmael, 1980).The African Investment Report, 2015 reports that real estate investment ranked 2nd by capital investment in 2014 in Africa. Chief among Nigerian collaborations include Actis Head Quarters in London partnering with Tayo Anusan (Nigeria) who developed in 2014 foremost shopping mall in Lekki (Palms Shopping Mall) (Odusote, 2008),Abuja World Trade Centre (valued at $1bn as at 2012), Eko Atlantic City (housing 400 people in housing and offices). The Palms Shopping Mall has succeeded and led to opening up of two other branches in Lagos and Abuja. Nigeria real estate industry is to hit $13.65Billion by 2016 and this is a very viable report on the sector (PricewaterhouseCoopers, 2015). This is due to Nigeria annual population growth rate of over 2% and urban growth rate of 4%. 50% of Nigerians live in cities and towns and therefore accommodation of all types are required to house them and their businesses

Issues on foreign real estate investment in Nigeria

Introduction:

Even though Nigeria has the above beautiful economy prospect, she has been known to be high risk market for investment(Agu,2015). In a concluded study in the sub- Saharan countries of which Nigeria is one, it was concluded that investment environment is negatively related to private investment. Several issues contribute to this and they are discussed hereunder:

1. **Land Registration Process**:

Foreign real estate investors need security to access mortgage fund. Such security must necessarily be registered both at the co-operate affairs commission and the Land Registry to give it legal backing (Lovells, 2013).

According to World Bank Doing Business Report (2013), Nigeria is ranked 182 out of 185 countries. She is among the worst in land registration. The process can take up to 12 processes, last between 6months to 2years and cost about 20.8% of the property value. Developers are usually frustrated and sometimes lose their source of funding or incur further costs in interest on bank loans (Emiedafe, 2015).

Real Estate Taxes Payable

The taxes payable include Value Added Tax (VAT) on the services of Estate Agents (5% of the fees charged), Capital Gains tax (10% on the value of the property), withholding tax(5% - 10%), stamp duties (assessed and paid by the payee on annual or ad valorem bases). Other taxes and levies include development levy, income tax, building plan approved levy, property tax, renovation tax (in the occasion of renovation of buildings) and other miscellaneous charges and levies. Most of these charges, in practice are arbitrarily charged. This informs the present advocacy by The Estate Surveyors Registration Board of Nigeria (ESVARBON) that the assessment and payment of Stamp duty and Estate Duty should be on Dutiable basis while Capital Gains Tax should be on Chargeable Gains (CG) (Mekadolf, 2015). As Christner (2009) and other authors reviewed above state, numerous, arbitrarily, and unfriendly taxes repress investment outcomes in returns.

Bribery and Corruption

This factor tops Lovells (2013) risk list for foreign real estate investment in Nigeria. This is because Nigeria is currently ranked by the Transparency International as the 35th most corrupt country globally. Buildings collapse because of non-compliance to building regulations by contractors engaging in sharp practices. The staffs of government Regulatory Agencies prefer taking bribes rather than ensuring that building regulations are adhered to. Investors can overcome this by keeping close personal monitoring on building projects or employ reliable project managers to do same.

Fraud

Fraud dominates real estate business in Nigeria. This was clearly demonstrated by Jones, Lang, Lasalle ranking in 2012, when Nigeria was ranked96/97 in transparency index. By the ranking, Nigeria was x-rayed to suffer from corruption, lack of operational real estate data and poor environment sustainable programs in massive property development (Emiedafe, 2015). Unqualified people are allocated land and the qualified developers denied. Popular global real estate investors prefer countries in North and South Africa where the investment environment is friendlier and more transparent. Makarova (2013) suggest that partnership with local investors can solve the riddle and eminent estate surveyors and valuers too.

Financial Sector risk

Nigeria mortgage industry is still under-developed. This is evidenced by statistics from World Bank. Between 1960 and 2009, its transaction profile stands at less than 100,000 (Emiedafe, 2015). The contribution of mortgage financing to Nigeria GDP is almost zero with real estate contributing 5% and mortgage loans and advances contributing 0.5%.

Alfred (2014) posits that finance sector risk is a great worry to foreign real estate investors to Nigeria. Omisore (2012) posits that Nigerian real estate sector lacks well-defined and reliable mortgage financing as it is seen not being affordable to support longer terms loans and funding. The Federal Mortgage bank and its subsidiary are the only mortgage institutions in Nigeria funding real estate investment and the cue to access the fund is unending. Therefore investors must move capital for investment into the country. The cost of such transfer may be huge considering the processes involved in the country (see more on this further down).

Legal Risk and Bureaucratic Encumbrances

This is the major risk as postulated by (Alfred, 2014) plaguing Nigerian real estate sector. The apex legislation controlling all land matters in Nigeria is the Land Use Decree, of 1978 now Land Use Act (Cap 202) of 1990. Land development is under the auspices of the Urban and Regional Planning Department by Decree of 1992. The bureaucracy of obtaining either the Right of Occupancy over a purchased land or the Development approval are very cumbersome to domestic operators not to talk of foreign investors. Government can be erratic and changing in its policies. Delays exist in passing relevant laws by National Assembly. The courts handling land matters are no better. Cases are left unresolved for years on end (Lovells, 2013). Aggrieved persons die and live cases unresolved. This discourages investors into the sector.

Political Instability/Violence

Lovells (2013) and Agu et al.(2013b) write that political instability and violence have killed the interest of both domestic and foreign investors in Nigeria. Bombing attacks, stampede, fighting, bomb explosions, kidnappings, killings have discouraged investors. Boko Haran sects terrorized the north east while Niger Delta militants hold swage in the South South, bombing and blowing off oil pipe lines. Buildings are destroyed and probability of rebuilding by investors is very slim for obvious reason – fear of repeated attacks. Hamilton et. al. (2009) posits that the risk assessment in the regions is very high.

Capital Importation/Repatriation and other Foreign Exchange rules

Foreign investors operating jointly with or without Nigerian investors must register with the Nigerian Investment Promotion Commission (NIPC) and obtain the certificate. The certificate will be needed before funds can be repatriated by foreign investors in non-exempt companies. Foreign investors are allowed free access to import into Nigeria recognized foreign currency to fund their operations, but subject to the country's money laundery law. Such importation must be through an authorized Agency (Bank) which must issue to the operator Certificate of Capital Importation (CCI) to evidence the inflow of such funds into Nigeria (Lovells,2013). The same rule applies to other imported resources like raw materials and equipment. The CCI will further on assist in the purchase of foreign exchange from official market for easy repatriation of the investors proceeds.

Devaluation of Naira (Exchange Rate)

The recent devaluation of Naira as compared to other world currency in international market has made housing cost to go up 25% to 35% and there is prospect for higher rise (Lovells, 2013). Some foreign developers peg their construction costs and value of selling finished product in the US dollars while they pay their clients in Naira. There will be no problem if the cost and value of the development in Naira translates into its anticipated equivalent in dollars. But this is not so as Naira continuous fall constitutes a loss to developers. (Ekpenyong, 2015).Emiedafe (2015) believes that higher construction cost is as a result of over dependent of the real estate industry on foreign equipment and raw materials. Naturally developers shift high construction costs on consumers. Real estate investment is actually a hedge against inflation as high inflation is rewarded by high interest yield on capital invested as income will go up if demand is strong (Solnik, 1993; Shapiro, 1993; Hoesli, et. al.,2000). If demand is not strong resulting in low rentals or voids, then losses will ensue. Even at high rental yields, the real value of money (purchasing power) is low, meaning a loss to investors.

Duplicity of Regulatory Roles

Duplicity of roles between the State and Federal Government regulatory bodies in real estate development is another risk in investment. For instance, Fed Capital Territory Fire Service does the same function as the Federal Fire Service in issuing Fire Service Design permit for real estate development. Again Abuja Environmental Protecting Board(AEPB) and National Environmental and Regulatory Enforcement Agency (NESREA) both deal with Environmental Impact Assessment Report in property development. A prospective developer who has obtained any of the reports or permit from either of the Agency will be accosted for the same permit by its counterpart, and in order to go on, must comply.(Ekpenyong, 2015).

High cost of Development/Disparity in currency purchasing power

Nigeria one time Finance Minister, Ngozi Okonjo Iweala, gave disparity in costs of constructing a 3-bedroom house in selected countries of the world compared to Nigeria thus:
Nigeria – US$50,000;
South Africa – US$36,000;
India – US$26,000
This is caused by high cost of dominant building material (cement - price of which in Nigeria is 30 – 40% higher than those in neighboring countries and world market prices), high skilled labour, poor road network, and inconsistent power supply. Inadequate infrastructure adds as high as 30% to total development cost (Emiedafe, 2015). All things being equal, investors will prefer markets of lower investment costs.

Expropriation and Nationalization

Nigeria has bilateral investment treaties with several countries of the world including United Kingdom, Turkey, China, France, Germany, Italy, Korea, Finland, Russia etcetera. Some of the treaties afford investors of the countries mutual mitigation against investment expropriation, repatriation of investment returns thereon and compensation for losses caused by wars, riots etc. In Nigeria except such treaties are ratified by National Assembly and made part of the Domestic laws, they cannot be enforced (Lovells, 2013)

The Nigerian Constitution safeguards every property owner's interest in their property whether Nigerians or foreigners. To this end foreign investors' properties are safe and are not subject to arbitrary confiscation. Prompt compensations are paid in occasion of their acquisition for overriding public interest. The NIPC Act and similar bilateral investment treaties between Nigeria and other world countries safeguard against expropriation of foreign assets.

Absence of Secondary real estate market/Illiquidity/ease of entry

The absence of this market and electronic listed platform make real estate market slow and many buildings remain vacant for long periods. Again it takes years to convert real estate investment to cash. It is a common experience to see completed properties remaining unlet for months if not years.
Foreign investors will be required to obtain other than NIPC certificate other operational licenses and business permits to carry on business in Nigeria. The NIPC is empowered to assist the intending investor to make the obtaining of the licenses/permits easy. Some state laws make it difficult for foreign investors to acquire land to invest except such investment has prior approval by the apex government. Investors are to note this closely.

III. Conclusion

This paper has successfully discussed some salient risk factors as they affect foreign real estate investments in Nigeria. Most of the risk factors are inherent in the macro economy of Nigeria. The government at the center has a lot to do to ameliorate the factors raised. The exchange rate of the naira has to be stabilized as it now changes daily, the double digit inflation rate, even though is a blessing to investors in the short run because of strong demand, will erode the real return of investors in the long run. The regulatory laws must be streamlined and handled by few specific agencies. Fraudsters must be brought to book and made to face punitive measures to checkmate their excesses. Processes of land registration must be overhauled and made to function effectively. Federal Government is already on security matters but more need to be done to ensure complete safety for foreign investors. Bilateral treaties on mitigation of repatriation of investment proceeds and other related matters should be ratified, accepted into Nigerian domestic laws and adopted by Nigerian government. These done, Nigeria foreign real estate investment terrain should be safer for investors to achieve their diversification benefits.

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