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Institutional barriers and mortgage investment risks in Nigeria

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ABSTRACT

Reinvention of the mortgage market through the creation of a secondary market has been identified as one of the solution to the lack of funds that plague the Nigerian housing sector. There is however a set of institutional barriers that have created risk factors that are responsible for the high interest rates on mortgage loans in economy. This paper identifies some of these barriers as the requirement of Governor's consent, revocation of right of occupancy, mortgage registration period and foreclosure period and the cost of foreclosure. It further reveals their nature in the present mortgage lending practice and makes recommendation to improve the practice in preparation for any secondary mortgage market operations.

Introduction

Housing is a highly visible, key indicator of social welfare (Lea and Chiquer,1999) and in developing countries and countries making the transition from a state-controlled economy to a market economy, promoting home ownership has been a way of stabilising the economy and creating the middle class (Appraisal Institute, 2001). Middle class citizenry is synonymous with homeownership but the reality in Nigeria is the fact that most of the working class citizens that should make up this class cannot afford decent accommodation. The lack of affordable housing is a major problem in Nigeria (Centre for Affordable Housing Finance in Africa, 2011; Ajanlekoko, 2001) and this has resulted in a situation in which 66.3 percent of Nigerian households live in single rooms (National Bureau of Statistics, 2009). Home ownership in Nigeria is put at 10% compared to 72% in the United States, 78% in the United Kingdom, 60% in China, 54% in Korea and 92% in Singapore (Financial System Strategy, 2010).

Finance has been identified as the major barrier to home ownership in the country (Nubi, 2005; Emoh and Nwachukwu, 2011; National Housing Policy, 1990). According to a study by the Federal Mortgage Bank of Nigeria, which is the apex mortgage institution in the country, about N35 trillion will be required to meet the shortfall in Nigeria's housing needs, which is currently put at about 14 million units (Ojo, 2009). The government had long ago identified the need to reinvent the mortgage market as a way out of this quagmire. When mortgage financing is available, the market for housing grows and a large share of the population can become homeowners (World Bank, 2008). The promulgation of the National Housing Fund decree of 1992 was thus in pursuant of an expansive mortgage market. The decree created the primary mortgage institutions (PMIs) that operate savings account for Nigerians with the mandate of facilitating their access to mortgage facilities provided through the National Housing Trust Fund. The fund has however performed woefully; as at the end of September 2011, FMBN mobilised a total of N76 billion from 3.6 million contributors while only 18,239 employees have benefited through the PMIs (Yinusa, 2011).

Provision of housing through the creation of mortgages has therefore remained a major challenge in sub-Saharan Africa (Akeju, 2007) and Nigeria in particular where mortgage loans account for 0.4 percent of the GDP which is far below its contribution in other African countries such as South Africa, Morocco, Tunisia and Namibia (Centre for Affordable Housing Finance in Africa, 2011). Outstanding mortgage loan is said to be 0.5% (2005) of GDP compared to 77% in the United States, 80% in the United Kingdom, 50% in Hong Kong, 33% in Malaysia and 61% in Singapore (Financial Sector Strategy 2020). The mortgage sector is thus virtually inactive and at its infancy (Nnanna, 2010) as most Nigerians rely on personal savings, remittances and small loans to finance home construction. Of the approximately 195 registered PMIs, only about 20 are active and the largest of these PMIs being Union Homes which had generated less than 10,000 loans over 10 years (Center for Affordable Housing Finance in Africa, 2011).

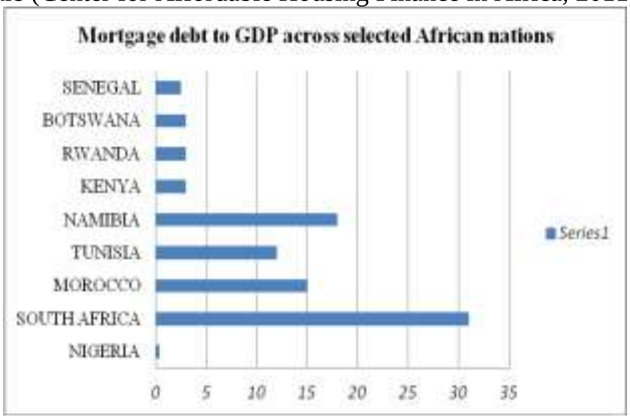

Fig 1: Ratio of Mortgage debt to GDP across selected African countries, Source: African centre for Affordable Housing Finance in Africa, 2011.

There have been requests for the implementation of secondary mortgage market system to strengthen housing

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finance system in Nigeria (Nubi, 2002; Sanusi, 2003; Ojo 2009). Emphasis has been placed on the need for a secondary mortgage market for the development of a vibrant and robust market as the National Housing Trust Fund decree which sought to widen the mortgage market by making the Federal Mortgage Bank of Nigeria the insurer for loans generated in the primary market has only mobilised N76 billion as at the end of 2011 with less than 20,000 beneficiaries. This amount is also a far cry from the N35 trillion required for meeting the nation's housing deficit (Ojo, 2009). There is therefore the need to bring the capital market into the mortgage sector through the introduction of mortgage backed securities and bonds. Introduction and use of mortgage securitization can improve housing affordability, increase the flow of funds to the housing sector and better allocate the risks inherent in housing finance. Lea (2000) had proposed a set of requirements to assess the readiness of any emerging market for effective implementation of secondary mortgage market and Nubi (2002) used these requirements to assess the preparedness of the mortgage market in Nigeria. The market at the time of this assessment was scored low on all the indices except for the availability of a competitive market.

The lack of market readiness of the Nigerian mortgage sector for securitization can be attributed to the inherent risks associated with mortgage transactions in Nigeria.

These risks are reflected in the high interest rate on mortgage loans in the country. Lea and Chiquer (1999) are of the view that interest rates on mortgages must be market determined and provide investors with a positive, real, risk-adjusted rate of return. Thus, the mortgage rate should cover the investor's marginal funding cost (both debt and equity), the risks of mortgage investment and the administrative cost of servicing the mortgage.

The absence of clear foreclosure laws in Nigeria makes lenders to remain vulnerable to credit, liquidity and interest rate risks (Nigeria Vision 2020 Program, 2009). Investors and any Special Purpose Vehicle (SPV) for secondary market operations will also be exposed to these risks where there are no clear foreclosure laws and security of title documents.

The time, cost and degree of certainty involved in registering a mortgage and title transfer and foreclosing on a property all play a key part in whether lenders are willing to assume the risk of a mortgage loan and, if so, what price they will charge to a prospective borrower given a certain level of risk (World Bank,2008).

No known study had focused on the risks that a prospective investor in the secondary mortgage market is likely to face from the existing legal and regulatory framework in the country (to the best of our knowledge) as concentration has been on raising awareness on the role of secondary market in strengthening the mortgage sector (Yakubu,2006; Ojo,2009; Sanusi, 2003). This paper therefore focuses on the nature of these risks in Nigeria and compares some of the regulatory procedures most especially in mortgage registration and foreclosure process in the country comparing it to what is obtainable in other countries with developed mortgage market.

Section 2 of the paper discusses the concept of mortgage securitization; section three exposes the nature of the risks from legal framework and constraints in the registration and foreclosure process while section four presents the conclusion and recommendations.

Concept of Mortgage Securitization

Appraisal Institute (2001) defines securities as investment instruments that convey partial ownership (stocks) or establish debt obligations (bonds). Mortgage securities are debt obligations that are repackaged for sale in the capital market with the buyer having the right to receive the periodic interest payment from the securitized loan. Mortgage securitization originated in the United States in the 1970s with the repackaging of residential mortgage loan cash flows into Mortgage – Backed Securities (MBS) (Van den Berg and Van Schalkwyk, 2002; Karoly, 2006). Mortgage loans with similar features (as to tenor, pricing, etc.) are converted into pools of securities for issuance to investors through the capital market (Ojo, 2009; Yakubu, 2006). As the underlying mortgage loans are repaid by the mortgagors, investors in Mortgage-Backed Securities receive payments of interest and principal. What is traded in essence is the investor's right to receive the repayments on the mortgages without a transfer of title in any.

This process of securitization is handled by four different parties viz; the originator or issuer, special purpose vehicles (SPV), trustees and investors. The originator purchases mortgages from a network of primary lenders such as mortgage banks or savings and loans institutions in exchange for funds which the latter use to create more mortgages for home buyers. It also warehouses mortgages for securitization.

The Special Purpose Vehicles (SPV) issues mortgage-backed securities by pooling mortgages transferred to it by the originator entity. Repayment of debt obligations (principal and interest) to MBS holders comes strictly from the cash flows of the securitized mortgages and not from the originator's own money. The SPV is bankruptcy remote from the originator entity. The trustee receives the repayments on the underlying mortgage loans and ensures monthly payments (interest and principal) to MBS holders.

The trustee operates under a deed of trust and protects the interest of the MBS investors. The investors mostly are institutional investors such as life funds, insurance companies, pension funds and trust funds. This is due to the long term nature of the funds in their investment portfolio.

The mortgage market landscape in Nigeria seems not ready for the implementation of mortgage securitization in despite the availability of funds in the insurance and pension sector. It is even more seriously misplaced when the emphasis is on mortgage securitization, which requires a level of complexity and sophistication that the legal and regulatory infrastructure and the financial markets in Nigeria do not presently possess (Nigeria Vision 2020 Program).

The Pension Reforms Act of 2004 mandated Pension Fund Administrators (PFAs) to invest 30 percent of their funds in REITs and Asset-Backed Securities.

These investment vehicles are not on ground and it has been opined that for the MBSs market to be sustainably viable, reforms and improvements should start with the primary and secondary mortgage markets, and latter involve the primary and secondary bond markets (Reside et al, 1999; Ojo, 2009).

Part of these reforms should look at the process of mortgage registration and foreclosure and the present legal framework guiding mortgage transactions in the country. These are very cumbersome in the country at the moment.

Barriers to Mortgage Transaction Process in Nigeria

Fig 2: Investor's Institutional risk factors in the present mortgage system

It is expected that mortgage will play a key role in the realization of Nigeria's vision 2020 (Centre for Affordable Housing Finance in Africa, 2011). Mortgage market has the tendency to develop the economy because when mortgage financing is available, the market for housing grows and the construction sector is thus stimulated. The decision of lenders to participate in the mortgage market depends on the time, cost and degree of certainty involved in registering a mortgage and title transfer and foreclosing on a property (World Bank, 2008). Efficiency of a mortgage transaction depends on the security of the mortgagee's interest. This security to a large extent determines the interest rate to be charged on loans i.e. the higher the risk involved the higher the interest rate.

However, there are barriers in the Nigerian mortgage market that would discourage investors from participating in the mortgage market and if they do there will be need for higher interest rate to compensate for such a high risk. Investors remain vulnerable to significant credit, liquidity, and interest rate risks in the absence of clear foreclosure law (Nigeria Vision 2020 program, 2009). These barriers are in two folds viz;

(i) Legal framework risks from the land use Act of 1978

(ii) Registration and Foreclosure Constraints

Land Use Act of 1978 Constraints

The Land Use Act as presently constituted has remained a clog in the wheel of mortgage market development in Nigeria. The Act significantly affects the market in the areas of Governor's consent provisions, Revocation and compensation and the nature of Certificate of Occupancy.

Consent Provisions in the Land Use Act of 1978

The Land Use Act of 1978 provides that all forms of alienation with the inclusion of mortgage transactions should be within the consent of the Governor of the state where the interest in land is to be mortgaged. Governor's consent is one of the pre-requisites of a valid mortgage transaction and comes after stamping but before registration of the document (Smith, 1999).The process of obtaining Governor's consent in Lagos state is initiated with an application made on "Land form L" obtainable from the consent section of the land registry and the completed form is expected to be signed by the two parties to the transaction and submitted with required documents. These documents include a covering letter, 3 years current tax clearance certificate of the two parties, evidence of payment of tenement rates on the property for the last three years and building plan of the property if the property is developed or an affidavit for an undeveloped land, a certified true copy of the title document and evidence of payment of ground rent where the land is a state land. The requirement of title document has been one of the factors that prevent a wider participation in the mortgage market. Most of the properties in Nigeria are held under informal title as not many certificate of occupancy are granted by state governors during their tenures in office. For those that applied for the certificate of occupancy, there have always been delays that last for years in getting the title. There has always been a gap between yearly applications received by the land bureau and certificates received. A look at the process in Lagos State between years 2000 and 2009 reveals this gap, it was only in 2007 that the number of certificates issued measure closely to the numbers of application received.

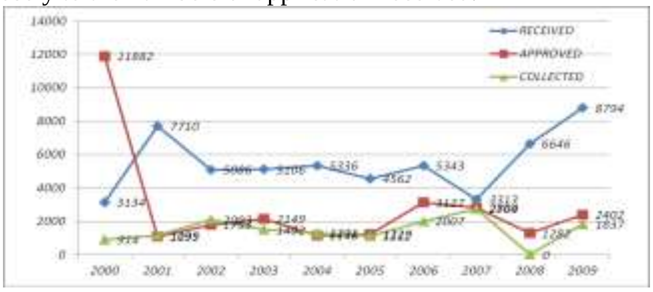

Fig 3: Certificate of occupancy application received by Lands Bureau, approved and collected by applicants between year 2000 and 2009. Source: Lagos Bureau of Statistics, 2010

A robust mortgage market at the secondary level cannot be developed in a system where it takes years for title documents to be processed. There are also considerable time lags between the period of application for this consent and the approval as reflected in Figures 3, 4 and 5 which depict the scenario in Lagos state between 2007 and 2009. This delay takes months to accomplish and there is no obligation on the governor to grant his consent when it is applied for and there is also no obligation on him to grant it within a specified period of time. As a matter of fact, it has been said that an order of mandamus cannot compel the performance of a similar function of the Governor in approving mortgage transactions. This delay is one of the major barriers to the effectiveness of the mortgage process and a secondary mortgage market will find it difficult to operate on such platform where application for consent cannot be guaranteed in a month.

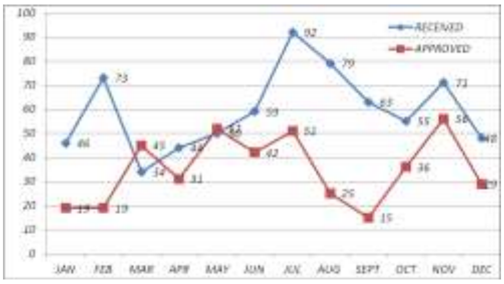

Fig 4: Monthly mortgage consent application received and approval granted between January to December, 2007. Source: Computed from Directorate of Land services data, Lagos Bureau of Statistics, 2010

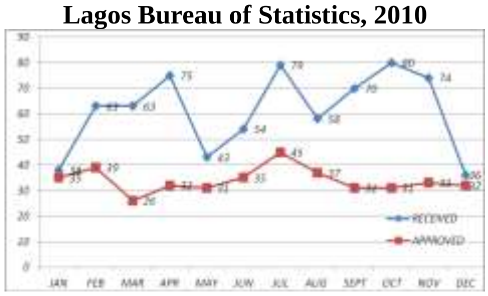

Fig 5: Monthly mortgage consent application received and approval granted between January to December, 2008. Source: Computed from Directorate of Land services data, Lagos Bureau of Statistics, 2010.

Fig 6: Monthly mortgage consent application received and approval granted between January to December, 2008. Source: Computed from Directorate of Land services data, Lagos Bureau of Statistics, 2010.

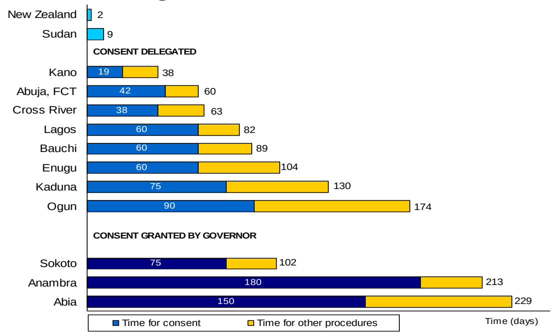

Fig 7: Nature of delays in Mortgage consent in some of the states of the Nigerian federation. Source: Ya u'kumo, G (2011)

Revocation and Compensation

Mortgage transactions are not protected in the case of revocation of the right of occupancy granted to the mortgagor. In this case the grantee of the right of occupancy is compensated for unexhausted improvement on the land. The mortgagor receives the compensation regardless of a subsisting mortgage transaction on the property though the adequacy of the compensation is questionable as the grantee is only compensated for the improvement and not for the land. This is a major drawback to mortgage transactions in Nigeria as the mortgagee's right to receive interest and foreclosure could be subverted by the government's right of eminent domain. This situation will obviously deter prospective investors into the mortgage market and it will also be a stumbling block to the development of a virile secondary mortgage market.

The nature of certificate of occupancy is such that it can be set aside if the owner had no right in the land or it is discovered that there is a pre 1978 conveyance in favour of a grantee on a land or a deemed grantee according to section 34 of the land use Act of 1978. The implication is that the mortgagee is exposed to a level of risk such that the certificate of occupancy could become just an ordinary paper without any real weight. Mortgages generated in this kind of situation can result in crisis in the secondary market.

Registration and Foreclosure Constraints

Where the system for registering a mortgage and title transfer functions poorly, it creates a bottleneck in the housing finance system and add substantially to the costs of a housing transaction. When registration is unreliable to the extent that there are long delays in publishing the registration or if there is a potential for competing title claims to emerge later, creditors in this instance face much higher risk in extending a mortgage. The result is likely to be higher interest rates and larger down payments for homeowners. Speed, low cost and simplicity are fundamental to an efficient system for registering mortgages and title transfers.

Mortgage Registration Period and Cost in Nigeria

Mortgage registration in Nigeria is both onerous and costly. World Bank (2008) puts Nigeria at number 173 (out of 178) in the country ranking of registering property with 14 procedures, a duration of 82 days and costs of 22.2 per cent of the property value. According to the 2011 World Bank Doing Business Survey, the average cost of the registration process is about 20.9 per cent of the value of the property (Centre for Affordable housing finance in Africa, 2011). This is not different from what is obtainable in most countries of sub-Saharan Africa and the developing countries of Asia and South America. For instance it takes 140 days to register a mortgage in Ghana, 360 days in Rwanda and 8 months in Egypt (World Bank, 2008). The burecracy in most of the states of the Nigerian federation is also a major contributor to the delay in the process. The registration requires visits to multiple agencies of government. The informal nature of most titles made it a condition that land must first be registered to formalize the title and thereafter registered for the mortgage transaction. These two registration process makes up the long process involving multiple government agencies. The lack of electronic registration in virtually all the states has created a paper work process that is bedeviled with rent seeking public officers.

The cost of mortgage registration in Nigeria is also one of the highest in the world. World Bank (2008) puts this cost at 20.09%. This cost is a sum of payment for different items such as stamp duty and transfer taxes. In Lagos state, the cost of registering a mortgage is 0.2% but the associated transfer tax is 10% of the property value. Until recently, when it was reduced to 15 percent of the value of property, the total cost of perfection (Consent fees, capital gains tax, stamp duties and registration fees) as high as 40 percent to register title in Lagos State. It is still very high in many states of the Federation (Mortgage Bankers Association of Nigeria, 2008).

Mortgage foreclosure Period and Cost

There is often difficulty in enforcing foreclosure process in most countries. This difficulty expresses itself in the number of days required to foreclose a property and the cost of implementing it. The lender in an attempt to foreclose the borrower's property applies to court. In his application, the lender includes evidence of indebtedness and show that the contractual payment date has passed with the principal or interest remaining unpaid and that a reasonable time has lapsed with the default continuing. An application for a court order to foreclose is made by originating summons and is supported by an affidavit verifying the claim. The deed of mortgage may prescribe the conditions for the exercise of a power of sale. If these conditions are not met the sale shall be ineffectual. Where the deed does not provide for a power of sale, the lender may apply to court for a judicial sale.

When foreclosure processes are slow and outcomes uncertain, housing finance becomes more expensive or even unavailable for many borrowers. Legal mortgagees have power of sale conferred by the provisions of the Conveyancing Act 1881 and the Property and Conveyancing Law 1959. Generally, a sale of collateral is by way of a public sale through a licensed auctioneer or by a private sale if the terms of the security instrument provide. Lenders cannot participate as buyers in a sale or it will be tainted by fraud. The process of enforcing foreclosure takes time in most countries of the world. New

Zealand has one of the most efficient mortgage market in the world in terms of the time it takes to register a mortgage, which is 3 days and outstanding mortgage debt of 86.65% compared to Nigeria's registration period of 82 days and outstanding mortgage debt of only 0.47% but a cursory look at the foreclosure time shows that it takes 112 days to foreclose a property in Nigeria while it takes 167 days in New Zealand. It also takes 105 days to enforce foreclosure in Canada where the outstanding mortgage loan is 51.14% of the GDP. Nigeria has one of the least number of days to complete a foreclosure in the world when compared to 410 days in Japan, 446 days in Tunisia and 240 days in Chile (A developing country with a secondary mortgage market). It is obvious from cross-country comparison that the foreclosure period in Nigeria is still within the range of what is obtainable in most of the efficient mortgage market of the world.

The cost of foreclosure in Nigeria is also single digit in terms of its percentage of property value. The cost in Nigeria is 6.19% and is a little higher than 4.97 in Canada. New Zealand has a mortgage foreclosure cost of 2.99 and so many countries have double digit figures such as 10.58% in Ghana, 17.10% in Argentina and 12.70% in Peru. The cost in Nigeria is also within the range of what is obtainable in the efficient mortgage markets of the world. This goes to show that the mortgage foreclosure process in Nigeria when viewed from an international perspective does not present much risk to lenders in terms of the cost and the number of day it takes to enforce it.

Conclusion

The findings of this study have further revealed the unpreparedness of the mortgage market in Nigeria for securitization. The can either be mortgages with high interest rates or loans with short tenor. If the mortgage market is to be expanded with full fledged secondary market operations the existing primary market operations need adjustments in the areas of legal, regulatory and operational frameworks. Foreclosure period and cost in Nigeria seems to be within what is obtained in developed mortgage market.

Based on the findings in this paper, the following recommendations will definitely improve the Nigerian mortgage market:

1. Sections of the Land use Act of 1978 dealing with Governor's consent and Revocation of right of occupancy should be amended. Amendments should be made such that the Governor will be compelled to grant consent within a specified period. Compensation for revocation of right of occupancy should be improved upon as the compensation for unexhausted improvement provided in the law does not always measure up to the value of mortgage loans provided. There is also the need to make the mortgagee have the right to receive such compensation in the case of revocation of the right of occupancy.
2. The states making up the Nigerian federation should be compelled to implement electronic land information systems. The states of Lagos and the Federal Capital Territory have made attempts in this regards. Efforts should also be made to reduce the mortgage registration period in the country which on the average is 82 days. The number of agencies involved in the process should be reduced. The cost of mortgage registration should also be reduced.

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Table 1: Mortgage-GDP ratio and Mortgage registration days across selected countries

Country	Mortgage- GDP (%)	Registration Time (days)
South Africa	30.6	15
Rwanda	3.0	360
Ghana	0.25	140
Botswana	2.3	18
Egypt	0.37	210
Uganda	1.00	34
Nigeria	**0.40**	**51**
Tunisia	7.13	49
Kenya	2.5	20
Tanzania	0.2	35
Senegal	2	40
Namibia	20	22
Japan	40.30	25
Mexico	10.10	89
Canada	51.14	21
New Zealand	86.65	3
Russia	0.60	53

Source: World Bank, 2008

Table 2: Mortgage Registration cost across selected countries

Country	Registration cost (% of property value)
Albania	0.54
Algeria	7.57
Argentina	7.69
Brazil	2.84
Nigeria	**20.90**
Canada	0.04
Chile	1.46
Croatia	5.09
Egypt	0.69
Guatemala	13.26
Ghana	2.69
India	7.66
Japan	3.82
Kenya	4.35
New Zealand	0.08
South Africa	5.50

Source: World Bank, 2008

Table 3: Foreclosure time across selected countries

Country	Foreclosure time (Days)
Albania	209
Argentina	285
Armenia	332
Brazil	271
B/Faso	111
Canada	105
Chile	240
Colombia	705
Croatia	247
Ghana	706
Japan	410
Kenya	239
New Zealand	167
Peru	279
Russia	259
Tunisia	446
Nigeria	112

Source: World Bank (2008)

Table 4: Foreclosure cost across selected countries

Country	Foreclosure cost (% of Property value)
Armenia	3.67
Argentina	17.10
Brazil	7.20
Burkina Faso	6.59
Canada	4.97
Colombia	8.59
Chile	7.05
Egypt	4.26
El Salvador	19.53
Ghana	10.58
India	2.20
Japan	1.44
Mexico	15.59
New Zealand	2.99
Nigeria	6.19
Pakistan	12.33
Peru	12.70
Romania	1.92
Zambia	47.83
Uzbekistan	32.35

Source: World Bank (2008)