Economic and Financial Review

Volume 57
Number 4 *Proceedings of the Executive Seminar On "Addressing Nigeria's Housing Deficit", for CBN Executive Staff at Transcorp Hotels, Calabar, Cross River State, October 07 - 09, 2019*

Article 7

12-2019

Developing the Housing Sector in Nigeria – A Regulator's Perspective

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I. Introduction

Housing is one of the basic needs of man. From time immemorial, mankind has sought for innovative ways to protect himself from the scorching heat of the sun by day and cold at night. If the concern of the weather elements was not sufficient reason to seek shelter, the fear of wild animals provided enough justification if mankind was to survive. Over the years, men have advanced from the primordial status of dwelling in caves to constructing mega cities with sky-high story buildings.

Without lodging, there would be little difference between man and animals. Addressing the need for housing is, therefore, a primary function of any government. In the same vein, ensuring sustainable access to housing finance is an essential concern of any central bank.

II. The Interest of the Regulator in the Housing Sector

Apart from the satisfaction of meeting a basic need, a thriving housing sector offers a broad range of economic benefits that are of keen interest to regulators. The housing sector is a critical employer of labour providing multiple direct and indirect jobs. These jobs are not only for professionals like architects, quantity surveyors and engineers but also for artisans like brick layers, plumbers and even general handy-men. Housing construction requires different building materials which results in patronage for small & medium enterprises involved in trading these items. Following the construction of a house and sale, the off-takers also engage in purchases of household appliances, furniture and interior décor to beautify the home and make it comfortable for their stay. More-so, as housing communities are established, the need for nearby schools, markets, hospitals, recreation centres become compelling for investors and governments alike. The economic activities associated with housing begin before the construction work commences (with activities like land

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purchase, registration, architectural design) and continue through the actual construction phase and long after it is completed.

In the exercise of its mandate of economic policy formulation, the Central Bank of Nigeria (CBN) has consistently striven to develop policies that would encourage lending to the real sector which include housing, owing to its multiple developmental components and economic growth potentials. CBN is also responsible for the regulation and supervision of all the financial institutions involved in providing housing finance. It, therefore, has interest to see that these institutions succeed and for the financial markets to develop in an orderly manner. Their success impact on its mandate to ensure monetary & price stability and to promote a sound financial system.

III. State of the Housing Sector in Nigeria – Defining the Issues

Despite the far-reaching economic benefits accruable from the housing sector, Nigeria has not fully maximised its potential in growing its economy. The construction sector's aggregate contribution to real GDP was 4.45 per cent in the second quarter of 2019, which was slightly lower than its contribution of 4.51 per cent in the same quarter of the previous year. Some of the issues that have hampered the growth of the housing sector include:

- Absence of access to low cost funding;
- Weak legal framework;
- Inadequate housing supply; and
- Undercapitalised Mortgage Banks.

III.1 Absence of access to Low-Cost Funding

The growth of the housing market has been stifled by absence of low-cost funding for construction and for mortgages. The cost of funds in Nigeria has remained high due to macro-economic conditions. High level of inflation had resulted in a regime of double-digit Monetary Policy Rate (MPR) of 11.0 and 14.0 per cent between 2015 and 2019 (currently 13.5 per cent). Cost of funds is also affected by the high cost of operations of banks and the inherent credit risk in lending.

Given the macroeconomic conditions, average lending rates for banks have hovered between 24.0 and 26.0 per cent (prime lending rates between 17.0 to 19.0 per cent). This has resulted in higher cost of delivery of housing units by construction companies and made the purchase of these properties unattractive. Even where there are willing buyers, the high interest rate remains a disincentive for off-takers to secure mortgages. Moreover, interest rates are too prohibitive to structure mortgages beyond 10 years. In addition, to the challenge of the high cost of funding, most lenders have grappled with the mismatch of funding long-term mortgages with short tenured deposits.

III.2 Weak Legal Framework

Land administration in Nigeria is governed by the Land Use Act (1978), which vests powers on the state governors to hold land/property in trust on behalf of its citizens. In this regard, the consent of the governor is required to perfect land title which is a necessary condition to delivering a legal mortgage instrument. Without the governor's consent, the mortgage transaction is void and unenforceable. In addition, the consent of the governor is required for the assignment of land/property and long-term lease.

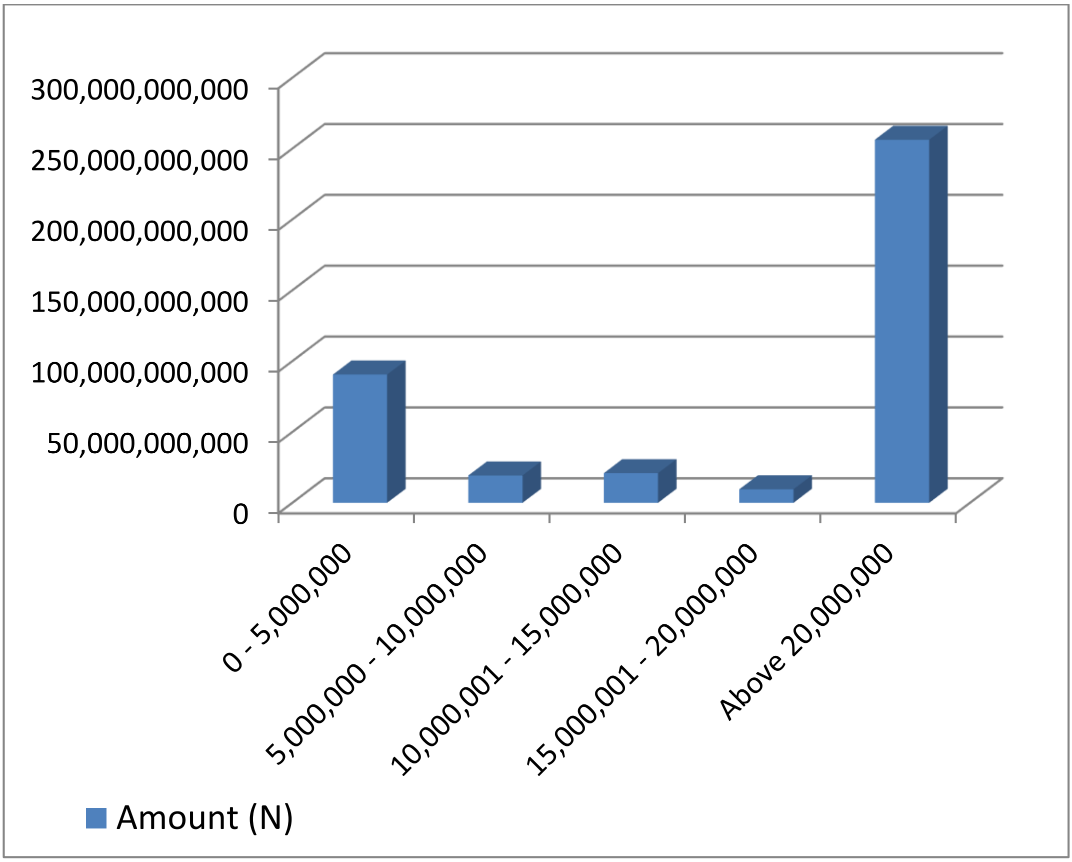
The process of securing title in Nigeria is often slow, costly and cumbersome. According to the 2019 World Bank Report on Doing Business, Nigeria ranks 184th out of 190 countries in ease of registering properties. Findings from the survey which focused on Lagos and Kano states indicated that Lagos had 12 procedures for property registration which took 105 days to complete and cost 11.1 per cent of the property. In Kano, however, the property registration process had 11 steps with a duration of 46 days and cost 11.8 per cent of the property value. In both states, the longest step was obtaining governor's consent. While it took 90 days to secure governor's consent in Lagos, the time for obtaining governor's consent in Kano was 30 days.

Another important aspect of the legal framework required to grow the mortgage market is the foreclosure process which allows the mortgagee to take possession of a property in event of default by the mortgagor. Given the difficulty in perfecting title, most properties in Nigeria are not registered and this eliminates the mortgagee's right to foreclose the property in event of default. Furthermore, the foreclosure process is also often lengthy and the law tilts on the side of the mortgagor who is often considered to be the weaker party in the mortgage contract when the court is approached to resolve breaches.

III.3 Inadequate Housing Supply

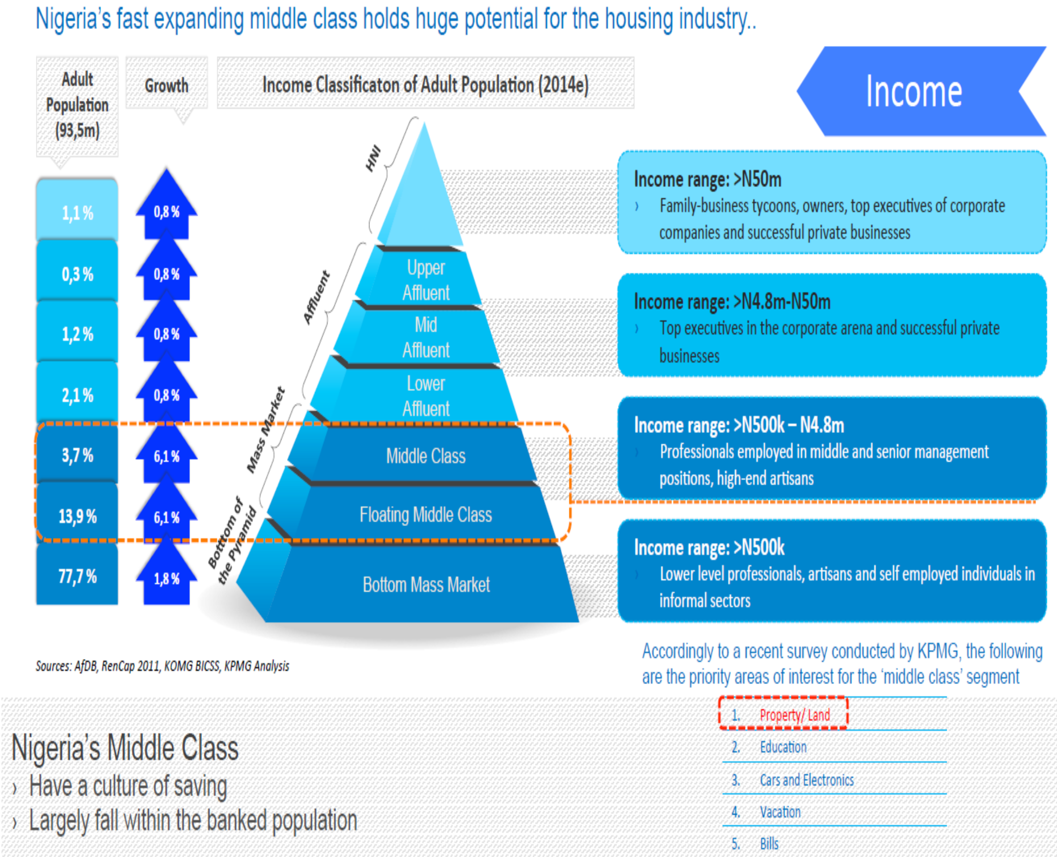
Nigeria's population is rapidly increasing. As the population increases, the demand for housing grows. Closely related is the rural-urban drift which has put immense pressure on the cities, further escalating the need for housing in urban settlements. At the current annual population growth rate of 3.5 per cent, it is estimated that it will cost US$363 billion to curb the current housing deficit. While the population increase and the housing deficit increase, the market structure does not favour participants at the lower end. Available statistics show that the mortgage market segment below ₦20 million is underserved as presented in the graph below.

Figure 1: Mortgage Value



The income distribution in Nigeria reveals that a significant proportion of the population cannot afford housing above ₦20 million. A 2014 survey by the African Development Bank (AfDB) indicated that 95.3 per cent of the Nigerian population are in the lower to middle class income bracket. The lower income class alone holds 77.7 per cent.

Figure 2: Nigeria's Fast Expanding Middle Class



The situation has worsened with the 2016 recession and sluggish growth, thereafter. A larger portion of the population fall within the lower to middle income bracket. Housing construction and mortgages are skewed towards people in the affluent income segment of the market. There remains a huge untapped market segment in the lower to middle income class. The Africa Housing Finance Yearbook 2018 reports that, most of the new developments are led by the private sector and target the middle and upper classes. Most developments targeted at the lower income market are government led, with no remarkable impact been made thus far.

Cases of building collapse have been on the rise. In most of these incidences, the houses have collapsed due to the use of poor building materials. There have also been wide complaints from home owners that have subscribed to mass housing estates developed by construction companies. These complaints border on the quality of the buildings. Some homeowners have resorted to rehabilitating these properties on purchase, and in extreme cases, pulling down the buildings and erecting new structures.

III.4 Mortgage Banks

Mortgage banks have had their fair share of impediments to home ownership through the provision of mortgages. Hitherto, operations of mortgage banks had been limited by the low threshold set for the minimum capital requirement. Following the revision of the Regulatory & Supervisory Guidelines for Primary Mortgage Banks (PMBs) in 2013, this problem was resolved as the minimum capital requirement was raised from ₦100 million to ₦2.5 billion for State PMBs and ₦5.0 billion for National PMBs. The increase in minimum capital requirement was to address the need for caution, arising from business risks and create confidence to depositors and investors needed to improve funding in the sector. With increasing prices of properties across the country, the new capital base is still inadequate for large volumes transactions. To overcome this hurdle, it became necessary to link the mortgage banks to the capital market. This has given rise to a sustainable model that allows mortgage banks to continually raise funds to run their businesses without the limitation of capital.

Prior to the issuance of the revised Guidelines for PMBs, mortgage banks were permitted to engage in real estate construction. Most of the mortgage banks that ventured into the construction business did not have the requisite knowledge or skills and suffered losses. Again, their foray into funding and executing construction projects led to a mission drift from their core mandate of providing mortgages. After the revised Guidelines for PMBs were issued in 2013, the CBN directed mortgage banks to dispose their investments in real estate development projects. To date, some of the PMBs have been unable to find buyers to purchase these properties. This had tied down their capital and constrained them from utilising those funds for mortgage creation.

Mortgage banks, like other operators in the Nigerian banking industry have also been affected by high non-performing loans (NPLs). The ugly trend has far reaching implications for the earnings of the mortgage banks, liquidity and overall viability as going concern entities. The situation is further worsened by the difficulty in foreclosure.

IV. The Regulator’s Perspective on Housing Market Development

The CBN has adopted an approach that focuses on two main areas:

i. Providing the regulatory framework that would allow participants in the primary and secondary markets of the mortgage sector to operate in a safe, sound and stable manner; and

ii. Market development to provide favourable conditions for mortgage businesses.

V. Providing the Regulatory Framework

The CBN is vested with the power to regulate the operations of Banks and Other Financial Institutions (OFIs) through BOFIA. All the institutions involved in providing financial services in the mortgage market are under the supervisory oversight of the CBN. These include:

- Primary Mortgage Lenders - Primary Mortgage Banks and Commercial Banks;
- Secondary Mortgage Institutions – Federal Mortgage Bank of Nigeria (FMBN) and Nigeria Mortgage Refinance Company (NMRC); and
- Mortgage Guarantee Companies.

In designing the regulatory framework for these institutions, CBN has made a deliberate effort to craft provisions that would focus the attention of the operators on their core objectives and thus, drive the growth of the market. Highlights of the regulatory framework for the various mortgage sub-sectors are provided as follows:

V.1 Primary Mortgage Banks

Primary Mortgage Banks (PMBs) are licensed and regulated under the Revised Regulatory & Supervisory Guidelines for PMBs in Nigeria (2011). The Guidelines prescribe the following prudential requirements:

- **Minimum Capital Requirement –** The minimum capital requirement was reviewed upward from ₦100 million to ₦2.5 billion for State License, and ₦5 billion for National License;
- **Mortgage Assets to Total Assets** – Mortgage assets should constitute a minimum of 50.0 per cent of the PMBs total assets;
- **Mortgage Assets to Loanable Funds** – Minimum ratio of mortgage to loanable funds is 60.0 per cent. Loanable funds include deposits and debt for on-lending; and
- **Mortgage Assets in Residential Mortgages** – A minimum of 75.0 per cent of total mortgage assets should be dedicated to residential mortgages.

V.2 Mortgage Refinance Companies

Mortgage Refinance Companies (MRCs) are licensed and regulated under the Regulatory & Supervisory Framework for MRCs in Nigeria (2013). MRCs are secondary mortgage market operators that provide liquidity to mortgage originators with minimum capital requirement of ₦5 billion.

Permissible activities under the Framework include:

- Refinancing of secured mortgages;
- Investment in debt obligations of the FGN;
- Issuing bonds & notes; and
- Issuing guarantees for mortgage loans as off-balance sheet engagements.

Non- Permissible activities under the framework include:

- Granting consumer or commercial loans;
- Origination of primary mortgage loans;
- Acceptance of deposits; and
- Financing real estate construction.

Sources of Fund include:

- Equity;
- Long-term loans;
- Debentures/Bonds; and
- Funds from development partners.

V.3 Mortgage Guarantee Companies

Mortgage Guarantee Companies (MGCs) are licensed and regulated under the Regulatory & Supervisory Framework for MGCs in Nigeria (2019). MGCs help to drive access to mortgages with minimum capital requirement of ₦10 billion.

Permissible activities under the Framework include:

- Full or partial guaranteeing of residential mortgage loans;
- Invest in Government securities;
- Assume ownership of residential property in the event that a lender is unable to dispose of a foreclosed property; and
- Issue bonds and notes to fund its operations.

Non- Permissible activities under the Framework include:

- Accept deposits;
- Grant consumer, commercial or mortgage loans;
- Finance real estate construction;
- Estate agency or facilities management; and
- Management of pension funds/schemes.

Sources of Fund include:

- Paid up share capital and reserves;
- Debentures/bonds;

- Loans from national and supra-national governments and other bodies;
- Donations/ Grants/ Loans from Development Partners; and
- Gifts and donations from charitable institutions.

VI. Market Development

The market development activities that the CBN has embarked on were aimed at addressing risks along the housing finance value chain to incentivise mortgage originators to increase lending.

VI.1 Addressing Liquidity Risk: Establishment of the Nigeria Mortgage Refinance Company (NMRC)

In recognition of the dearth of long-term funds for mortgage creation, the CBN through the World Bank assisted Nigeria Housing Finance Program (NHFP) established the Nigeria Mortgage Refinance Company as a secondary mortgage market institution.

The NMRC raises funds for refinancing by issuing bonds in the capital market. This ensures that there is adequate liquidity for mortgage lenders to create mortgages and eliminate the challenge of financing long tenured assets with short tenured deposits. Since inception, the NMRC has issued bonds of a total value of ₦19 billion and refinanced over ₦18.394 billion worth of mortgages. The NMRC bonds are backed by the mortgages it refinances and guaranteed by the Federal Government of Nigeria.

Under the NHFP, the NMRC was allocated the sum of US$250 million from a US$300 million World Bank IDA loan. The NMRC was able to achieve the disbursement linked indicators for the first 3 tranches of the loan and accessed a total of US$168.136 million before the program closed in December 2018. The IDA loan is not available for on-lending. It is provided as Tier II capital and serves to strengthen the balance sheet of the NMRC to engender public confidence in the company as a bond issuing entity.

VI.2 Addressing Liquidity Risk: Establishment of the Mortgage Warehouse Funding Limited (MWFL)

While the NMRC addresses the issue of refinancing, the Mortgage Warehouse Funding Limited (MWFL) sets-up a mechanism to deal with pre-financing requirement of mortgage lenders. It was established to mitigate the risk of having refinancing and pre-financing on the same institutions balance sheet.

The MWFL is a private sector institution Incorporated in 2014, to operate as a Special Purpose Funding Company ("SPC"). It operates by issuing high grade commercial paper in the money market and using the proceeds to fund the steady creation of mortgages at the short end of the spectrum. The commercial papers are issued in series for a 6 months tenure to correspond with the time required for mortgages to be seasoned before they are eligible for refinancing by the NMRC.

VI.3 Addressing Operational Risk: Uniform Underwriting Standards (UUS)

In collaboration with the Mortgage Banking Association of Nigeria (MBAN) and the NMRC, the CBN, through the NHFP, has facilitated the development of three sets of underwriting standards for the mortgage industry:

- UUS for the Formal Sector;
- UUS for the Informal Sector;
- UUS for the Non-Interest Market; and
- UUS for the Diaspora Market.

The underwriting standards are critical to:

- Enable access to housing finance for a wider spectrum of the population and market identification;
- Ensure consistency in lending practices across mortgage lending institutions, thereby, facilitating financial literacy;
- Engender growth of mortgage portfolios with diversified clientele, thereby, improving stability and quality of earnings for lenders;
- Enhance ease of supervision by regulators;
- Encourage investor comfort and confidence; and
- Enable the pooling of cashflow expected from conforming mortgage loans as underlying receivables for payment of securities/ issued bonds.

VI.4 Addressing Legal Risk: Model Mortgage & Foreclosure Law

The Nigeria Mortgage Refinance Company (NMRC) engaged the services of a team of six Senior Advocates of Nigeria (SAN) to develop the Model Mortgage & Foreclosure Law ('MMFL') that would address the following challenges which have dogged the mortgage sector for decades:

- Multiplicity of laws governing mortgages in different states;
- Difficulties & delays in perfection of mortgages due to consent requirements of the Land Use Act 1978;
- Exorbitant costs of creation & perfection of mortgages;

- Judicial intervention in exercise of mortgagee's enforcement rights; and
- Inherent difficulties and delays in the exercise of Judiciary-driven enforcement rights such as foreclosures.

The MMFL (copy attached) has been conceived to address these issues and challenges by:

- Fast-tracking the process for creating legal mortgages (including reducing the cost to 3.0 per cent of the value of the property and the processes for obtaining the relevant consents and registration to 5 steps);
- Engendering timely resolution of disputes arising out of mortgage transactions;
- Strengthening consumer protection;
- Creating an efficient foreclosure process; and
- Providing for electronic/digitised land registry and electronic mortgage assets registry (e-MARS) that would enable market efficiency in commoditised mortgage assets in the securities market.

Lagos and Kaduna states have both adopted versions of the law in 2010 and 2017, respectively. The new law has brought uniformity and clarity to disparate laws on mortgages as only one law now governs the creation and perfection of mortgages as opposed to the multiplicity of laws.

Table 1

	State	**Status**
1	Ogun	The Executive has presented draft housing law to the State House of Assembly for review and passage
2	Osun	The Executive has presented draft housing law to the State House of Assembly for review and passage
3	Kebbi	Draft housing law presented to the Executive for review.
4	Plateau	Draft housing law presented to the Executive for review.
5	Edo	A Joint Working Committee has been set-up to finalise a draft bill and presenting it to the Governor via the Ministry of Justice for approval;

Discussions are on-going with Bayelsa, Rivers, Anambra, Akwa-Ibom, Cross Rivers Niger, and Oyo states. In addition, there are engagements with the Nigeria Governors' Forum (NGF).

In September 2017, the Project Administration Team (PAT) of the NHFP in conjunction with the National Judicial Institute (NJI), organised a workshop for judicial officers (copy of approval attached) with the theme, "*Mortgage Disputes in Nigeria: The Need for Expeditious Resolution of Cases*". A total of 161 participants from the Federal and State judiciaries, Financial Institutions and private organisations attended the Workshop, including the former Chief Justice of Nigeria Hon. Justice Walter Samuel Nkanu Onnoghen, *GCON*, *FNJI*. A key take-away from the workshop was that all states of the Federation should be encouraged to pass the MMFL into law.

In July 2018, another workshop was organised for State Attorney Generals', Law Makers and Commissioners for Housing with the theme, "*Creating an Enabling Environment for the Growth of the Housing & Mortgage Sector: The Need for Land & Law Reform*". The purpose of the workshop was to advocate for the adoption of the Model Mortgage & Foreclosure Law (MMFL) by all states of the Federation and the undertaking of land titling and administration reforms, aimed at making land more readily available for housing development.

VI.5 Addressing Credit Risk: Ongoing set-up of the Nigeria Mortgage Guarantee Company

The establishment of the NMRC, creation of the MWFL as a pre-financing vehicle, launch of the uniform underwriting standards and the drafting of the model mortgage & foreclosure law has set the stage for the set-up of a mortgage guarantee company. Mortgage guarantee is designed to drive the reach of mortgages down the income strata. A mortgage guarantee aims to mitigate the risk of onboarding lower end intending mortgage customers by reducing or removing the necessity for equity contribution by mortgagors. This is especially true for those with Retirement Savings Account (RSA) under the Pension Commission (PENCOM) who by law, could use 25.0 per cent of their retirement savings as proxy for equity down payment.

The business plan proposes two product offerings for the NMGC namely:

1. **Legal Mortgage Guarantees:** This would be offered for mortgage loans that have title documents which have been fully perfected. The maximum LTV eligible for such guarantees would be 90.0 per cent. Passage of the MMFL is an important element in the success of this product.

2. **Equitable Mortgage Guarantees:** This would be provided to mortgage clients that have title documents that are not perfected. In view of the higher inherent risk, maximum LTV would be 85.0 per cent for this form of guarantees.

Guarantee fees are to be paid upfront by the lender at the onset of guarantee tenure and then recouped from the mortgagor through an amortised payment structure over the life of the loan. The NMGC would bear 50.0 per cent of credit risk and maximum payment of indemnities to lenders would be limited to 40.0 per cent of the original loan amount. Upon declaration of foreclosure process, 50 per cent of the guaranteed sum would be released to the mortgagee to continue with its lending operations before the foreclosure process is completed and asset disposed.

VII. New Frontiers for the Housing Sector

The CBN is not relenting in its efforts to develop the housing sector. Going forward with the gains from implementing the World Bank supported Nigeria Housing Finance Program which ended in December 2018, the CBN is looking towards implementing the following initiatives for the housing sector.

VII.1 Mortgage Interest Drawback Program

In an effort to accelerate home ownership for lower income households, the CBN is establishing a mortgage interest drawback program (MIDP) that would enable a single digit interest rate regime for mortgagors. To actualise this objective, the program would provide an interest rate rebate, through primary mortgage banks and commercial banks, on loans granted to eligible mortgagors. The program is aimed at increasing the demand for housing through mortgages and, thereby, reduce the housing deficit in Nigeria. With the improved demand, there will be growth in the housing stock, especially for the lower income households, and subsequently, this will boost the mortgage to GDP ratio.

VII.2 Mortgage Backed Securities

A framework for mortgage backed securities is contained in the five-year strategic plan of the CBN Governor. This is intended to increase the liquidity available to primary mortgage originators, provide an avenue for credit risk transfer and create investment instruments that would deepen the capital market.

VII.3 Mortgage Guarantee Company

Following the issuance of the Framework for Mortgage Guarantee Companies, the CBN is working alongside private investors to promote the launch of the Nigeria Mortgage Guarantee Company. The CBN will not be subscribing to the equity of the Company. The launch of the Company would usher in the implementation of a compulsory guarantee regime for mortgages with loan-to-value ratio of 70.0 per cent and above. In addition, mortgage lenders would begin to enjoy capital relief on mortgage assets that are guaranteed.

VII.4 Capital Relief

Capital relief for mortgage assets that are guaranteed in consonance with the principles of Basel II and Basel III accord. Accordingly, the following risk weightings have been established for mortgage assets:

i. A risk weight of 50.0 per cent to guaranteed legal mortgages;
ii. A risk weight of 75.0 per cent on non-guaranteed legal mortgages with an LTV threshold at 70.0 per cent instead of the current 80.0 per cent; and
iii. A risk weight of 100.0 per cent on equitable mortgages.

VII.5 Compulsory Guarantee for Mortgages with 70 per cent Loan-to-Value and above

A critical success factor for MGCs that would operate under the Framework is a policy that would make mortgage guarantee mandatory for mortgage lending with Loan-to-Value (LTV) above 70.0 per cent. This is important because:

i. Mortgage guarantee business thrives on volumes. Without adequate numbers, the guarantee business would remain un-profitable. A mandatory mortgage guarantee regime for mortgages with LTV above 70.0 per cent would help to grow the market; and
ii. There is a tendency for banks to practice adverse selection. In which case, they would only request for guarantees on mortgages that had a high risk leaving the guarantee company with a concentration of mortgages that have a greater potential for default. Making mortgage guarantee compulsory for mortgages with LTV above 70.0 per cent would help to address the risk of adverse selection.

VII.6 Advocacy for the Model Mortgage & Foreclosure Law

The advocacy programme for the adoption of the model mortgage & foreclosure law is continuing with an engagement with the Nigerian Governors’ Forum (NGF). The CBN, in partnership with the NMRC and FMBN, had already begun discussions with the Secretariat of the NGF.

VII.7 Global Standing Instruction (GSI)

The CBN is introducing a framework for the implementation of a system termed Global Standing Instruction (GSI). The GSI would allow banks to call on the deposits of loan defaulters in other banks or investments in government securities to offset outstanding loan amounts upon meeting the set criteria set-up by the CBN. The GSI would rely on the Bank Verification Number (BVN) of the loan clients to track deposit accounts of loan defaulters across the financial system. Mortgagors would now be required to sign-off loan agreements that empower the mortgage lenders to activate the GSI in the event of default.

VIII. Conclusion

The CBN has extended its role in developing the housing sector in Nigeria beyond the bounds of providing the regulatory framework and oversight functions to facilitating market development. To this end, CBN is continually creating housing finance solutions that would enable home ownership for the different income levels. The Bank is also incentivising mortgage lenders to grow their portfolios by de-risking the housing finance landscape. The initiatives are expected to result in the realisation of a modern housing market, increased contribution of the housing sector to GDP, creation of employment opportunities, growth of SMEs and industrialisation.

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